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# ANALYSIS OF CAPITAL STRUCTURE OF INDIAN OIL CORPORATION LIMITED (IOCL)

**Ghatliya Vaishali Ishwarbhai**

Ph.D. Research Scholar, Gujarat University, Ahmedabad.

## ABSTRACT

Capital structure refers to the mix of different securities known as debt equity ratio in a corporate firm. Capital structure decisions are considered to be one of the most crucial decisions of a company as it has a direct bearing on the success or failure of the company. A number of theories have been proposed and lot of research has been done in the past few decades on the capital structure decisions and the factors which influence them. This paper attempts to examine the firm specific factors which determine the capital structure decisions of IOCL. In this study research has taken six years data 2014-15 to 2019-20. Data has been taken from the annual reports of IOCL. Share capital, paid up capital, total debt, financial leverage and operating leverage data has been analysed for this study.

**KEYWORDS:** IOCL, Capital Structure, Financial Leverage, Share Capital

### 1. CAPITAL STRUCTURE:

Capital structure is one the arguable area of financial research and the mystery of debt and equity equation in firms' capital structure is not completely clarified. However, the tax shield benefit of debt financing obviously accepted and understood by both financial managers and researchers. There are three approaches of capital structure. At on extreme, net income (NI) approach (Durand, 1952) states that firm can lessen its cost of capital and thus increase its value by debt financing. In contrast, net operating income (NOI) approach, also proposed by Modigliani and Miller (1958) claims that firm's value and capital structure are independent and debt and equity financing create the same value.

Solomon (1963) introduced intermediate approached of capital structure, also known as traditional approaches, which explains that the firm's value increase when financial leverage rises and it becomes constant on designated level of debt and finally the firm's value decrease. In fact this approach holds the concept of optimal capital structure. In other word, the companies should have a target capital structure and follow it in order to increase firms' value. Various theories of capital structure have been developed during past five decades that mainly tried to illustrate relation between capital structure and firms value, and also find important factors of effect capital structure selection. At the same time, vast amount of empirical studies have tried to test and confirm capital structure theories, however, they have shown various results regarding effectiveness of these theories.

### 2. LITERATURE REVIEW:

The importance of a company's capital structure nowadays has become the subject of heated academic debate. In general, there are two sources of capital: debt and equity. Based on Denzil and Antony (2004), it is usually rational to finance any business project with a combination of these two in order to fulfil the changing objectives of the firm. Equity finance represents the highest level of risk due to both uncertainty of dividend payments and capital gains, and the ranking when a company goes into liquidation. While there is no uncertainty of debt finance unless a company is likely to be declared bankruptcy and also debt financing enjoys some tax advantage. However, according to the financial analysis of Jessops (2008), a very high level of dependence on debt finance does not allow the firm to take the advantage of tax benefit, conversely making the firm vulnerable to buyout due to very low payment of dividend that the share holders may no longer be interested in the continuation of the situation and the company faces bankruptcy risk. Therefore, it is very important to determine the proportion of financing through debt and equity respectively.

Previous studies found that the relationships exist between company characteristics and capital structure. Talberg et al. (2008) examined the capital structure across different industries for 50 largest companies listed on a stock exchange and headquartered in the United States. The research found that asset structure, growth, profitability, size, age, revenue per employee, and liquidity influence the capital structure across industries. In addition, the research proves that there is significant difference in the capital structure depending on the industry.

Vasiliou and Neokosmidi (2007) studied how firm characteristics affect capital structure. This research used 129 Greek companies listed in the Athens Stock Exchange during 1997 and 2001. This research found that firms' size is positively related to their capital structure. In addition, the research also found that the growth, quick ratio, and interest coverage ratio is negatively related to the capital structure.

Sibikov (2009) examined the effect of asset liquidity on capital structure by using data from a broad sample of U.S public companies. This research found that the asset liquidity is positively related to capital structure. Similarly, Al-Najjar and Taylor (2008) asserted that asset liquidity affects the capital structure.

### 3. RESEARCH OBJECTIVE:

1 To examine the capital structure policy and pattern of IOCL.

2 To understand the capital structure of Indian Oil Corporation Limited.

3 To identify the share capital and debt of the company.

### 4. DATA ANALYSIS:

**Share Capital:**

| Year | 2020 | 2019 | 2018 | 2017 | 2016 | 2015 |
|---|---|---|---|---|---|---|
| Authorised Capital | 6286 | 6000 | 6000 | 6000 | 6000 | 2500 |
| Issued Capital | 2428 | 2428 | 2428 | 2428 | 2428 | 2428 |

**Authorised Capital:** The maximum equity capital a company can raise, which is mentioned in the Memorandum of Association and Articles of Association of the Company. However, share premium is excluded from the definition of authorized capital.

**Issued Capital:** Issued Capital is the amount of nominal value of share held by the shareholders. It is the face value of the shares that have been issued to the shareholders. Issued share capital and share premium represent the amount invested by the shareholders in the company. It is also known as the subscribed capital or subscribed share capital.

**Analysis:** But here, IOCL issued very less share capital in previous year if I compared to Authorized capital. IOCL is only issued the limited share to the shareholders.

**Paid Up Capital:**

| Year | Instrument | Shares (nos) | Face Value | Capital (in crore Rs) |
|---|---|---|---|---|
| 2019-2020 | Equity Shares | 762986920 | 10 | 2427.95 |
| 2018-2019 | Equity Shares | 2427952482 | 10 | 2427.95 |
| 2017-2018 | Equity Shares | 2427952482 | 10 | 2427.95 |
| 2016-2017 | Equity Shares | 2427952482 | 10 | 2427.95 |
| 2015-2016 | Equity Shares | 1192374306 | 10 | 1192.37 |
| 2009-2015 | Equity Shares | 1192374306 | 10 | 1192.37 |
| 2008-2009 | Equity Shares | 778674809 | 10 | 778.67 |

The amount of a company's capital that has been funded by shareholders, paid up capital can be less than a company's total capital because a company may not issue all the shares that it has been authorized to sell. Paid up capital can also reflect how a company depends on equity financing.

Here, from the year 2016-2019 the company's paid up capital remain same. Its means the IOCL collected average funded by shareholders and they have to issue more share capital to shareholders in future periods.

**Total Debt:**
The IOCL has only two debts:

- Secured Loan
- Unsecured Loan

Total debts means here include Debenture, Bonds, Long term loan, Short term loan etc. But Indian Oil Corporation Limited (IOCL) did not issued debenture, bonds etc.

| Year | Secured Loan |
|---|---|
| 2020 | 19390 |
| 2019 | 17866 |
| 2018 | 14457 |
| 2017 | 13046 |
| 2016 | 20380 |
| 2015 | 18292 |

**Interpretation:**
In 2020 the secured loan proportion is high than 2019. The Indian Oil Corporation Limited (IOCL) has try to reduce the secured loan because secured loan effect the assets of the company and it will be effect on future periods so the IOCL increasingly firms are moving from secured debt to unsecured debt in order to free their assets.

Secured loan have the largest positive impact on company's credit when they are repaid. If company have never taken a secured loan, company's credit may be low despite your good record of repayment.

**Unsecured Loan:** On the other hand, unsecured loans are the opposite of secured loans and include things like credit card purchases, education loans, or personal loans. Lenders take more of a risk by making such a loan, with no property or assets to recover in case of default, which is why the interest rates are considerably higher. If you have been turned down for unsecured credit, you may still be able to obtain secure loans, as long as you have something of value or if the purchase you wish to make can be used as collateral.

When you apply for a loan that is unsecured, the lender believes that you can repay the loan on the basis of your financial resources. You will be judged based on the five (5) C's of credit – Character, Capacity, Capital, Collateral and Conditions. These are all criteria used to assess a borrower's creditworthiness character, capacity and collateral refers to borrower's willingness and ability to repay the debt. Conditions include the borrower's situation as well as general economic factors.

| Year | Unsecured Loan |
|---|---|
| 2020 | 64800 |
| 2019 | 62733 |
| 2018 | 63869 |
| 2017 | 57278 |
| 2016 | 32355 |
| 2015 | 26274 |

**Interpretation:**
Here unsecured loan is constantly high from 2016-2020. Indian Oil Corporation Limited (IOCL).

Unsecured loan is better than secured loan, because secured loan will be affect the assets of the company in future period of time so the IOCL has increasing the unsecured loan for reducing the risk of the company. Most of the company preferred the unsecured debt which will not affect any assets of the company.

In some cases, IOCL may be able to reduce IOCL unsecured debts by negotiating with creditors for a lower balance. Either IOCL can talk to creditors on IOCL own, or IOCL can solicit the help of a credit counseling organization. In some cases, credit counselor can negotiate with creditors better than debtors can. However, if IOCL choose to work with a credit counselor make sure the organization is reputable.

**Financial Leverage:**
Financial Leverage is a leverage created with the help of debt component in the capital structure of a company. Higher the debt, higher would be the financial leverage because with higher debts comes the higher amount of interest that needs to be paid. Leverage can be both good and bad for a business depending on the situation. If a firm is able to generate a higher return on investment (ROI) than the interest rate it is paying, leverage will have its positive affect share-holder's return. The darker side is that if the situation is opposite, higher leverage can take a business to a worst situation like bankruptcy. The degree of financial leverage (DFL) can be calculated with the following formula;

DFL = % Change in EPS / % Change in EBIT

Where EPS is the Earning Per Share and EBIT is the Earnings Before Interest And Taxes.

**Degree Financial Leverage of IOCL:**

| YEAR | FINANCIAL LEVERAGE |
|---|---|
| 2020 | 2.19 |
| 2019 | 1.61 |
| 2018 | 1.91 |
| 2017 | 1.49 |
| 2016 | 1.31 |
| 2015 | 1.11 |

Interpretation:
In 2020 degree of financial leverage of Indian Oil Corporation Limited IOCL ratio is 2.19 and it has constantly higher than previous years.

By borrowing funds, IOCL incurs a debt that must be paid. But this debt is paid in small installments over a relatively long period of time. This frees funds for more immediate use. Indian Oil Corporation Limited that successfully uses leverage demonstrate by its success that it can handle the risks associated with carrying debt. This can become an important factors when additional financing is needed. Not only will loans more likely be available, but they will be available at more attractive interest's rates. Like individuals, companies with solid financials.

**Operating Leverage:**
Operating Leverage, just like the financial leverage, is the result of operating fixed expenses. Higher the fixed expense, higher the operating leverage. Like the financial leverage had an impact on the shareholder's return or say earning per share, operating leverage directly impacts the operating profits (Profit before interest and taxes (PBIT)). Under good economic conditions, due to operating leverage, an increase of 1% in sales will have more than 1% change in operating profits.

The formula used for determining the Degree Of Operating Leverage or DOL is as follows :

DOL = % Change in EBIT / % Change in Sales

So, Indian Oil Corporation Limited IOCL need to be very careful in adding any of the leverages to your business viz. financial leverage or operating leverage as it can also work as a double edged sword.

| Year | Operational Leverage |
|---|---|
| 2020 | 1.46 |
| 2019 | 1.12 |
| 2018 | 1.14 |
| 2017 | 1.09 |
| 2016 | 1.13 |
| 2015 | 1.01 |

In 2020 Indian Oil Corporation Limited has degree of operating ratio is 1.46.

According to this chart IOCL having a good position in future period of time. The more operating leverage a company has, the more it has to sell before it can make a profit. Indian Oil Corporation Limited IOCL with a high operating leverage must generate a high number of sales to cover high fixed costs, and as this sales increase, so does the profitability of the company. Conversely, a company with a lower operating leverage will not see a dramatic improvement in profitability with higher volume, because variable costs, or costs that are based on the number of unit sold, increase with volume.

**Total Leverage Of Indian Oil Corporation Limited (IOCL):**

| Year | Total Leverage |
|---|---|
| 2020 | 1.75 |
| 2019 | 1.82 |
| 2018 | 2.43 |
| 2017 | 1.64 |
| 2016 | 1.49 |
| 2015 | 1.21 |

**Interpretation:**
Combined or total leverage measures total risk of the Indian Oil Corporation Limited

IOCL. In this year Indian Oil Corporation has minimum risk than last two years which ratio was 1.82 & 2.43. In this diagram is measured by percentage change in earning per share EPS due to percentage change in sales.

IOCL asks their existing shareholders to issuing common stock rights. Stocks right allow existing shareholders to purchase additional shares at below market prices, in order to raise equity. While this practice does improve a company's financial strength, it also dilutes the current shareholder's percentage of ownership.

## 5. FINDINGS:

- IOCL has issued less shares capital to the shareholders, constantly from 2015-2020.
- IOCL does not fulfill the authorized share capital which is mention in memorandum of association (MOA).
- IOCL, preferences share and debenture do not exist.
- The return on investment ratio of IOCL is the lowest among its competitors which imply that the degree of efficiency of IOCL is utilizing the funds entrusted by shareholders and long term creditors is lower than its competitors.
- IOCL has maximum numbers of total debts in 2020, if I compared with previous years.
- In 2020, IOCL has maintained the secured loan amount. Which is mostly remain same with previous year.
- In 2020, earning per share EPS value is Rs. 38.61 which is higher than 2019, but overall five years, IOCL shareholders has earned minimum EPS in 2019.
- IOCL has Degree of operating leverage (DOL) almost same with last five years. IOCL heaving a good position in future period of time.
- In 2020, Degree of financial leverage is very high than previous years, IOCL incurs a debt that must be paid. But this debt is paid in small installment over a relatively long period of time.
- The overall efficiency of IOCL is higher than those of its competitors in previous years of comparison.

## 6. CONCLUSION:

From the above discussion it can be concluded that IOCL (Indian Oil Corporation Limited) running with low debt fund. Therefore they may increase it to get benefits of low cost capital. It has found that Indian Oil Corporation Limited IOCL largely employing shareholders' funds in their assets it has crossed even 100% in the first two years. Moreover EOL is on high degree financial risk. Therefore, they may reduce the debt capital and employ more equity fund. The study undertaken has brought in to the light of the following conclusions. According to this project I came to know that from the analysis of capital structure it is clear that Indian Oil Corporation Limited have been doing a satisfactory job. But the firms has certain area to ponder upon like capital employment. So the firm should focus on getting of profits in the coming years by taking care internal as well as external factors. And with regard to resources, the firm is take utilization of the borrowed funds in a right place.

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