

## A PROJECT REPORT ON CAPITAL STRUCTURE ANALYSIS

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### ABSTRACT

This paper analyzes the explanatory power of some of the recent theories of optimal capital structure. The study extends empirical work on capital structure theory in three ways. First, it examines a much broader set of capital structure theories, many of which have not previously been analyzed empirically. Second, since the theories have different empirical implications in regard to different types of debt instruments, the authors analyze measures of short-term, long-term, and convertible debt rather than an aggregate measure of total debt. Third, the study uses a factor analytic technique that mitigates the measurement problems encountered when working with proxy variables. In recent years, a number of theories have been proposed to explain the variation in debt ratios across firms. The theories suggest that firms select capital structures depending on attributes that determine the various costs and benefits associated with debt and equity financing. Empirical work in this area has lagged behind the theoretical research, perhaps because the relevant firm attributes are expressed in terms of fairly abstract concepts that are not directly observable.

**Keywords:** explanatory power, capital structure, equity financing.

### 1. INTRODUCTION

#### CAPITAL STRUCTURE DEFINED:

Capital shape method the allocation of debt and equity that a corporation makes use of to finance its operations and enlargement.

The belongings of the business enterprise can be financed with the resource of elevating the proprietors' claim or through the creditors' claim. Owners' claims increase at the same time as the employer collects finances with the aid of issuing commonplace stocks or maintaining income, and debtors' borrowing will increase via borrowing. The economic structure of the employer is proven via the left side of the balance sheet (liabilities and fairness). Traditionally, quick-term debt is excluded from the economic method stock of the firm's capital expenditure and, therefore, lengthy-term claims are stated from the company's capital shape. The capital shape is used to symbolize the proportional courting amongst debt and equity. Equity includes paid-up percent capital, share top magnificence and reserves and surplus.

The financing or capital structure desire is an critical managerial choice. This influences shareholder returns and, therefore, loss; Share marketplace value can be induced via capital shape determination. The enterprise could have its plan

During its promotions at the beginning of capital formation.

The capital shape is how the company price range its entire operations and growth through using several funding sources. Debt come within the shape of bond issues or lengthy-term notes payable, whilst equity is classified as not unusual stocks, preferred inventory or retained earnings.

In financing or capital formation, the selection is a essential managerial selection. This impacts shareholder returns and threat. Consequently the market charge of a share is stimulated with the resource of the capital shape selection. The business enterprise wishes to plan its capital shape early in its advertising. This choice includes an evaluation of the reducing-edges capital structures and issue that manage the decision at the cutting-edge shareholders' fairness function, reinforcing the sales. Therefore, if the dividend preference impacts the capital formation choice, the enterprise's dividend policy need to recall whether or not or not the company's new financing selection affects its debt fairness combo.

#### Equity Shares:

Equity shares constitute the possession function inside the corporation and that they offer lasting capital. They have voting rights and acquire dividends on the discretions of the Board of Directors.

**Priority Shares:**

In the context of the liquidation of a corporation, those who keep a preferred stake are desired over equity shareholders. Reference percentage may also provide for the accumulation of dividends. This is referred to as cumulative preference proportion.

**Debentures:**

Debenture refers back to the long-term debt issued by the holder of the debentures to the corporation. If the interest charge is special and the hobby prices are treated there could be deductible charges at the hands of the agency. Debentures may be issued without hobby. They are called 0 interest rate debentures. Such debentures are issued at plenty decrease charge than their face charge. So, they are additionally called deep good deal debentures.

**2. REVIEW OF LITERATURE****ARTICLE: 1****TITLE The Analysis of Capital Structure**

**Author:** Ziwei Wang

**Source:** Proceedings of the 2021 3rd International Conference on Economic Management and Cultural Industry (ICEMCI 2021)

**ABSTRACT**

A corporate's financing of its real investments has recently attracted considerable attention from academics who have proposed various theories. This paper firstly studies the Gordon growth model and the weighted average cost of capital formula with the empirical tests and the sensitivity analysis. Then, we exam changes in a company's market value concerning different combinations of capital structures and identify an arbitrage opportunity based on the Modigliani-Miller propositions. Finally, we investigate the relationship between a firm's funding sources and its profit using panel data regression to figure out the optimal way to financing. These studies enable us to realize the fundamental relationship between a corporate's price and its capital structure. In light of those studies, we could have some insightful ideas regarding funding decision-making in reality.

**ARTICLE: 2****TITLE:** A Study On Capital Structure

**Author:** 1a.haritha, 2k. Divya

**Source:** JES Journal of Engineering Sciences

Taub (1975) tried to ascertain the factors influencing a firm's choice of a debt equity ratio. For this study a total of 89 firms from Unites States were chosen randomly over a period of ten year from 1960 to 1969 and the likelihood-ratio statistics and t-test were used to test the hypothesis described therein. The empirical results of the study in terms of the expected sign of the co-efficient were mixed. The return to the firm, long term rate of interest, Bhat (1980) made an attempt to analyze the determinants of financial leverage and to investigate the relationship between the leverage ratio and institutional characteristics viz. firm size, variation in income, growth, profitability, debt service and dividend payout through correlation and regression analysis. The cross-section data for this study were collected for six years from 1973 to 1978 from only one industry i.e., Engineering Industry, so as to alleviate the effect of industry type on the financial leverage ratio. The study reveals that firm size, growth rate and the degree of operating leverage does not have any significant relationship with financial leverage whereas earnings rate, business risk, dividend payout ratio and debt service ratio have been found to be negatively related. Only the relation of operating leverage with leverage has been found positive but insignificant relationship. The study observed that the institutional characteristics are important determinants of financial leverage ratio.

**ARTICLE: 3****TITLE:** A STUDY ON CAPITAL STRUCTURE ANALYSIS AND SM EXPORTS PROJECT REPORT FOR SM EXPORTS

**Author:** P. Balasathiya

**Source:** ISSN (PRINT): 2393-8374, (ONLINE): 2394-0697, VOLUME-5, ISSUE-4, 2018

Venkatesan (1983) tried to explore the relationship of certain exogenous variables with the financial leverage. He used the data of 66 firms from four different industries for a time span of four year from 1977 to 1980. He attempted to analyze the impact of seven different variables on financial structure of firms by using the multiple regression model, correlation and t-test. The study reveals that null hypothesis proposed in the study that size does not have any

relationship with financial leverage could not be rejected for any of the industries. Coverage ratios revealed the significant relationship to the financial structure in all the industries except for steel industry in intraindustry model during study period. Business risk and growth was not found significantly related to financial structure in any of the industries examined. In the inter-industry model, low-levered firms revealed significant relationship between selected variables except growth ratio and financial leverage. But medium and high levered firms were not having any significant common determinant of their financial structure.

#### RESEARCH GAP:

Only the relation of operating leverage with leverage has been found positive but insignificant relationship. The study observed that the institutional characteristics are important determinants of financial leverage ratio.

#### OBJECTIVES:

- To examine the leverage of the chosen agency.
- To preserving tune of financing trends for the duration 2021-2023.
- To take a look at the debt / equity ratio for the chosen period.
- Studying the pricing way for shares.
- Analyzing the motives for the trade in proportion charge.

### 3. RESEARCH METHODOLOGY

#### Need For The Study

- The price of the agency is based upon on its predicted sales motion and the expenses at which this movement is used to cut price. This is the prices of return or capital expenditure required via the organization to bargain the sales movement. Therefore, the capital formation choice not best impacts the organisation's earnings via changing its income; but it moreover influence the residuals incomes of shareholders.
- The effect of leverage on capital expenditure isn't always very smooth. Contradictory opinions were expressed on the problem. In reality, this problems is one of the maximum continual areas of finance precept, and masses extra theoretical and empirical artwork have been carried out at the problem.

#### Scope Of The Study:

The take a look at of capital form examines the long-term and quick-time period assets that an company can tap to fulfill its finance needs. The scope of the take a look at is restricted to the property tapped by way of way of the Indian Oil Corporations for the years under check.

The purpose of the examiner is to analyze and find out the prevailing fee of shares and debentures in the oil enterprise. The final results of the researches describes how the price of share and debenture have elevated or decreased over the last 2 yr and the reasons for the change.

#### Methodology

The process used to accumulate truth and statistic for the purpose of making industrial corporation choices. This method may additionally moreover encompass posted studies, interviews, surveys, and extraordinary studies methods and may embody modern and historic records.

#### Basic records:

Preliminary information had been amassed for the primary time.

#### Secondary statistics:

The number one records is gathered by using using a person else or for a motive aside from contemporary-day. The deliver for this have a study turned into journals, books, and organization web websites.

#### Sources of information:

The number one supply of this mission is extracted from the employer's posted annual reviews for 2017-2023.

Tools used:

- Ratio evaluation
- Graphical Analysis
- Year-with the aid of manner of-yr analysis

This system enter into the translation and statistics of the current view of capital formation.

#### 4. DATA ANALYSIS & INTERPRETATION

##### EBIT LEVELS

Particulars	2019-20	2020-21	2021-22	2022-23
Earnings Before Interest & Tax	514.5	484.75	509.61	765.05
Change	-	-(27.75)	-(2.39)	252.55
% Change	-	5.41%	0.466%	49.27%

##### DEGREE OF FINANCIAL LEVERAGE:

$$DFL = \frac{\% \text{ Change in EPS}}{\% \text{ Change in EBIT}}$$

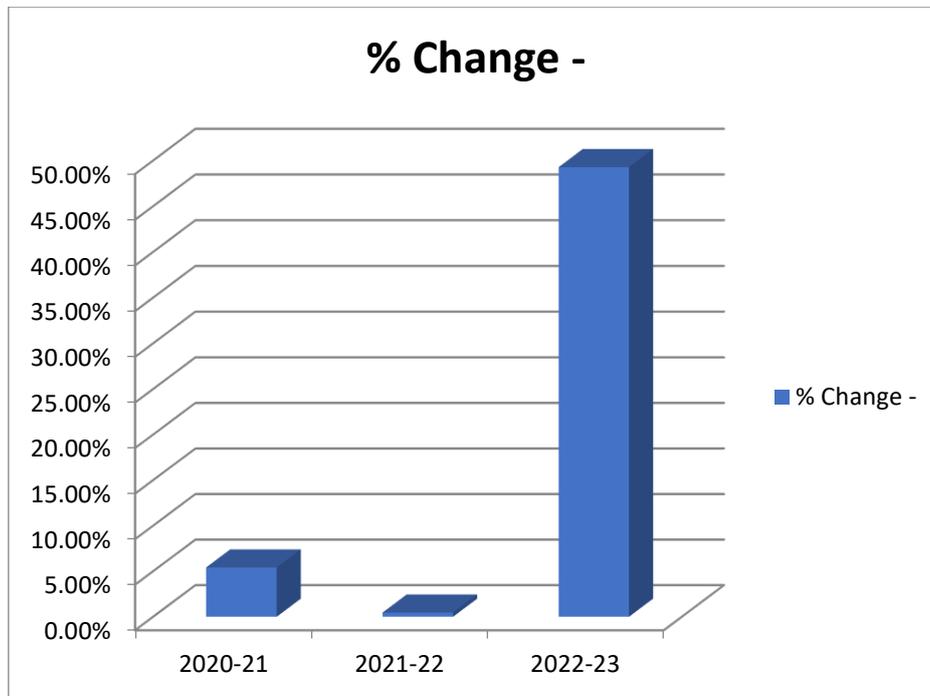
The higher the quotient of DFL, the greater the leverage.

##### In this case

During 2019-2020, to 2020-2021 it is increasing because decrease in EBIT level.

During 2020-2021, to 2021-2022 it is decreasing because increase in EBIT level.

##### EBIT LEVELS



##### INTERPRETATION:

The EBIT level in 2019 is at 514.5 and is decreasing till the next year 2020. The EBIT levels in 2021 again started growing and reached to 509.61 and in 2022 were at 765.05

##### EPS ANALYSIS

Particulars	2019-20	2020-21	2021-22	2022-23
Profit after tax	24646000	28866000	31522000	40172000
Less: Preference Dividend	-	-	-	-
Amount of Equity share holder	24646000	28866000	31522000	40172000
No. Of Equity share	210680007	210680007	210680007	210680007
EPS	0.118	0.157	0.168	0.190

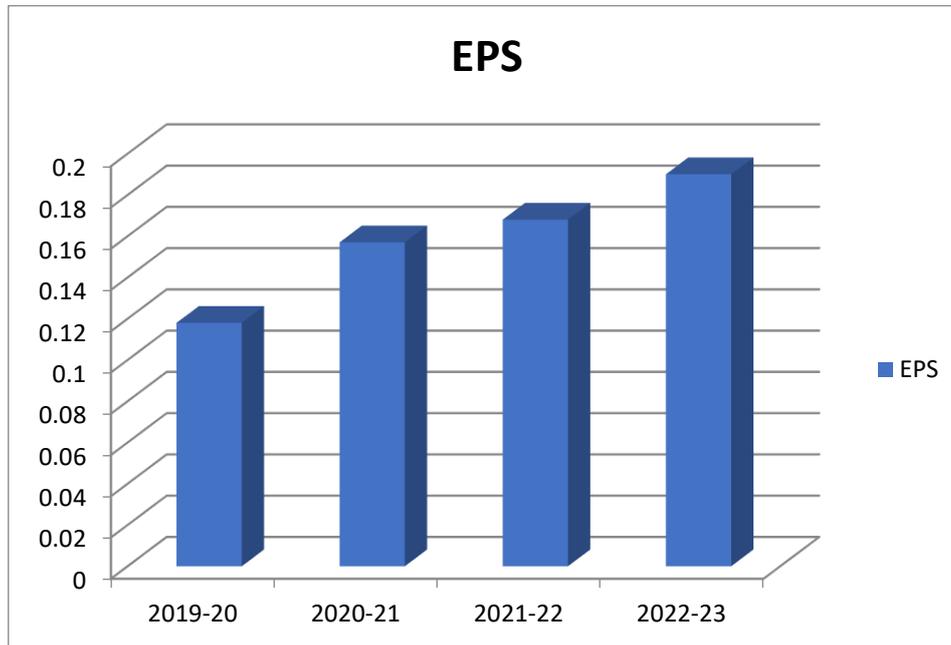
$$EPS (19-20) = 24646000/210680007 = 0.118$$

$$EPS (20-21) = 28866000/210680007 = 0.157$$

$$EPS (21-22) = 31522000/210680007 = 0.168$$

$$EPS (22-23) = 40172000/210680007 = 0.190$$

**EPS LEVELS**



**INTERPRETATION:**

The PAT is in increasing trend from 2019-2020. PAT has increased considerably, which leads to higher EPS, which is at 0.190 in 2023

**THE FUNDING MIX**

Particulars	2019-20	2020-21	2021-22	2022-23
<b>Source of funds</b>				
a) Share capital	210680.01	210680.01	210680.01	210680
b) Reserves and surplus	44409.46	74052.28	105374.24	165526
c) Deferred tax	37423.46	48793.82	58200.74	79247
<b>TOTAL(A)</b>	<b>292514</b>	<b>333525</b>	<b>374254</b>	<b>435453</b>
<b>Loan Funds</b>				
a) Secured loans	718640.84	889177.75	980298.14	1101978
b) Unsecured loans	199495.69	186064.67	149665.44	66577
<b>TOTAL(B)</b>	<b>918155</b>	<b>1075221</b>	<b>1109963</b>	<b>1188555</b>
<b>TOTAL(A+B)</b>	<b>1410647</b>	<b>1608746</b>	<b>1684217</b>	<b>1804008</b>
% of SH in Total CE	<b>24.18</b>	<b>23.67</b>	<b>25.21</b>	<b>27.16</b>
% of Loan fund in total CE	<b>75.83</b>	<b>76.32</b>	<b>74.78</b>	<b>72.85</b>

% of SH in total CE =  $292514/1410647 * 100$   
=24.18

% of SH in total CE =  $333525/1608746 * 100$   
=23.67

% of SH in total CE =  $374254/1684217 * 100$   
=25.21

% of SH in total CE =  $435453/1804008 * 100$   
=27.16

% of Loan fund in total CE =  $918155/1410647 * 100$   
=75.83

% of Loan fund in total CE =  $1075221/1608746 \times 100$   
= 76.32

% of Loan fund in total CE =  $1109963/1684217 \times 100$   
= 74.78

% of Loan fund in total CE =  $1188555/1804008 \times 100$   
= 72.85

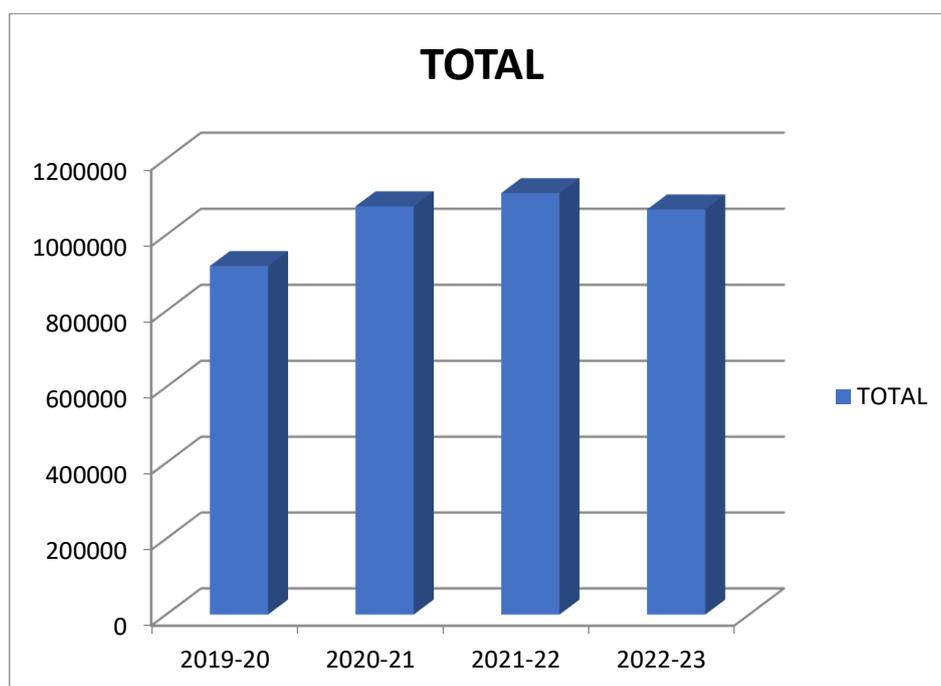
**INTERPRETATION:**

The shareholder fund is at 292514 constitutes 24.18% in total CE and loan funds constitute 75.83% in 2019-20. The funding mix on an average for 4 years will be 25% of shareholders fund and 75% of loan funds there by the company is trying to maintain a good Funding Mix. The leverage or trading on equity is also good because the company affectively utilizing the Loan funds in the Capital Structure. So that it leads to higher profit increase of EPS.

**TERM LOANS**

PARTICULARS	2019-20	2020-21	2021-22	2022-23
<b>SECURED LOANS</b>				
Loans from Scheduled Banks	155633	194921	217651	207871
Loans from Financial institutions	583007	694236	764646	740256
<b>UN SECURED LOANS</b>				
Non convertible GENCO Bonds	168460	166375	98690	52950
Loans from Financial institutions	42371.61	31526.94	22921	58068
Loans from Banks	4583.30	4083.07	3582	2582
Other loans and Advances	4080.78	4279.66	4471	5235
<b>TOTAL</b>	<b>918154</b>	<b>1075220</b>	<b>1109961</b>	<b>1066962</b>

**TERM LOANS**



**INTERPRETATION**

The non convertible debentures are being redeemed from 2020-2021 financial year onwards and where completely repaid by 2021-2023.

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## **5. CONCLUSION**

Financial management is primarily concerned with the optimal use of finance - the most notable scarce resource in modern societies. Financial management decisions can be grouped into four broad categories namely, investment decision, capital structure decision, working capital decision and dividend policy decision. All these decisions aim at maximizing the return and minimizing the risk. To ensure this, each of the above decisions is related to the objectives of financial management.

Capital structure decision is a significant decision. In organisations, increasing the proportion of debt - otherwise known as financial leverage - helps in bringing down the overall cost of capital because debt is the cheapest source of finance. Various theories on capital structure decision support this fact. For a firm one of the most important financing decisions is to choose between the most appropriate level of debt and equity in its capital structure. Excess use of debt may endanger the very survival of a firm, on the other hand, a conservative policy may deprive its equity holders a higher return on their investments as debt is considered a relatively cheaper source of finance.

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