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Capital Structure and Leverage Analysis of The True Sai Works

P. Vanitha[1], P. S. Kaviya[2*]
[1,2]*Department of Management, M. Kumarasamy College of Engineering, Karur, India*

***Abstract*: This study examines the influence of capital structure and leverage analysis on the performance of the company. It is measured using ratio analysis. This research has been done to analyze the capital structure and leverage of The True Sai Works dealer of Tata Motors for the last five years from 2015-2020, in order to find out the impact and the factors which influenced the capital structure decisions of regarding profitability and performance. to know the Growth of the Company and to understand about the three types of leverage involved in the company. And at last to find out the relationship between the Leverage and Profitability. Finally from the analysis it was found that debt to assets ratio indicates that company own more assets than liabilities, debt to capital ratio indicates that company is considered to be less risky, debt to equity ratio indicates that company is more funded by debt, operating leverage states that the contribution of the company was fluctuated positively, financial leverage states that from the last five years the EBIT & EBT of the company was decreased and combined leverage states that the operating and financial leverage of the company was improperly fluctuated.**

***Keywords*: Capital structure, Debt, EBIT, Leverage, Profitability.**

1. Introduction

A company's capital structure is the unique mix of debt and equity it uses to fund its overall operations and growth. Equity capital is derived from a company's ownership interests as well as claims on potential cash flows and earnings. Bonds and loans are examples of debt, while common stock, preferred stock, and retained earnings are examples of equity. Short-term debt is used in the capital structure as well.

The balance sheet contains both debt and equity. This debt and equity are used to buy company properties, which are also reported on the balance sheet. Long-term debt, short-term debt, common stock, and preferred stock may all be part of a company's capital structure. When assessing a company's capital structure, the proportion of short-term debt to long-term debt is taken into account. As investors talk about capital structure, they're usually talking about a company's debt-to-equity (D/E) ratio, which shows how risky the company's funding activities are. A business with a high debt-to-equity ratio typically has a more conservative capital structure and thus presents a greater risk to investors. This risk, on the other hand, may be the company's primary source of growth.

One of the two key ways a business can raise funds in the capital markets is through debt. In comparison to equity, debt helps a corporation or enterprise to hold control. Furthermore, debt is plentiful and easy to obtain during periods of low interest rates. Outside investors can purchase equity in a company and own a portion of it. Especially when interest rates are low, equity is more costly than debt. Equity, on the other hand, does not require repayment, unlike debt. In the event of declining profits, this is advantageous to the organization.

Equity, on the other hand, is a bet by the owner on the company's potential earnings. When a company invests to increase its asset base and achieve returns on risk capital, it uses borrowed capital as a funding source. Leverage is an investing tactic that involves leveraging borrowed money—specifically, different financial instruments or borrowed capital—to boost an investment's potential return. The amount of collateral a business uses to fund investments is often referred to as leverage.

2. Objectives of the Study

1. To investigate the firm's capital structure during the research period.
2. To examine the impact of capital structure on return on equity.
3. To assess the company's development.
4. To perform the True Sai Works' Leverage Analysis.
5. To examine the link between leverage and profitability.

3. Review of Literature

Gautam Sen, Ravi Ranjan (2018) have examined the impact of leverage on the profitability and performance of the company. The study covered a period of ten years from 2006 to 2016. The tools used are mean, SD, CV, CAGR, ANOVA and simple linear regression model. Results suggested that operating, financial and combined leverage of the company does not play any major role in making investment decisions of the company.

Amandeep Kaur (2018) has conducted the study to know the financial performance, leverage analysis and its relationship with profitability of Ambuja Cements Limited. The study period has been taken from 2013 to 2017. The necessary data has been obtained from the published annual reports. It is

*Corresponding author: kaviya2014karur@gmail.com

resulted that Ambuja cements Limited should take maximum advantage of financial leverage when its revenues are on rise on the other hand company should be cautious about higher degrees of operating leverages as in the year 2015 above, as it increases the risk of future cash flows.

S. Poongavanam (2017) identified the financial performance and how the performance is going on for the last five years, of Indian Farmers Fertilizer Co-operative Limited. The study investigated the performance of South Africa's commercial banking sector for the period 2000-2008 to 2011-2012. It has concluded that the proprietary ratio in all the five years is above the satisfactory level, that is, 50%. It means that the creditors are in a better position and are not under any pressure. The debt-to-equity ratio is declining year after year, indicating that debt servicing is becoming less burdensome and, as a result, the company's credit status is not being affected.

Suresh Kumar (2019) studied the impact of capital structure on profitability of automobile companies in India with special reference to Tata Motors Ltd and Mahindra & Mahindra Ltd. The study period has been taken from 2016-2018. It is concluded that the debt equity ratio of the two selected companies is very less within the ideal ratio "2".

N. S. Pandey, Ponni R (2017) have examined the impact of corporate leverage on profitability of pharmaceutical industry in India. The period of study considered for 10 years i.e. from 2004-05 to 2013-14. It is suggested that the CL on Profitability has a substantial effect on the pharmaceutical industry in India for the study period.

Sowmya Kethi Reddy, V. Harileela (2019) have studied the relationship between liquidity and profitability and to examine the impact of financial leverage and liquidity on the performance of the organization. The tools used for the study are descriptive statistics and correlation. The data have been taken from 2014 to 2018.It has revealed that D/A ratio and D/E ratio are negatively correlated with the ROA of the firm and also the liquidity ratios.

Stuti Shukla (2018) have studied the relationship between Financial Leverage and Return of Investment, Operating Leverage and Return on Investment and combined Leverage and Return on Investment for Dr. Reddy's Laboratories. The research was carried out between the years 2010 and 2014.It is observed that the liquidity position of Dr. Reddy's Laboratories is not satisfactory so the firm though can meet its short term obligations effectively but at the opportunity cost of excessive liquidity.

4. Research Methodology

A. Source of data

The study is based on secondary data. The data were collected from the annual reports of the True Sai Works. The present study is descriptive in nature.

B. Study Period

Study period covers a period of 5 years starting from the period of 1st April 2016 to 31st March 2020.

C. Tools for analysis

To have a worthwhile analysis and interpretation of the data collected, tools like Ratio Analysis such as Leverage Analysis has been applied.

D. Limitation of the Study

- This analysis focuses on a single company rather than contrasting companies, and it is constrained by the fact that it is focused on secondary data.
- Due to the confidentiality of records, certain data is not accessible.
- The analysis was limited to a 5-year duration due to time constraints and data availability issues.

5. Data Analysis

A. Debt to assets ratio

Debt to assets ratio is the primary and the most utilized evaluation, which can be made, while evaluating the risk of the creditor. This indicator is calculated by the following formula:

$$Debt\ to\ assets\ ratio = \frac{Total\ Liabilities}{Total\ Assets}$$

This indicator is calculated for a point in time, but not for a period. It calculates the share of the "other money" in the total amount of claims on the assets of the company. The higher this coefficient, the larger is the probable risk for the creditor.

Table 1
Debt to Assets ratio

Year	Total Liabilities	Total Assets	Debt to Assets ratio
2016	30,58,73,631	38,74,75,784	0.79
2017	28,39,14,284	36,86,40,605	0.77
2018	30,66,33,896	38,70,33,557	0.79
2019	27,22,07,150	38,82,04,775	0.70
2020	22,88,46,500	30,75,51,595	0.74

Interpretation:

A ratio of less than (< 1) indicates that The True Sai Works owns more assets than liabilities and can meet its obligations by selling its assets if needed. The lower the debt to asset ratio, the less risky the company.

B. Debt to Capital ratio

Debt to capital ratio is an indicator that is calculated based on the proportion between the size of the long-term debt and the size of the capital. This measure provides the analyst with a better image of risk due to the use of borrowed funds. In this calculation, capital is defined as the total amount of company's capital (including common and preferred stock as well as long-term debt), minus the short term liabilities. The coefficient can be computed according to the following formula:

$$Debt\ to\ Capital\ ratio = \frac{Long\ term\ Liabilities}{Long\ term\ Liabilities\ +\ Shareholder's\ Equity}$$

Table 2
Debt to Capital ratio

Year	Long-term Liabilities	Long-term Liabilities + Shareholder's equity	Debt to Capital ratio
2016	139720933	221323086	0.63
2017	209146096	293872417	0.71
2018	264700817	345100478	0.77
2019	293625860	379623484	0.77
2020	220027440	298732535	0.74

Interpretation:

Thus, a ratio obtained is less than 1, the debt levels are manageable and the firm is considered less risky to invest or loan to given other factors are taken into consideration.

C. Debt to Equity ratio

Debt to Equity Ratio can be modified to include current liabilities (short term debts) divided by the total equity of the company.

$$Debt\ to\ Equity\ ratio = \frac{Short\ term\ Liabilities}{Shareholder's\ Equity}$$

Table 3
Debt to Equity ratio

Year	Short-term Liabilities	Shareholder's equity	Debt to Equity ratio
2016	166152698	81602153	2.04
2017	74768188	84726321	0.88
2018	41933079	80399661	0.52
2019	8581290	85997624	0.10
2020	8819060	78705095	0.11

Interpretation:

A ratio in the year 2016 indicates that assets of, The True Sai Works are more funded by debt and from the year 2017 – 2020 it results, assets are more funded by equity.

D. Analysis of Leverage

1) Operating Leverage

In a company's cost structure, the proportion of fixed costs. In general, the higher the operating leverage, the more a company's income is impacted by sales volume fluctuations. A lower proportion of variable costs means the company doesn't have to pay as much more for each unit generated or sold, resulting in a higher profits vs. revenue ratio. The greater the volume of revenue, the higher the expenditure on fixed costs would be.

Table 4
Operating Leverage

S. No.	Year	Contribution	EBIT	Ratio
1	2015-2016	60,83,98,884	7,42,85,134	8.19
2	2016-2017	65,79,31,874	5,42,91,968	12.12
3	2017-2018	75,42,92,197	76,84,464	98.16
4	2018-2019	68,04,94,435	2,03,18,270	33.48
5	2019-2020	54,23,00,263	1,45,99,202	37.15

The table 4, reveals that the contribution of the company was fluctuated positively from 2015-2016 to 2017-2018 during the study period. The EBIT of the company was continuously decreased from 2016-2017 to 2019-2020. The operating leverage of the company was highest in the year, 2017-2018 (98.16) and it was lowest (8.19) in the year 2015-2016.

2) Financial Leverage

Financial leverage is that the using of equity share capital and preference share capital together with long run fixed interest bearing debt. the corporate can use future fixed interest bearing debt very effectively. If so, the earnings of quite fixed interest is obtainable only to the equity shareholders. during this way, the return to equity shareholders is increased. It implies that the earnings of equity shareholders are increase by effective use of long run fixed interest bearing debt. it's also referred to as trading on equity.

Table 5
Financial Leverage

S. No.	Year	EBIT	EBT	Ratio
1	2015-2016	7,42,85,134	4,54,68,825	1.63
2	2016-2017	5,42,91,968	2,40,72,758	2.26
3	2017-2018	76,84,464	-1,93,50,077	-0.40
4	2018-2019	2,03,18,270	-94,37,299	-2.15
5	2019-2020	1,45,99,202	86,02,964	1.70

Table 5 states that the EBIT & EBT of the company was decreased during the study period. The financial leverage of the company was highest (2.26) in the year 2016-2017 and it was lowest (-0.40) in the year 2017-2018.

3) Combined Leverage

Combined leverage is a leverage which refers to high profits due to fixed costs. It includes fixed operating expenses with fixed financial expenses. It indicates leverage benefits and risk which are in quantity. Competitive firms select a high degree of combined leverage, whereas traditional firms select a lower degree of combined leverage. The degree of combined leverage shows the advantages and risks associated with this leverage.

Table 6
Combined Leverage

S. No.	Year	Operating Leverage	Financial Leverage	Ratio
1	2015-2016	8.19	1.63	13.35
2	2016-2017	12.12	2.26	27.40
3	2017-2018	98.16	-0.40	-39.26
4	2018-2019	33.48	-2.15	-72.00
5	2019-2020	37.15	1.70	63.16

It can be understood from the table 6 that the operating and financial leverage of the company was improperly fluctuated during the study period. The combined leverage of the company was highest (63.16) in the year 2019-2020 and it was lowest (-72.00) in the year 2018-2019.

6. Findings

1. The operating leverage of the company was highest in the year, 2017-2018 (98.16) and it was lowest (8.19) in the year 2015-2016.
2. The financial leverage of the company was highest (2.26) in the year 2016-2017 and it was lowest (-0.40) in the year 2017-2018.
3. The combined leverage of the company was highest (63.16) in the year 2019-2020 and it was lowest (-72.00) in the year

2018-2019.

A. Suggestions

1. Both high and low operating and financial leverage are very risky. The company's operating and financial positions were unfairly changed. A company must strike the right balance between financial and operational leverage.
2. To achieve adequate benefit, the company must manage both fixed and variable costs.
3. The company should maximize profit by lowering its sales price and cost of production.

7. Conclusion

The aim of the research was to decide The True Sai Works' leverage position. According to the results, the company's overall financial and organizational performance was satisfactory. The results reveal that the organization has some weaknesses and proposed some ways to fix them. If the suggestions are implemented, the company's sustainability and overall results will enhance.

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