



# Leverage, Financial Risk, and Market Signals: A Survey of Corporate Finance Managers in an Emerging Economy

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**Abstract** – Debt financing raises a firm's fixed payment obligations, and with them, financial risk. This paper tests how finance managers in Bangladesh perceive that trade-off, and whether they connect it to two market-facing outcomes: sales revenue and share price. Fifty finance managers from six industry groups completed a structured, five-point Likert questionnaire. A one-sample Z-test, run at the 95 per cent confidence level, rejects the null hypothesis for all three relationships tested. Ninety-four per cent of respondents agreed that leverage raises financial risk ( $Z = -6.20$ ). All fifty respondents agreed that leverage raises sales revenue ( $Z = -7.04$ ). Eighty-four per cent agreed that return moves together with share price ( $Z = -4.79$ ). Ninety-two per cent of firms in the sample pay 16 to 20 per cent interest on their debt capital, which helps explain why risk perception runs high. The paper argues that Bangladeshi finance managers hold a risk-return view of leverage that lines up with core capital structure theory, despite operating in a market with thin bond markets and high borrowing costs.

**Keywords** - financial risk, leverage, sales revenue, share price, cost of debt, capital structure, emerging markets, Bangladesh

## I. INTRODUCTION

Every borrowing decision carries a trade-off. More debt can grow a business faster than equity alone would allow, but it also locks in a fixed payment that must be met regardless of how the business performs in a given year. This is financial risk: the added uncertainty that debt service places on a firm's cash flow and, ultimately, on its shareholders.

Textbook treatments of this trade-off describe financial risk as a direct, mechanical result of the degree of financial leverage carried by a firm. What is less studied is whether the finance managers making borrowing decisions in emerging markets actually hold this view, and whether they connect leverage-driven risk to visible market outcomes such as sales revenue and share price. This paper addresses that gap using primary survey data from Bangladesh.

Two market signals are of particular interest here. Sales revenue is the top-line outcome most exposed to a firm's operating decisions, and by extension its investment choices, which leverage helps fund. Share price is the outcome most exposed to investor sentiment, and it should, in theory, respond to the market's read of a firm's risk and return profile. Testing perception of both signals together gives a fuller picture of how leverage is understood to move through a firm, from operations to the equity market.

## II. LITERATURE REVIEW

### 1. Financial risk and the trade-off view of leverage

The idea that leverage magnifies both risk and return is well established in the corporate finance literature. Financial risk has long been described as the added variability in earnings and cash flow that a firm's owners bear once fixed debt charges enter the picture, an idea that goes back to early treatments of operating and financial

leverage in managerial finance textbooks. A firm's fixed costs, whether these arise from operations or from financing, add a layer of risk that magnifies the effect of a change in sales on the earnings ultimately available to shareholders.

Gahlon (1981) and Lev (1974) both connect operating leverage to a firm's systematic risk, arguing that fixed costs add a layer of risk that shows up in a firm's market beta. Cai and Zhang (2011) studied the relationship between leverage change and stock prices directly, and found that increases in leverage tend to depress stock prices around the announcement date, consistent with the market pricing in default risk as leverage rises.

### 2. Leverage, Debt Overhang, And Sales Revenue

On the sales revenue side, the debt overhang literature associated with Myers (1977) argues that heavily leveraged firms may under-invest in future growth, since a share of any new positive net present value project's payoff would flow to existing debt holders rather than to shareholders. This creates a natural counter-hypothesis to what many practitioners believe day to day, namely that debt funds the very investment that grows the top line. Testing which of these views dominates managerial perception, in a market with limited external financing alternatives, is one motivation for this study.

- H1: Leverage has a positive and significant relationship with financial risk.
- H2: Leverage has a positive and significant relationship with sales revenue.
- H3: Return has a positive and significant relationship with share price.

## III. RESEARCH METHOD

### 1. Sample

Fifty finance managers across banking, non-bank financial, pharmaceutical, engineering, automobile, and ceramic



firms in Bangladesh completed a structured questionnaire through direct interview. The sampling method is purposive rather than random, chosen to reach respondents with direct authority over financing decisions.

**2. Measures**

Financial risk, sales revenue, and share price perceptions were each measured with statements rated on a five-point Likert scale, ranging from strongly disagree to strongly agree. The questionnaire also collected the interest rate each firm pays on its debt capital, grouped into bands.

**3. Statistical Procedure**

Likert responses were collapsed into an agree or disagree binary outcome. Each hypothesis was tested with a one-sample Z-test for a population proportion, benchmarked against 0.50, at a 95 per cent confidence level, giving a critical value of  $Z = \pm 1.64$ .

**IV. RESULTS**

Descriptive statistics show a mean of 4.22 (standard deviation 0.70) for financial risk, 4.18 (standard deviation 0.38) for sales revenue, and 4.22 (standard deviation 0.70) for share price, all measured on the five-point scale.

For financial risk (H1), 47 of 50 respondents (94 per cent) agreed that leverage raises financial risk, giving  $Z = -6.20$  and rejecting the null hypothesis. The higher standard deviation for this item, relative to the other measures in this study, points to somewhat more varied views on how much risk debt actually adds, plausibly linked to differences in each firm's own debt level and industry.

For sales revenue (H2), all fifty respondents (100 per cent) agreed that leverage raises sales revenue, giving  $Z = -7.04$ . This result runs against the debt overhang concern raised by Myers (1977); in this sample, managers see debt financing as fuel for growth, not a brake on it.

For the return and share price relationship (H3), 42 of 50 respondents (84 per cent) agreed, giving  $Z = -4.79$ . This is the weakest agreement of the three tests in this paper, with eight respondents (16 per cent) unconvinced, which may reflect the fact that share price is set by external market forces the firm does not fully control, unlike revenue or risk, which are closer to internal management decisions.

On the cost side, 92 per cent of sampled firms report paying 16 to 20 per cent interest on their debt capital, with the remaining 8 per cent in the 11 to 15 per cent band. No firm in the sample reported single-digit borrowing costs.

**V. SUPPLEMENTARY STATISTICAL ANALYSIS**

The hypothesis tests above treat each survey item as an isolated agree/disagree outcome. To test whether these

perceptions move together, and to check the internal consistency of related items, we ran four further tests on the underlying respondent-level Likert data (n = 50): a Pearson correlation matrix across six leverage-perception items, a linear regression of share price perception on return perception, a Cronbach's alpha reliability check on a three-item risk-return perception scale, and a chi-square test of association between financial risk perception and market interest rate perception.

**Correlation Among Perception Items**

Table 1 reports Pearson correlations across six items: sales revenue, financial risk, share price, the combined "leverage raises both risk and return" item, market interest rate, and return. Financial risk correlates most strongly with the combined risk-and-return item ( $r = 0.559$ ) and with the tax benefit item ( $r = 0.528$ ), suggesting managers who see leverage as risk-and-return-raising also tend to see it as tax-advantaged, rather than treating these as unrelated beliefs. Sales revenue and financial risk show a small negative correlation ( $r = -0.147$ ), consistent with some respondents distinguishing growth effects from risk effects rather than treating leverage as uniformly positive or negative across every measure.

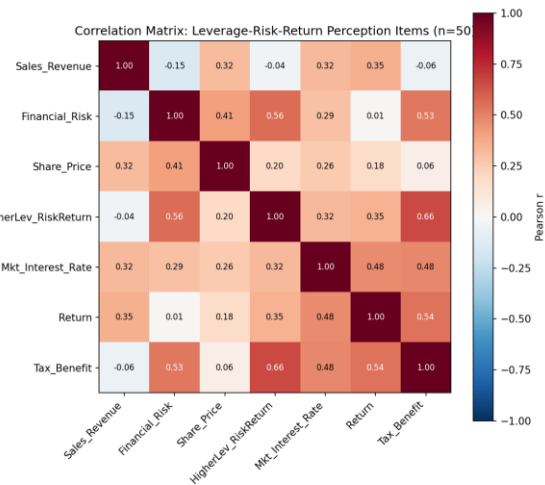


Figure 1. Correlation matrix across six leverage-perception items (n = 50).

Table 1. Pearson correlation matrix, six leverage-perception items (n = 50)

	Sales Revenue	Financial Risk	Share Price	Higher Lev Risk&Return	Mkt Interest Rate	Return
Sales Revenue	1.00	-0.15	0.32	-0.04	0.32	0.35



Financial Risk	-0.15	1.00	0.41	0.56	0.29	0.01
Share Price	0.32	0.41	1.00	0.20	0.26	0.18
Higher Lev	-0.04	0.56	0.20	1.00	0.32	0.35
Mkt Interest	0.32	0.29	0.26	0.32	1.00	0.48
Return	0.35	0.01	0.18	0.35	0.48	1.00

**Reliability of the Risk-Return Perception Scale**

Combining financial risk, the "leverage raises both risk and return" item, and share price into a single three-item scale gives a Cronbach's alpha of 0.654. This falls in the conventionally acceptable range for an exploratory scale (above 0.60) but below the stricter 0.70 threshold often used for confirmatory research, suggesting these three items tap a related but not fully unified underlying perception, consistent with the moderate, rather than strong, correlations reported in Table 1.

**Association Between Financial Risk and Interest Rate Perception**

Table 2 cross-tabulates respondents who agree leverage raises financial risk against respondents who agree market interest rate affects return. A chi-square test of independence gives chi-square = 5.674 (df = 1, p = 0.017), indicating a statistically significant association between the two beliefs. Because two of the four expected cell counts fall below 5, we also ran Fisher's exact test as a robustness check, which confirms the association (p = 0.023). Managers who see leverage as raising financial risk are considerably more likely to also see market interest rates as a driver of return, consistent with both perceptions being rooted in the same underlying awareness of the cost and volatility of debt financing.

**Regression: Share Price Perception on Return Perception**

H3 was tested above as a binary agree/disagree item. Using the underlying five-point Likert scores directly, a simple linear regression of share price perception on return perception gives share price = 2.72 + 0.32 x return (r = 0.182, R-squared = 0.033, p = 0.205, n = 50). The relationship is positive, matching the direction of H3, but is weak and not statistically significant at this sample size, indicating that while most managers agree with the general statement that return and share price move together, the strength of that link varies enough across individuals that it does not translate into a tight linear relationship in the raw scores.

Table 2. Financial risk perception x market interest rate perception (n = 50)

	Disagrees market interest rate affects return	Agrees market interest rate affects return
Disagrees leverage raises financial risk	2	1
Agrees leverage raises financial risk	3	44

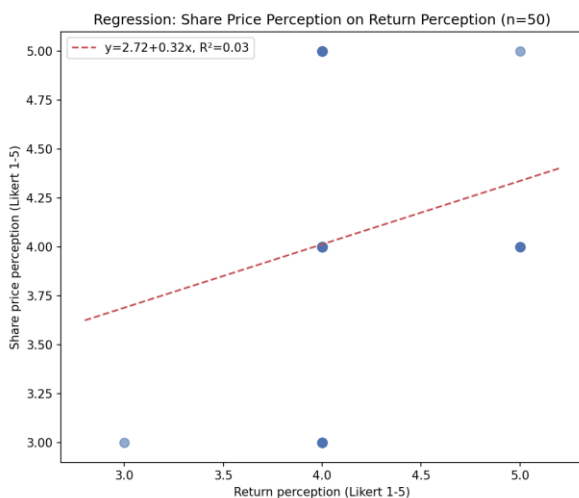


Figure 2. Regression of share price perception on return perception (n = 50).

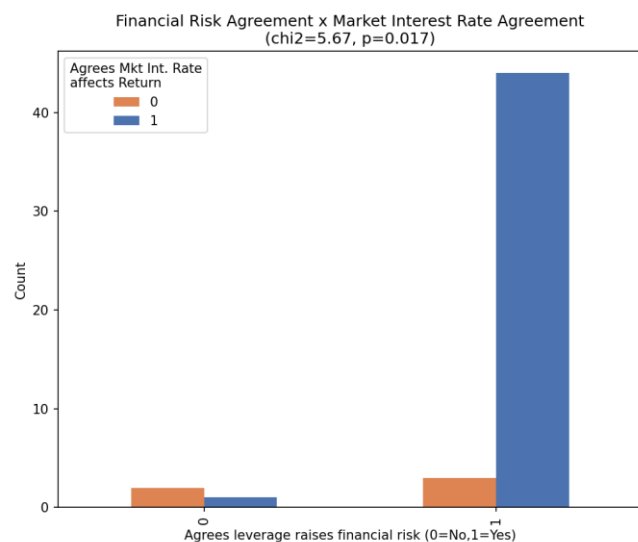


Figure 3. Financial risk agreement by market interest rate agreement (n = 50).



Together, these four supplementary tests show that the perception items behave as a loosely-connected belief system rather than either fully independent opinions or a single unified attitude: correlations are moderate, the risk-return scale shows acceptable but not strong internal reliability, the return-share price link is directionally positive but weak, and financial risk perception is significantly associated with interest rate perception. This adds statistical texture to the single-item hypothesis tests reported above, without changing their overall direction.

## VI. DISCUSSION

Taken together, these results describe a managerial mindset that accepts the basic risk-return logic of leverage: more debt, more risk, and, in this sample's view, more revenue growth. The near-unanimous agreement on sales revenue is worth flagging. It suggests that in a market where equity financing is hard to raise and bond markets barely exist, debt is viewed less as a risk-management trade-off and more as the primary engine of growth itself.

The high cost of debt reported by the sample, mostly 16 to 20 per cent, adds context to the strong risk perception found here. When borrowing is this expensive, the fixed burden on cash flow is heavier, and managers are more likely to feel, and report, that debt raises risk. This matches the theoretical prediction that financial risk scales with both the amount of leverage and its cost.

The comparatively weaker link seen for share price fits with market microstructure realities in Bangladesh, where share prices are shaped by liquidity, political news, and speculative trading as much as by fundamentals. Managers may reasonably see the return-to-price link as less direct than the leverage-to-risk or leverage-to-revenue links.

### Limitations

This is a cross-sectional, perception-based study with a small, purposively selected sample. It cannot establish causality, and it does not verify managerial perception against the firms' actual financial statements. The findings describe how managers think about leverage, not how leverage has actually performed for their firms.

## VII. CONCLUSION

Bangladeshi finance managers connect leverage to higher financial risk and, in this sample, to higher sales revenue as well. The weaker link to share price points to a gap between what managers believe drives firm value and what actually moves market prices in a thin, sentiment-driven exchange. Policymakers looking to deepen Bangladesh's bond market may find this gap useful: it suggests firms lean on debt partly because they see few better tools for funding growth, not because they are blind to the risk it carries.

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