

SOLUTION 7.2

	APRIL	MAY	JUNE
ROE= Net profit/Equity	$\frac{(7,200 - 0) \times 0.80}{60,000}$ $= 9.60\%$	$\frac{(7,200 - 2,000) \times 0.80}{40,000}$ $= 10.40\%$	$\frac{(7,200 - 4,000) \times 0.80}{20,000}$ $= 12.80\%$
	The most highly geared business (June) has generated the highest ROE (12.80%).		
ROA' = $\frac{\text{Net profit} + \text{Interest payable} (1-t)}{\text{Equity} + \text{Non-current liabilities}}$	$\frac{5,760 + 0}{60,000}$ $= 9.60\%$	$\frac{4,160 + (2,000 \times 0.80)}{60,000}$ $= 9.60\%$	$\frac{2,560 + (4,000 \times 0.80)}{60,000}$ $= 9.60\%$
	ROA' is identical for the three businesses.		
Financial leverage = $\frac{(\text{ROA}' - \text{interest rate}) \times \text{Average liabilities}}{\text{Average equity}}$	$\frac{(0.096 - 0.08) \times 0}{60,000} = 0$	$\frac{(0.096 - 0.08) \times 20,000}{40,000} = 0.80\%$	$\frac{(0.096 - 0.08) \times 40,000}{20,000} = 3.20\%$
	Both May and June's shareholders benefit from financial leverage (ROE is higher than ROA').		
ROE = ROA' + Financial leverage	$9.60\% + 0 = 9.60\%$	$9.60\% + 0.80\% = 10.40\%$	$9.60\% + 3.20\% = 12.80\%$