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PATTERN OF CAPITAL STRUCTURE IN AMARA RAJA BATTERIES LIMITED, TIRUPATI - AN ANALYSIS

K. KALYANI
RESEARCH SCHOLAR
S.V. UNIVERSITY
TIRUPATI

DR. P. MOHAN REDDY
PROFESSOR
DEPARTMENT OF COMMERCE
S.V. UNIVERSITY
TIRUPATI

ABSTRACT

In this paper, an attempt has been made to study the "Pattern of Capital Structure in Amara Raja Batteries Limited", Tirupati. An analysis of long-term solvency, assessment of debt-equity, debt to total fund and justification for the use of debt in ARBL through the application of ratio analysis and statistical test has been undertaken. The time period considered for evaluating the study is six years i.e. from 2004 to 2009. It is found that long term funds had contributed more on an average 74.08 percent of total funds when compared to short term funds (25.92 percent) in ARBL. Long term funds had apportioned nearly two-third of total funds. Shareholders' funds had occupied on an average 48.35 percent major chunk of the total funds when compared to the borrowed funds (25.73 percent). The ARBL had shown an inclination in strengthening long term funds consisting of both shareholders funds as well as long term borrowed funds in order to finance its assets requirement. ARBL mostly depended on equity financing. So, the financial risk of the company is low, but it could fail to enjoy the advantages of financial gearing. ARBL should raise the debt funds to bring the optimum capital structure for improving the financial performance of the company. A higher interest coverage ratio is desirable, but too high ratio is some of the years of the study indicate that the ARBL is very conservative in using debt, and it is not using debt to the best advantage of the shareholders.

KEYWORDS
Debt-equity ratio, Debt to total fund ratio, Interest coverage ratio and Quantum and structure of total funds in Amara Raja Batteries Limited.

INTRODUCTION
One of the most critical areas of the finance function is to make decisions about the firm's capital structure. Capital is required to finance investments in plant and machinery, inventory, accounts receivable and so on. Capital structure is the part of financial structure, which represents long term sources. It is the permanent financing of the company represented primarily by shareholders' funds and long term debt and excluding all short-term credit. To quote Walker, "The term capital structure is generally defined to include only long term debt and total stockholders' investment" (Walker). It refers to the capitalisation of long term sources of funds such as debentures, preference share capital, long term debt and equity share capital including reserves and surplus (retained earnings). According to Bogen, "The capital structure may consist of a single class of stock, or it may be complicated by several issues of bonds and preferred stock, the characteristics of which may vary considerably"(Bogen). In other words, "capital structure refers to the composition of capitalisation i.e., to the proportion between debt and equity that make up capitalisation" (Philips). According to Childs, "Capital Structure includes all long term obligations and equity that is only items of permanent capital" (Childs). The term capital structure is used to represent the proportionate relationship between debt and equity. Capital structure decision is a significant managerial decision. The market value of the share may be affected by the capital structure decision (Pandey). The selection of the capital structure will obviously depend on the bearing that is has on the firm's objective of maximisation of shareholders' wealth (Khan and Jain). Estimation of requirement of capital is necessary, but the formation of capital structure is most important (Sharma and Gupta). Harry Gouthmann and Herbert E. Dougall stated that the phrase capital structure, may be used to cover any long term debts like mortgages and long-term loans as well as total stockholders' investment including retained earnings as well as original investment (Gouthmann and Dougall). Weston and Brigham have indicated the capital structure by the following equation (Weston):
Capital Structure = Long term debt – Preferred stock + Net worth (or)
Capital Structure = Total Assets – Current Liabilities.

OBJECTIVES
The present research paper aims at endeavouring the following objectives:
- to analyse the pattern of capital structure;
- to assess of long-term solvency; and
- to ascertain the justification for the use of debt.

TOOLS OF ANALYSIS
The data drawn from the annual reports of ARBL have been carefully analysed, tabulated and interpreted by using well established financial tools. The analysis of data is carried out through capital structure ratios such as debt-equity ratio, debt to total fund ratio and interest coverage ratio. Statistical tools like mean, standard deviation, coefficient of variation and coefficient of correlation are also applied. Graphs and diagrams are presented to illuminate the facts and figures.

SCOPE AND COVERAGE
The present study is confined to Amara Raja Batteries Limited. The Amara Raja Batteries Limited, Tirupati in Andhra Pradesh, India has been selected because of the proximity to the investigator. This study is restricted to assess the pattern of capital structure in ARBL with the help of the ratio analysis. The time period considered for evaluating the study is six years i.e. from 2004 to 2009.

PATTERN OF CAPITAL STRUCTURE
In case of new company the capital structure may be of any of the following four patterns:
- Capital structure with equity shares only
- Capital structure with equity as well as preference shares
- Capital structure with equity shares and debt capital
- Capital structure with equity shares, preference shares and debt capital.

The choice of an appropriate pattern of capital structure may depend on various factors such as the nature of the company, size of a company, capital market conditions, sales stability, lenders attitude, assets structure, financial flexibility, loan convenants, capacity of raising funds, leverage effect on earnings per share, cost of capital, growth rate, conditions of the money market, control, government policies and regularity of the earnings etc. A firm that finances its assets by debt and equity is called levered firm while on the other hand if a firm that uses no debt and finances its assets entirely by equity is called unlevered firm. Unlevered company's total assets are always equal to total equity and it is the total value of the company. However, a high proportion of debt content in the capital structure increases the risk and may lead to financial insolvency of the company in adverse times. But, raising of funds through debt is cheaper as compared to raising funds through issue of shares. It increases the earning per share of company.

MIX OF DEBT AND EQUITY

The mix of debt and equity has many implications. The use of debt capital tends to decrease the overall cost of capital and increases the wealth of the shareholders'. It is due to the tax deductability of the interest paid on debt. It is also known as Trade-on-Equity. Another implications debt is relatively cheaper than equity in terms of cost of issue and interest cost (Bansal). It also that the use of debt financing does not result in a dilution of control over the enterprises of the existing shareholders'. Therefore, use of debt in capital structure is most advantageous. The high use of debt leads to higher financial risk in the form of fixed interest and principal payments. It's necessary that companies should have optimal capital structure that can maximize the price of the company's stocks. Companies can choose a mix of financing options to finance its assets but it is very necessary that they choose the financing options that maximise its overall value.

CAPITAL STRUCTURE – PLANNING

A company should plan its capital structure to maximise the use of funds. The primary objective of every capital structure planning is to minimise the cost of capital and to maximise the share value of the firm. A theoretical model capital structure cannot handle adequately all those factors. As the capital markets are not perfect, these factors are highly psychological, complex, and qualitative and do not always follow an accepted theory. Thus, it is not possible to find out the exact debt-equity mix where the capital structure would be optimum. Proper planning of capital structure also helps companies to enlarge their area for getting funds as well as creates the mobility of sources of the funds. But a range can be determined on the basis of empirical study. The quantum and structure of total funds in ARBL is shown in Table – 1.

TABLE – 1: QUANTUM AND STRUCTURE OF TOTAL FUNDS IN ARBL (Rs. in crores)

	Particulars	2004		2005		2006		2007		2008		2009		AVERAGE	
		Rs.	**%**	**Rs.**	**%**	**Rs.**	**%**	**Rs.**	**%**	**Rs.**	**%**	**Rs.**	**%**	**Rs.**	**%**
	Share Capital	11.39	4.73	11.39	4.05	11.39	3.08	11.39	2.15	11.39	1.31	17.08	1.91	12.34	2.33
	Reserves & Surplus	163.20	67.76	169.30	60.25	189.90	51.43	232.28	43.89	321.71	37.05	388.51	43.46	244.15	46.03
	Share holders' funds – I	174.59	72.49	180.69	64.30	201.29	54.51	243.67	46.04	333.10	38.36	405.59	45.37	256.49	48.35
	Secured loans	4.49	1.86	7.37	2.62	16.23	4.40	107.49	20.31	226.65	26.10	207.83	23.25	95.01	17.91
	Unsecured loans	10.39	4.31	15.94	5.67	21.64	5.86	33.22	6.28	89.61	10.32	78.04	8.73	41.47	7.82
	Borrowed funds – II	14.88	6.18	23.31	8.30	37.87	10.26	140.71	26.59	316.26	36.42	285.87	31.98	136.48	25.73
A	**Long term funds (I+II)**	**189.47**	**78.66**	**204.00**	**72.60**	**239.16**	**64.77**	**384.38**	**72.63**	**649.36**	**74.78**	**691.46**	**77.34**	**392.97**	**74.08**
	Current liabilities	31.55	13.10	47.60	16.94	82.09	22.23	87.14	16.47	119.69	13.78	132.05	14.77	83.35	15.71
	Provisions	19.84	8.24	29.39	10.46	48.01	13.00	57.70	10.90	99.34	11.44	70.51	7.89	54.13	10.20
B	**Short term funds**	**51.39**	**21.34**	**76.99**	**27.40**	**130.10**	**35.23**	**144.84**	**27.37**	**219.03**	**25.22**	**202.56**	**22.66**	**137.49**	**25.92**
C	**TOTAL FUNDS (A+B)**	**240.86**	**100.00**	**280.99**	**100.00**	**369.26**	**100.00**	**529.22**	**100.00**	**868.39**	**100.00**	**894.02**	**100.00**	**530.46**	**100.00**

Source: Compiled from Annual Reports of Amara Raja Batteries Limited

Note: Figures in parentheses represent common size percentages considering total funds for the respective years equal to hundred.

It is evident that long term funds had contributed more on an average 74.08 percent of total funds when compared to short term funds (25.92 percent) during the entire period of the study. Long term funds were more than the short term funds in ARBL. In other words, long term funds had apportioned nearly two-third of total funds. The borrowed funds had reported a rise while short term funds depicted inverse direction in quantitative terms. Shareholders' funds had jumped from Rs.174.59 crores in 2004 to Rs.405.59 crores in 2009. Reserves and surplus had almost doubled in the concluding year of the study. Shareholders' funds had occupied on an average 48.35 percent major chunk of the total funds when compared to the borrowed funds (25.73 percent). In other words, borrowed funds were very less as against the shareholders' funds during the entire period of the study. It may be concluded that ARBL had used more owned funds when compared to borrowed funds. It may be also observed that short term funds are more relatively than borrowed funds in ARBL. The ARBL had shown an inclination in strengthening long term funds consisting of both shareholders funds as well as long term borrowed funds in order to finance it's assets requirement.

ASSESSMENT OF LONG-TERM SOLVENCY

Leverage ratios indicate the extent to which the firm has used its long-term solvency by borrowing funds. The short-term creditors, like bankers and suppliers of raw material, are more concerned with the firm's current debt-paying ability. On the other hand, long-term creditors, like debenture holders, financial institutions etc. are more concerned with the firm's long-term financial strength. In fact, a firm should have a strong short–term as well as long-term financial position. To judge the long-term financial position of the firm, financial leverage, or capital structure ratios are calculated. These ratios indicate mix of funds provided by owners and lenders. As a general rule, there should be an appropriate mix of debt and owner's equity in financing the firm's assets. The leverage or capital structure ratio include for the purpose of analysis:

- Debt-equity ratio
- Debt to total fund ratio
- Interest coverage ratio

DEBT - EQUITY RATIO

The main object of calculating the debt-equity ratio is to measure the relative interest of owners and creditors in the firm. From the creditors point of view, it measures the extent to which their interest is covered by owned funds. A standard debt-equity norm for all industrial units is neither desirable nor practicable. Different standard debt-equity ratios are used for different industry groups. However, in less developed countries, such standards cannot be accepted. Therefore, this ratio depends upon industry, circumstances, prevailing practices and so on. The generally accepted standard norm of debt-equity ratio is 2:1. The ratio may be calculated in terms of the relative proportion of long term debt i.e. borrowed funds and shareholders' equity i.e. networth. This is a vital ratio to determine the efficiency of the financial management of a business undertakings (Roy Choudhary). Debt - equity ratio is calculated by using the following formula : Debt – Equity Ratio = Long Term Debt / Net Worth.

The debt - equity ratio of Amara Raja Batteries Limited is presented in Table - 2 and Figure - 1.

TABLE – 2: DEBT - EQUITY RATIO OF ARBL

Year	Long-term Debt (Rs. in Crores)	Net Worth (Rs. in Crores)	Ratio (in times)
2004	14.88	174.59	0.09
2005	23.31	180.69	0.13
2006	37.87	201.29	0.19
2007	140.71	243.67	0.58
2008	316.26	333.10	0.95
2009	285.87	405.59	0.70
Mean	**136.48**	**256.49**	**0.44**
Standard Deviation	**135.63**	**93.56**	**0.36**
C.V. (%)	**99.37**	**36.48**	**81.15**
Co-efficient of correlation between debt and equity **(r) = 0.95**			

Source: Compiled from Annual Reports of Amara Raja Batteries Limited

FIGURE - 1

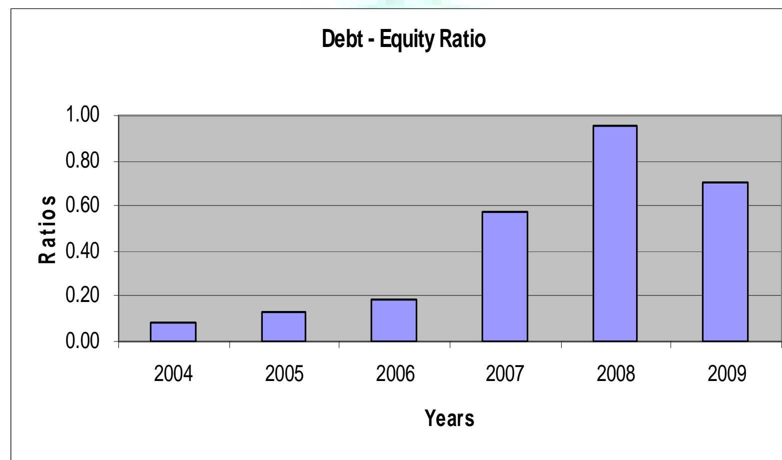

Table - 2 shows debt-equity ratio of ARBL. The debt-equity ratio is calculated by dividing the long term debt with net worth. It is evident that long term debt of the company had increased remarkably from Rs.14.88 crores in 2004 to Rs.285.87 crores in 2009. Net worth had gradually moved from Rs.174.59 crores to Rs.405.59 crores over the study period. Debt-equity ratio had varied from the lowest of 0.09 times in 2004 to the highest of 0.95 times in 2008. The ratio is well below than the standard ratio of 2:1. It means that the debt employed by the company was low from the point of view as the standard ratio. However, the interest of the debt- holders of the company was well protected. The mean, standard deviation and co-efficient of variation (C.V) of debt-equity ratio in ARBL are 0.44 times, 0.36 times and 81.15 percent respectively. The coefficient of correlation between debt and equity in ARBL was 0.95 and thereby indicating that there was highly positive relation between debt and equity. It may be concluded that the ARBL could still mobilize the debt funds in order to reap the benefits of financial leverage. It increases the earning per share of company.

DEBT TO TOTAL FUND RATIO

Several debt ratios may be used to analyze the long-term solvency of a firm. The firm may be interested in knowing the proportion of the debt in the financial structure. It may, therefore, compute debt to total fund ratio by dividing total debt by total fund. Total debt will include short-term funds plus long-term debt i.e. borrowed funds. Total fund will include total debt plus net worth. A high ratio means that claims of creditors are greater than those of owners. A high level of debt introduces inflexibility in the firm's operations due to the increasing interference and pressures from creditors. Debt to total fund ratio is calculated by using the following formula: Debt to Total Fund Ratio = Total Debt / Total Fund. The debt to total fund ratio of Amara Raja Batteries Limited is presented in table - 3 and figure - 2.

TABLE – 3: DEBT TO TOTAL FUND RATIO OF ARBL

Year	Total Debt (Rs. in Crores)	Total Fund (Rs. in Crores)	Ratio (in times)
2004	66.27	240.86	0.28
2005	100.30	280.99	0.36
2006	167.97	369.26	0.45
2007	285.55	529.22	0.54
2008	535.29	868.39	0.62
2009	488.43	894.02	0.55
Mean	**273.97**	**530.46**	**0.46**
Standard Deviation	**199.48**	**289.30**	**0.13**
C.V. (%)	**72.81**	**54.54**	**27.70**
Co-efficient of Correlation of total debt and total fund **(r) = 0.99**			

Source: Compiled from Annual Reports of Amara Raja Batteries Limited

FIGURE - 2

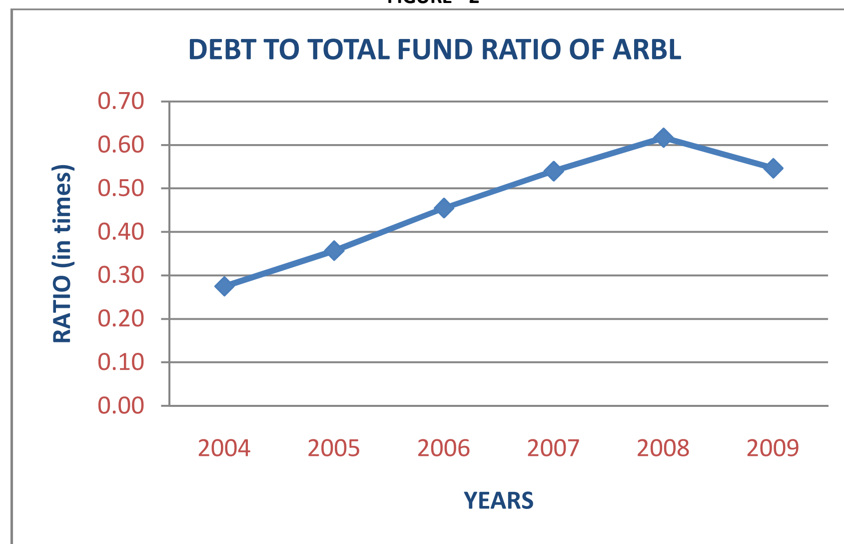

Table - 3 provides the debt to total fund ratio. The financial variables considered for the competition of debt to total fund ratio include total debt and total fund. It is obvious that total debt and total fund had reported an increasing trend with the exception of 2009 in the case of total debt. Total fund had jumped from Rs.240.86 crores in 2004 to Rs.894.02 crores in 2009. The total fund had exceeded over the total debt during the entire period of the study. The ratio is less than the unity. The mean, standard deviation and co-efficient of variation (C.V) of debt to total fund ratio in ARBL are 0.46 times, 0.13 times and 27.70 percent respectively. The debt to total fund of ARBL had a positive relationship as the coefficient of correlation is very high i.e., 0.99 that means almost all one. It may be concluded that the financial risk of the company is low. But the company could fail to enjoy the advantages of financial gearing.

INTEREST COVERAGE RATIO

The interest coverage ratio is used to test the firm's debt-servicing capacity. The use of debt in any business undertaking is justified, provided, the coverage for fixed interest charges is adequate. It indicates the number of times the fixed interest charges (debenture interest, interest on loans) is covered by the net profit (net profit before interest and tax). The interest coverage ratio shows the number of times the interest charges are covered by funds that are ordinarily available for their payment. The lender will be interested in finding out whether the business would earn sufficient profits to pay the interest charges and interest being paid periodically. Cost of debt is the percentage of interest paid on debt. The interest on debt, being a prior charge on profits affects profitability of a concern. The capital structure of a firm, therefore, affects its profitability. In order to accomplish this objective, the interest coverage ratio of the ARBL is computed. The higher the coverage, the better will be the position of debenture holders or loan creditors regarding their fixed payment of interest, the greater will be the profitability, and the better will be the position of debenture holders or loan creditors regarding their fixed payment of interest, the greater will be the profitability, and the better will be the management efficiency (Paul). The universal standard of Interest Coverage Ratio is around 7 to 8 times. The ratio indicates the extent to which the earnings may fall without causing any embarrassment to the firm regarding the payment of fixed interest charges. Interest coverage ratio is calculated by using the following formula: Interest Coverage Ratio = EBIT / Interest. The interest coverage ratio of ARBL presented in Table - 4.

TABLE – 4: INTEREST COVERAGE RATIO OF ARBL

YEAR	EBIT (Rs. in crores)	INTEREST (Rs. in crores)	Ratio (in times)
2004	2.08	0.18	11.56
2005	13.75	0.14	98.21
2006	38.79	1.34	28.95
2007	76.15	4.73	16.10
2008	161.54	14.71	10.98
2009	145.23	20.60	7.05
Mean	**72.92**	**6.95**	**28.81**
Standard Deviation	**67.49**	**8.66**	**34.84**
C.V. (%)	**92.55**	**124.63**	**120.92**

Source: Compiled from Annual Reports of ARBL.

This ratio is used to determine how easily a company can pay interest on outstanding debt. Interest coverage ratio is calculated by dividing the earnings before interest and taxes with interest charges. It is clear that earnings before interest and taxes and interest charges as shown an increasing trend over the study period. In other words while earnings before interest and taxes had jumped from Rs.2.08 crores to Rs.145.23 crores and interest charges had moved from Rs.0.18 crores to Rs.20.60 crores over the study period. The highest interest coverage ratio was recorded at 98.21 times in 2005 and the lowest being 7.05 times in 2009. The mean, standard deviation and co-efficient of variation (C.V) of interest coverage ratio in ARBL are 28.81 times, 34.84 times and 120.92 percent respectively. It may be observed that the behaviour of the ratio was so erratic indicating ups and downs over the period under the reference.

It is evident that the interest charges are fully covered by the earnings before interest and taxes. A higher ratio is desirable, but too high ratio is some of the years of the study indicate that the ARBL is very conservative in using debt, and that it is not using debt to the best advantage of the shareholders. From the point of view of the creditors safety, the larger the coverage, greater the ability of the firm to handle fixed charges and more assured the payment of interest. In contrast, a low ratio is a danger signal indicating that firm uses excessive thereby a firm is indicating inability to honour the assured payment of interest to the creditors.

CONCLUSION

Foregoing analysis reveals that long term funds had contributed more on an average 74.08 percent of total funds when compared to short term funds (25.92 percent) in Amara Raja Batteries Limited. Long term funds had apportioned nearly two-third of total funds. The company had used more owned funds on an average 48.35 percent than borrowed funds (25.73 percent). The ARBL had shown an inclination in strengthening long term funds consisting of both shareholders funds as well as long term borrowed funds in order to finance its assets requirement. ARBL mostly depended on equity financing. So, the financial risk of the company is low. But the company could fail to enjoy the advantages of financial gearing. Raising of funds through debt is relatively cheaper than equity in terms of cost of issue and interest cost. The company could still mobilize the debt funds. It means that the company could raise the external funds to bring the optimum capital structure i.e. minimise the cost of capital and maximise the share value of the firm. It is due to the tax deductibility of the interest paid on debt. So, these benefits of financial leverage shall be reaped for improving the financial performance of the company. The behaviour of the interest

coverage ratio was so erratic. The interest charges are fully covered by the earnings before interest and taxes. A higher interest coverage ratio is desirable, but too high ratio is some of the years of the study indicate that the ARBL is very conservative in using debt, and it is not using debt to the best advantage of the shareholders. Hence, it is suggested that ARBL shall tap the debt funds optimumly to maintain the balanced capital structure.

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