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A STUDY ON CAPITAL STRUCTURE OF SELECTED INDIAN COMPANIES

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ABSTRACT

Capital structure refers to blend of equity and debt fund for raising long term funds. This blend of equity and debt is called as financial leverage. The use of financial leverage affects earning per share and consequently affects value of the firm. This is because the cost of equity is higher than debt and cost of debt is further reduced because of tax shield. The tax shield is available to only debt and not to equity. There are pros and cons of both equity and debt funds. The decision of debt affects profitability, liquidity, EPS and value of the firm. Theories of capital structure discuss the impact of financial leverage on EPS and market value of the firm. Steel manufacturing companies require large amount of long term funds and therefore they have used both types of sources of long term funds in their capital structure. Researcher has taken selected nine steel companies of India to study the capital structure of these companies.

KEYWORDS: Capital Structure, India, Debt, Financial Leverage.

1. INTRODUCTION:

Concept of Capital:

Business is an economic activity as it is concerned with earning money and acquiring wealth through the production and distribution of goods and services. Businesses are predominant in capitalist economies, most being privately owned and formed to earn profit that will increase the wealth of its owners and grow the business itself. The main objective of any business owner or operator is to generate a financial return in exchange for work and acceptance of risk.

There are several common forms of business ownership like sole proprietorship, partnership, corporation and cooperative. In order to generate a financial output, a financial input is most important. This financial input is termed as capital in business.

In economics, capital or capital goods or real capital refers to factors of production used to create goods or services that are not themselves significantly consumed in the production process. Capital goods may be acquired with money or financial capital. In finance and accounting, capital generally refers to financial wealth especially that used to start or maintain a business.

There are two possible approaches to the concept of capital. One of them is “Fund” concept while the other is “Asset” concept of capital. According to the fund concept, the capital of a firm is the total of the funds that have been employed for its operation. It may also be described as “financial capital”. The fund concept recognizes the separate entity of a firm and considers capital from the liability side of the balance sheet.

According to the asset concept capital means money invested in fixed asset and current asset. In both the cases asset may be comprising of both tangible or intangible including fictitious assets.

Financial capital represents obligation, and is liquidated as money for trade, and owned by legal entities. It is in the form of capital assets, traded in financial markets.

The financial capital which is required by entrepreneurs can be obtained through various sources. There are long term sources like share capital, debenture capital, venture capital, mortgage, retained profit, etc. Financial capital can also be obtained through medium term sources like term loans, leasing, etc. and through short term sources like bank overdraft, trade credit, factoring, etc.

Meaning of Capital Structure

The term 'structure' means the arrangement of the various parts. So capital structure means the arrangement of capital from different sources so that the long-term funds needed for the business are raised.

Thus, capital structure refers to the proportions or combinations of equity share capital, preference share capital, debentures, long-term loans, retained earnings and other long-term sources of funds in the total amount of capital which a firm should raise to run its business.

Definition Given by Financial Experts:

- “Capital structure of a company refers to the make-up of its capitalisation and it includes all long-term capital resources like… loans, reserves, shares and bonds.” — Gerstenberg.
- “Capital structure is the combination of debt and equity securities that comprise a firm's financing of its assets.” — John J. Hampton.
- “Capital structure refers to the mix of long-term sources of funds, such as, debentures, long-term debts, preference share capital and equity share capital including reserves and surplus.” — I. M. Pandey.

2. LITERATURE REVIEW:

Dr. R. Kavitha (2014) undertook a study to examine the effect of all 8 factors of capital structure over financial leverage. For this purpose sample data set of total 21 large Indian pharmaceutical companies for the period of 10 years from 2002-03 to 2011-12 was considered. In order to do an analysis descriptive as well as quantitative statistics as well as multiple regression was used. Finding of the study indicate that out of 8 factors 4 factors (size, profitability, tangibility and debt service capacity) are found to be statically significant, while remaining four factors are found to be insignificant. Further researcher recommended that policy makers should focus on these determinants while making any decision regarding capital structure.

Chette SrinivasYadav (2014) investigates the relationship between financial leverage and determinants of capital structure by considering sample of 50 listed firms on NSE during the period 2002-2012 and taking 10 factors as an independent variables and financial leverage as an dependent variables. Study used ANOVA model which indicate all determinants has a significant relationship with leverage. Further with the help of correlation found that 3 factors (liquidity, debt service, growth) are positively correlated to debt equity ratio, while rests are negatively related.

Dr. SukhdevSingh (2015) done a research over the “Emerging trends in corporate capital structure patterns-A study of selected manufacturing industries” By taking a sample of 19 manufacturing companies for a period of 10 years from 2002-2003 to 2011-2012, he studied the future rising trends of debt in pharma industry and rising trends in equity in cement industry 2019-2020. His study found to be identical with pecking order theory and trade off theory.

John Jacob, Dr. Jyothijayakrishnan (2015) has done an analysis over the “Impact of capital structure on profitability-Empirical evidence from cement industry in India”. Data collection has been done for a period from 2007 to 2014 as well as purposive sampling technique is used for selection of industries. Their study resulted that debt ratio, long term debt ratio and GDP ratio influenced the profitability.

Dr. A. K. Adhikaray, Mr. Bhattsatyaki (2015) done a research study on “Capital structure patterns of selected consumer electronic company”. The objective of their study is to examine the existence of inter firm and inter industry difference in the capital structure of Indian firms as well as to determine the financing pattern of capital structure of electronic firm based from 2005 to 2014 comprising of 5 companies. Results of the study indicate a significant difference in the determinants of long and short term forms of debt as well as most of the determinants are found to be relevant for firms.

Ashim Gupta (2016) has done an analytical study over the topic of “Capital structure Practices: Industry Wise Analysis of Companies" The objective of there is to study the variation in the capital structure practices. For this purpose they have collected the data based on 4 sectors for the period of 2005-2014. In order to examine the variation ratio analysis techniques has been used. His study resulted that nature of industry influence the capital structure practices of corporate firms and the industry group under study have market inclination towards shareholders fund in capital structure.

Dr. Rohit. R. Manjule (2014) has done a research study on "Impact of capital structure in Indian industries". The objective of their study is to see the existence or the lion existence of intra and inter-sectoral difference in the debt structure of various industrial sectors in India, also to identify the factors affecting the capital structure decisions. Sample of 151 Indian firms selected categorized into 13 industrial sectors. He founds that variables like liquidity and growth in terms of performance has a significant influence on debt-equity ratio. Also, determinants are found to be industry specific which implies that the weight of explanatory variables varies from sector to sector.

Dr. Rakeshkumar Rasiklal Jani, Mr. Satyaki Bhatt (2015) studied "Capital structure determinants: A case study of automobile industry". The objective of their study is to examine empirically the existence of inter firm and inter industry difference in capital structure. Secondary data collected for a period of 2008-2012 by consisting a sample of 3 companies. Data has been analyzed using correlation and regression. Their study indicate that service firms relies more on equity and less on debt, in case of manufacturing companies vice versa . They also find the significant difference in the long and short term forms of debts.

Manjunath S. Awalakhi (2015) done a research study on "Financing decision: A case study of selected cement companies of India". The objective of his study is to analyse the effect of changes in capital structure pattern on its investment over the period of 2008-09 to 2013-14 as well as to make an intra company analysis. In order to study the financing decision, he has taken a sample of five most reputed cement companies. Trend analysis technique has been applied on the company financial statement to analyze the change in capital structure and its impact on investment pattern of the companies. His study resulted that capital structure decision has a very little impact on the investment pattern, which defines that company is using long term source of fund for its operational activities in order to attain a long term solvency and maximizing profitability with least cost of capital.

N. SureshBabu, Prof. G.V. Chalam (2016) has done a research study on "Capital structure and its determinants of the automobile companies in India". For the study purpose secondary data has been collected. Sample consists of 58 Indian automobile companies. Listed on BSE covering the period from 1997-1998 to 2010-2014. For the analysis purpose fixed effect regression model has been used. Result of their study shows that variables like profitability, size, tangibility, growth and non-debt tax shield are negatively related with leverage, and risk and liquidity are positively related with leverage. Profitability found to be significant variable of capital structure.

Dr. V.Gangadhar, Dr. Narasimha chary & K.Deepsari (2016) done a research study on "Capital structure pattern of public sector enterprise". In order to do the study trend analysis of debt-equity ratio of 3 refinery companies has been chosen as a sample size from 1000 manufacturing companies for 10 years. It is to be found that due to the fear of financial risk, companies are using debt equity financing also to maximum possible extent and it is also give advised to maintain a right balance between debt financing and equity financing.

S. Ravethy, Dr. Santhi (2016) conducted a study on "Impact of capital structure on profitability of manufacturing companies in India". Sample of 70 companies has been chosen by multistage sampling method. Their study resulted that there has been a strong one -to-one relationship between capital structure variable and profitability and increase debt equity ratio inversely affect profit of manufacturing companies listed on BSE in India.

3. RESEARCH OBJECTIVE:

1. To analyze capital structure of selected steel companies.
2. To study the impact of capital structure on profitability.

4. SOURCES OF DATA:

Secondary sources of data utilized for this proposed study. Secondary data have been collected from annual reports of steel companies

5. SAMPLE SIZE:

1. JSW Steel Ltd.
2. Tata Steel Ltd.
3. Steel Authorities of India Ltd.
4. Bhushan Steel Ltd.
5. Visa Steel Ltd.
6. Uttam Galva Steel Ltd.
7. Steel Strips and Wheel Ltd.
8. Jindal Stainless Ltd.
9. Steel Exchange of India Ltd.

6. TIME PERIOD:

Last five years of data 2019-20 to 2015-16 have been analysed for this study.

7. DATA ANALYSIS

Company	Debt Equity Ratio					Company Wise Average
	2019-20	2018-19	2017-18	2016-17	2015-16	
Bhushan Steel Ltd.	23.44	22.14	10.36	9.11	8.77	14.76
Jindal Stainless Ltd.	2.97	10.25	8.66	19.72	8.57	10.03
JSW Steel Ltd.	1.65	1.99	1.60	1.53	1.13	1.58
Steel Authorities of India Ltd.	1.05	0.82	0.69	0.58	0.54	0.74
Steel Exchange of India Ltd.	8.72	2.31	2.86	1.62	2.05	3.51
Steel Strips and Wheel Ltd.	1.63	1.30	1.41	1.81	1.79	1.59
Tata Steel Ltd.	2.38	3.02	2.28	1.74	1.68	2.22
Uttam Galva Steel Ltd.	28.33	15.24	2.68	2.66	2.18	10.22
Visa Steel Ltd.	34.25	25.11	19.11	37.44	10.63	25.31
Year Wise Average	11.60	9.13	5.52	8.47	4.15	7.77

Multiple Regression:

Summary Output:

Regression Statistics	
Multiple R	0.764878
R Square	0.585039
Adjusted R Square	0.411023
Standard Error	7.02158
Observations	45

ANOVA

	df	SS	MS	F	Significance F
Regression	13	2154.808	165.7545	3.361983	0.002766
Residual	31	1528.38	49.30259		
Total	44	3683.189			

	Coefficients	Standard Error	t Stat	P-value	Lower 95%	Upper 95%	Lower 95.0%	Upper 95.0%
Intercept	17.34409	16.36676	1.059714	0.297462	-16.0361	50.72432	-16.0361	50.72432
Asset Turnover Ratio	0.912469	13.66813	0.066759	0.947202	-26.9639	28.78881	-26.9639	28.78881
Current Ratio	-19.0868	9.411903	-2.02794	0.051235	-38.2825	0.108919	-38.2825	0.108919
Debtors Turnover Ratio	-0.04653	0.445982	-0.10433	0.917576	-0.95612	0.863055	-0.95612	0.863055
Fixed Assets Turnover Ratio	13.94666	11.23331	1.241545	0.223717	-8.96382	36.85714	-8.96382	36.85714
Gross Profit Margin	0.292816	1.220036	0.240006	0.811906	-2.19546	2.781096	-2.19546	2.781096
Net Profit Margin	-0.30782	0.209642	-1.46832	0.152091	-0.73539	0.119745	-0.73539	0.119745
Operating Profit Margin	-0.02454	1.167707	-0.02101	0.98337	-2.40609	2.357019	-2.40609	2.357019
Quick Ratio	-2.82272	3.585069	-0.78735	0.437054	-10.1345	4.48908	-10.1345	4.48908
Return on Assets	-0.01093	0.010503	-1.04083	0.306002	-0.03235	0.010489	-0.03235	0.010489
Return On Capital Employed	0.287549	1.358969	0.211594	0.833809	-2.48409	3.059184	-2.48409	3.059184
Return on Long Term Funds	-0.71851	0.77811	-0.9234	0.36293	-2.30547	0.868459	-2.30547	0.868459
Total Assets Turnover Ratio	-5.74644	9.834551	-0.58431	0.56324	-25.8041	14.31126	-25.8041	14.31126
Earning Per Share	0.049494	0.048064	1.029737	0.311101	-0.04853	0.147522	-0.04853	0.147522

Interpretation:
From the above table it can be seen that p value for all variables is higher than 0.05 significant value. So there is no linear correlation between Debt Equity Ratio and all other 9 financial ratios of selected nine steel companies of India.

7. CONCLUSION:
Higher the Debt-Equity ratio, risky the financial position of the company and lower the ratio safe the financial position of the company. Visa Steel Ltd has an average outstanding higher value (25.31) of the Debt Equity ratio, which indicates that this company has the riskiest financial position. Whereas Steel Authorities of India Ltd has an average outstanding lower value (0.74) of the Debt Equity ratio, which indicates that this company has the safest financial position. Based on the multiple regression it is seen that there is no linear correlation between Debt Equity Ratio and all other 9 financial ratios of selected nine steel companies of India.

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