International Journal on Science and Technology (IJSAT)

E-ISSN: 2229-7677 ● Website: www.ijsat.org ● Email: editor@ijsat.org

Capital Structure Analysis of Indian Oil Corporation: A Comprehensive Study

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Abstract

The economic development of a country depends more on real factors such as the industrial growth & development, modernization of agriculture, expansion of internal trade and foreign trade. A solid and well-functioning financial system is a powerful engine behind economic development of a nation. The major role in financial system is of banking sector.The role and importance of banking sector and the monetary mechanism cannot be under-estimated in the development of a nation. Hence the banks and financial institutions play significant and crucial role by contributing in economic planning. Decomposition analysis has been used to check the structural variability of asset portfolio of Scheduled Commercial Public Sector Banks in India. The study of portfolio behavior of scheduled commercial public sector banks is important as it is a significant explanatory factor for the magnitude and changes in the banking industry.

Keywords: Capital structure, EBIT- EPS Analysis, Profitability

Introduction:

The assets of a company can be financed either by increasing the owners claim or the creditors claim. The owners claims increase when the firm raises funds by issuing ordinary shares or by retaining the earning, the creditors' claims increase by borrowing The various means of financing represents the "financial structure" of an enterprise. The Financial structure of an enterprise is shown by the left hand side (liabilities plus equity)of the balance sheet. Traditionally, short-term borrowings are excluded from the list of method of financial the firm's capital expenditure, and therefore, the long term claims are said to from the capital structure of the enterprise. The capital structure is used to represent the proportionate relationship between debt and equity. Equity includes paid-up share capital, share premium and reserves and surplus.The financing or capital structure decision is a significant managerial decision. It influences the shareholders returns and risk consequently; the market value of share may be affected by the capital structure decision. The company will have to plan itscapital structure initially at the time of its promotions. The capital structure is how firm finances its overall operations and growth by using different sources of funds. Debt comes in the form of bond issues or long-term Notes payable, while equity is classified as common stock, preferred stock or retained Earning .

The financing or capital structure, decision is a significant managerial decision. It influences the shareholders return and risk. Consequently the market value of the share may be affected by the capital structure decision. The firm will have to plan its capital structure initially at the time of its promotion. The decision will involve an analysis of the existing capital structure and factors, which will govern the decision at present shareholders equity position, strengthen by retention of earnings.

Thus, the dividend decision has a bearing on the capital structure decision, the dividend policy of the firm should be considered the new financing decision of the firm might affect its debt equity mix.

Need of The Study

The value of the firm depends upon its expected earnings stream and the rate used to discount this stream. The rate used to discount earning stream it's the firm's required rate of return or the cost of capital. Thus, the capital structure decision can affect the of the firm either by changing the expected earnings of the firm, but it can affect the residue earnings of the shareholders. The effect of leverage on the cost of capital is not very clear. Conflicting opinions have been expressed on this issue. In fact, this issue is one of most continuous areas in the theory of finance, and perhaps more theoretical and empirical work has been done on this subject than any other.The existence of an optimum capital structure is beneficial for the organization.

Scope of the Study

A study of capital structure involves an examination of long term as well as short term sources that a company taps in order to meet its requirements of finance. The scope of the study is confined to the sources that INDIAN OIL CORPORATION tapped over the years under study.The purpose of the study is to analyze and to explore the present value of the shares.

Objectives of the Study

1. To study the capital structure of INDIAN OIL CORPORATION through EBIT-EPS analysis.
2. To study effectiveness of financing decision on EPS and EBIT of the firm.
3. To analyze the leverage analysis of the selected company.
4. To observe the financing trends during the period of 2016-2021.

Research Methodology

Sources of Data:

The primary source for the project is collected from Published annual reports of the company for the year 2018-2021.

Tools used:

- Ratio analysis
- Graphical analysis
- Year-year analysis

These tools access in the interpretation and understanding of the Existing scenario of the Capital Structure.

Literature Review

NIKHAT FATIMA (2019)A strong banking infrastructure plays a major role in supporting economic activity and meeting the financial needs of all the sections of society and thus contributed in the overall growth of the country. For the smooth flow of credit in an economy, it is essential that banks should be financially sound so as to meet the various requirements of other fields.

KMAUMITA CHOUDHURY (2020) Micro, small and medium enterprises have been an area of great research interest. Credit is reported as a crucial input for promoting the growth of the MSME sector. The paper aims at finding out the role of MSMEs in the development of an economy and the issues associated with institutional lending to MSMEs. The important factors that influence lending to MSMEs are competition among banks, legal framework, credit policies and lack of information about SME borrowers, firm characteristics and firm size. But interestingly, only a negligible number of MSMEs have registered with DICs till date. Also, very limited studies have been found on unregistered and informal MSMEs.

NEHA, DR.GURCHARAN SINGH (2020) The economic development of a country depends more on real factors such as the industrial growth & development, modernization of agriculture, expansion of internal trade and foreign trade. Decomposition analysis has been used to check the structural variability of asset portfolio of Scheduled Commercial Public Sector Banks in India. The study of portfolio behavior of scheduled commercial public sector banks is important as it is a significant explanatory factor for the magnitude and changes in the banking industry.

Data Analysis
EBIT LEVELS

Particulars	**2017-18**	**2018-19**	**2019-20**	**2020-21**
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%

Table 1: EBIT Levels During the Period from 2017-2021

DEGREE OF FINANCIAL LEVERAGE:

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

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

In this case
During 2017-2018, to 2018-2019 it is increasing because decrease in EBIT level.
During 2019-2020, to 2020-2021 it is decreasing because increase in EBIT level.

EBIT LEVELS

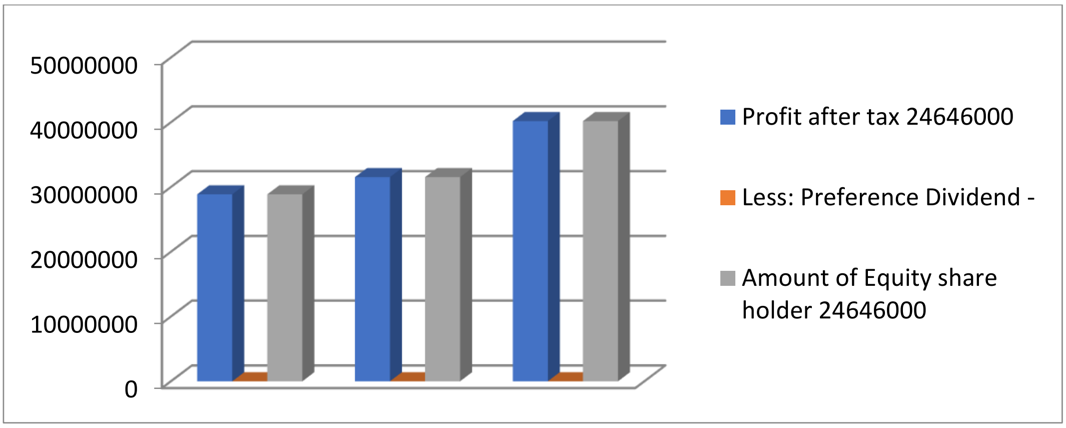

Figure 1: Levels during the Period from 2017-2021

INTERPRETATION:

The EBIT level in 2018 is at 514.5 and is decreasing till the next year 2019. The EBIT levels in 2020 again started growing and reached to 509.61 and in 2021 were at 765.05.

PERFORMANCE:

EPS ANALYSIS

Particulars	**2017-18**	**2018-19**	**2019-20**	**2020-21**
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

Table 2: EPS Analysis from The Period 2017-2021

EPS (17-18) = 24646000/210680007 = 0.118
EPS (18-19) = 28866000/210680007 = 0.157
EPS (19-20) = 31522000/210680007 = 0.168
EPS (20-21) = 40172000/210680007 = 0.190

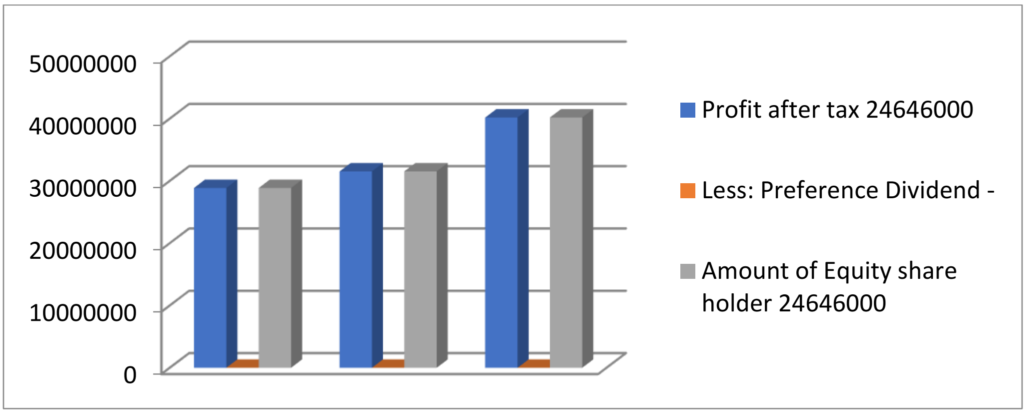

Figure 2: EPS Levels

INTERPRETATION:
The PAT is in increasing trend from 2017-2018.PAT has increased considerably, which leads to higher EPS, which is at 0.190 in 2021.

EBIT – EPS CHART
One convenient and useful way showing the relationship between EBIT and EPS for the alternative financial plans is to prepare the EBIT-EPS chart. The chart is easy to prepare since for any given level of financial leverage, EPS is linearly related to EBIT. As noted earlier, the formula for calculating EPS is

$$\text{EPS} = \frac{(\text{EBIT}-\text{INT})(1-\text{T})}{\text{N}} = \frac{(\text{EBIT}-\text{INT})(1-\text{T})}{\text{N}}$$

We assume that the level of debt, the cost of debt and the tax rate are constant. Therefore in equation, the terms (1-T)/N and INT (=iD) are constant. EPS will increase if EBIT increases and fall if EBIT declines.

Findings
- The returns on net worth is high in the year 2021 by indicating 17% that the firm earned greater returns on the investment.
- From EBIT-EPS analysis EPS will be high when capital structure consists of 25% equity 75% debt capital.
- The EBIT level in 2018 is at 514.5 and is decreasing till the next year 2019. The EBIT levels in 2020 again started growing and reached to 509.61 and in 2021 were at 765.05.
- The PAT is in increasing trend from 2017-2018.PAT has increased considerably, which leads to higher EPS, which is at 0.190 in 2021.

Suggestions
1. The company has to maintain the optimal capital structure and leverage so that in coming years it can contribute to the wealth of the shareholders.
2. The company has to exercise control over its outside purchases and overheads which have effect on the profitability of the company.

Conclusion

Financial management is primarily concerned with the optimal use of finance - the most notable scarce resource in modern societies. All financing 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 organizations, 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 die 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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