ISSN No: 2348-4845
International Journal & Magazine of Engineering, Technology, Management and Research
A Peer Reviewed Open Access International Journal

Capital Structure Pattern of Public Sector Enterprises- A Study of Select Companies

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ABSTRACT:

The corporate finance pattern is of vital important financial decision foe financial well being of companies. The choice of appropriate source of fund for capital structure is one of the major policy decisions taken by a firm. The combination of debt & equity is known as capital structure of the firm. In this paper an attempt has been made to study the practices in financial pattern of capital structure pattern of refinery industry in India to understand the importance of financing pattern in capital structure decisions.

To achieve the objective of analyzing the trend in financing pattern of selected industries, the trend analysis of debt-equity ratio of 3 refinery companies has been chosen as sample size from 100 manufacturing companies for 10 years. The data of these companies have been collected from financial statements of the companies published in their annual reports as well as from capita line database also.

KEYWORDS:

Capital Structure, Financial Risk, Financial Decisions, Leverage.

INTRODUCTION:

The corporate finance pattern is of vital importance for financial well being of companies (Mishra, 2011). The finance manager of a company is concerned with solution of three major decisions of financial operations of a firm relating to investment, financing and dividend decisions. The choice of appropriate source of fund for capital structure is one of the major policy decisions taken by a firm (Kumar, Anjum & Nayyar, 2012).

The major concern for finance personnel is to determine the proportion of debt and equity with the effects of financial risk factors. The combination of debt & equity is known as capital structure of the firm. The trem 'capital structure' is generally used to refer to proportion of debt & equity deployed by a company to finance its asset (Srivastava, 2012).

CAPITAL STRUCTURE:

Capital structure is that part of financial structure which represents long-term sources. Capital structure includes only long-term debt and total stockholder's investment. It is the mix of long-term sources of funds, such as equity shares, reserves and surplus, debentures, long-term debt form outsie sources and preference share capital. The firm's mixture of debt & equity is known as capital structure (Ehrhardt, Brigham, 2008). Capital atructure refers to composition of capitalization i.e. to the proportion between debt& equity which makes up capitalization. The term 'structure' has been associated with the term 'capital'. The term 'capital' may be defined as the long-term funds of the firm. Capital is the aggregation of items appearing on the left hand side of the balance sheet minus current liabities.

Capital= Total Assets- Current Liabilities.
Capital of a company can be broadly categorized into 'equity' & 'debt'.

Equity= Equity Share Capital + Preference share capital + share premium + free reserves + surplus profits + provision for contingency + development rebate reserve.

Debt= All borrowings from government, semi-government, statutory financial corporations and other agencies + term loans from banks, financial institutions etc + Debentures + All deferred payment liabilities.

PATTERNS OF CAPITAL STRUCTURE:

•Capital Structure with equity shares only.
•Capital Structure with equity and preference.
•Capital Structure with equity and debentures.
•Capital Structure with equity, preference shares and debentures.

The capital structure of financing pattern decision is a significant managerial decision. This decision is a continuos process. The pattern of this decision changes from what it was at the inception as compared to expanding the business. This decision is normally concerned about:

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•The proportion of debt & equity to finance the operations of a company.
•How does the debt to equity mix look like?
•The extent to which internal as well as external funds can be used to finance the company's various activities.

REVIEW OF LITERATURE:

Capital structure has become one of the most significant subjects in modern finance. It has received lot of recognition from researchers during recent years. How a firm determines its capital structure continues to be a puzzle for researchers? Rajan & Zingales (1995) investigated the determinants of capital structure choce by analyzing the financial decisions of public firms in major industrialized countries. The firm leverage was fairly similar across the G-7 countries. Booth, Aivazian, Kunt & Maksimovic (2001) in their study analyzed the capital structure choices of firms in 10 developing countries. It was found that variables which are relevant in developing countries. Bhole and Mahakud (2004), in their study analysed the trends in corporate capital structure in india in respect of public limited companies and private limited companies during the period of 1966-67 to 2000-01.

The determinants of capital structure have also been studied by using panel data pertaining to 330 private limited companies. It was found that leverage ratios of public limited 7 private limited companies have increased significantly during 1966 – 2000. The dependence on debt is more in case public limited companies as compared to private limited companies.Mishra (2011) in his study observed a changing pattern in financing of PSUs with reforms in Indian economy. He found that PSUs have challenge to access the market for both equity & debt finance.

Kumar, Anjum & Nayyar (2012) in their paper analysed the change in capital structure pattern of three reputed pharmaceutical companies for the period of 2007 – 2011. It was found that in the initial period, companies were raising maxmimum debt fund to reduce the cost of capital but which resulted in increase of financial risk. So, later on they shifted to equity financing. Kalyani & Reddy (2012) in their study found that Amara Raja Batteries Ltd mostly depended on Equity financing. It was suggested that ARBL should raise the debt funds to bring the optimum capital structure for improving financial performance of the companies.

RESEARCH METHODOLOGY:

The study has been based on the secondary data i.e. financial information from company's annual reports of refinery industry comprising of 3 refinery companies has been chosen as sample size from top 100 manufacturing companies comprising of ten manufacturing industries listed in capital line data base. To achieve the objective of analyzing the trend in financing pattern of selected industries, the trend analysis of debt-equity mix as well as debt-equity ratio for 10 years has been used for study.

DATA ANALYSIS OF STUDY:

(i)Trends in financing pattern of refinery industry:

To study the trend in financing pattern of refinery industry, the composition of capital structure of 3 refinery companies I.e. Indian Oil Corporation Limited, Bharat Petroleum, Hindustan Petroleum, has been analysed from 2004-05 to 2013-14. The table given below shows the trend in debt & equity calculated from the tables of composition of capital structure of these companies.

TRENDS IN FINANCING PATTERN OF REFINERY INDUSTRY

COMPANIES	2004-05		2005-06		2006-07		2007-08		2008-09		2009-10		2010-11		2011-12		2012-13		2013-14	
	TREND IN DEBT	TREND IN EQUITY	TREND IN DEBT	TREND IN EQUITY	TREND IN DEBT	TREND IN EQUITY	TREND IN DEBT	TREND IN EQUITY	TREND IN DEBT	TREND IN EQUITY	TREND IN DEBT	TREND IN EQUITY	TREND IN DEBT	TREND IN EQUITY	TREND IN DEBT	TREND IN EQUITY	TREND IN DEBT	TREND IN EQUITY	TREND IN DEBT	TREND IN EQUITY
INDIAN OIL CO LIMITED	100	100	84	121.7	119	137	182	154.8	187	184.2	245	217	310	232.4	307	267	363.8	292	485	306
BHARAT	100	100	81.8	123.2	118	134	254	192.5	330	216.3	457	246	645	255.4	676	275.6	577.6	296	952	314

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PETRO LEUM																				
HINDU STAN PETRO LEUM	100	100	124	115.9	160	126	488	130.8	770	143	1228	158	1665	160.2	1559	173.7	1832	188	2012	196
TOTAL	300	300	290	361	397	397	924	478	1287	544	1930	621	2620	648	2542	716	2773	776	3449	816
AVER AGE	100	100	97	120	132	132	308	159	429	181	643	207	873	216	847	239	924	259	1150	272

T table 1. Shows the trend in financing pattern of debt& equity of refinery industry. There is a rising trend in pattern of debt in Indian Oil, Bharat Petroleum, and Hindustan Petroleum. The overall average of trend of debt & equity in all the companies of the refinery industry from 2004-2014.

(ii)Debt equity ratio of refinery industry:

DEBT EQUITY RATIO FOR REFINERY INDUSTRY										
COMPANIES	2004-05	2005-06	2006-07	2007-08	2008-09-	2009-10	2010-11	2011-12	2012-13	2013-14
Indian Oil Co Limited	0.77	0.53	0.67	0.9	0.78	0.86	1.02	0.88	0.95	1.22
Bharat Petroleum	0.69	0.46	0.61	0.92	1.06	1.29	1.75	1.7	1.35	1.42
Hindustan Petroleum	2.99	1.99	1.84	2.13	1.59	1.1	0.75	0.26	0.22	0.2
TOTAL	4.45	2.98	3.12	3.95	3.43	3.25	3.52	2.84	2.52	2.84
AVERAGE	1.48	0.99	1.04	1.32	1.14	1.08	1.17	0.95	0.84	0.95

The table shows that in 2004-05 the debt equity ratio is highest in Hindustan Petroleum i.e. 2.99 and lowest in Bharat Petroleum i.e. 0.69. In 2005-06, it is highest in Hindustan petroleum i.e. 1.99 and lowest in Bharat Petroleum i.e. 0.46. In 2006-07, it is highest in Hindustan Petroleum i.e. 1.84 and lowest in Bharat Petroleum i.e. 0.61. In 2007-08, highest in Hindustan Petroleum i.e. 2.13 and lowest in Indian Oil Corporation Limited i.e. 0.9. In 2008-09, highest in Hindustan Petroleum i.e. 1.59 and lowest in Indian Oil Corporation Limited i.e. 0.78.

In 2009-10 highest in Bharat Petroleum i.e. 1.29 and lowest in Indian Oil Corporation Limited i.e. 0.86. In 2010-11 highest in Bharat Petroleum i.e. 1.75 and lowest in Hindustan Petroleum i.e. 0.75. In 2011-12, highest in Bharat Petroleum i.e. 1.35 and lowest in Hindustan Petroleum i.e. 0.26. In 2012-13, highest in Bharat Petroleum i.e. 1.35 and lowest in Hindustan Petroleum i.e 0.22. In 2013-14, highest in Bharat Petroleum i.e 1.42 and lowest in Hindustan Petroleum i.e. 0.2. The average of debt equity ratio is highest in2004-05 i.e. 1.48 in refinery industry.

FINDINGS:

The rising overall average of trend of debt & equity in case of refinery industry implies that these industries have access to market for both equity and debt financing. Initially, companies were raising maximum debt fund to reduce the cost of capital but which resulted in increase in financial risk. So they shifted to equity financing also. They are maintaining a trade-off between debt & equity.

SUGGESTIONS:

The refinery industry should improve their debt & equity ratio as it is not as per the standard norm. These industries are not using as much debt as expected from them. The refinery industries are advised to maintain a trade-off between debt & equity in future also so as to achieve the objective of optimum capital structure.

CONCLUSION:

An optimum capital structure is that which maximizes the shareholder's wealth with best combination of debt and equity mix by minimizing the firm's cost of capital.

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Firm's capital structure trends have a great impact on firm's financial performance. The analysis of the study concludes that companies are using both debt & equity financing as a part of their capital structure pattern. Although the trend in debt & equity financing is increasing in refinery industry which implies that due to fear of financial risk, the companies are using debt financing also to the maximum possible extent. But they are advised to maintain a right balance between debt financing and equity financing.

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