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   INTRODUCTION

   REVIEW OF LITERATURE

   NEED/IMPORTANCE OF THE STUDY

   STATEMENT OF THE PROBLEM

   OBJECTIVES

   HYPOTHESES

   RESEARCH METHODOLOGY

   RESULTS & DISCUSSION

   FINDINGS

   RECOMMENDATIONS/SUGGESTIONS

   CONCLUSIONS

   SCOPE FOR FURTHER RESEARCH

   ACKNOWLEDGMENTS

   REFERENCES

   APPENDIX/ANNEXURE

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CONTRIBUTIONS TO BOOKS

- Sharma T., Kwatra, G. (2008) Effectiveness of Social Advertising: A Study of Selected Campaigns, Corporate Social Responsibility, Edited by David Crowther & Nicholas Capaldi, Ashgate Research Companion to Corporate Social Responsibility, Chapter 15, pp 287-303.

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- Schemenner, R.W., Huber, J.C. and Cook, R.L. (1987), "Geographic Differences and the Location of New Manufacturing Facilities," Journal of Urban Economics, Vol. 21, No. 1, pp. 83-104.

CONFERENCE PAPERS

- Garg, Sambhav (2011): "Business Ethics" Paper presented at the Annual International Conference for the All India Management Association, New Delhi, India, 19–22 June.

UNPUBLISHED DISSERTATIONS AND THESES

- Kumar S. (2011): "Customer Value: A Comparative Study of Rural and Urban Customers," Thesis, Kurukshetra University, Kurukshetra.

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- Garg, Bhavet (2011): Towards a New Natural Gas Policy, Political Weekly, Viewed on January 01, 2012 http://epw.in/user/viewabstract.jsp

CAPITAL STRUCTURE (DEBT-EQUITY) OF INDIAN REAL-ESTATE INDUSTRY (IREI): A STUDY

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ABSTRACT

In this paper, an attempt has been made to study the "Capital Structure (Debt-Equity) of Indian Real-Estate Industry (IREI)". To this end, 6 Real-Estate companies have been chosen basing on the value of fixed assets of Rs. 10,000 millions and above. An analysis of long-term solvency, impact of financial leverage on the shareholders' earnings and justification for the use of debt by the Indian Real-Estate industry through the application of ratio analysis, trend analysis and statistical test has been undertaken. From the study, it is found that Indian Real-Estate Industry depended on equity financing. The debt-equity mix of IREI tended to be pro-equity. The degree of financial leverage did not alter the earnings of the shareholders un-favourably in IREI. The interest coverage has been sufficient in IREI and therefore, justification for the use of debt is valid.

KEYWORDS

Debt-Equity Ratio, Financial Leverage, Indian Real-Estate Industry (IREI), Interest Coverage Ratio.

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. The term 'Financial Structure' refers to a firm's total liabilities. The current liabilities, funded debt and net worth including surplus and the various kinds of stock constitute the financial structure (Burtchett, F.F., and Hicks). The items on the liabilities side are of two kinds - those representing claims of creditors and those representing the claims of equity owners (Guthmann, H.G1976). The meaning of "Capital Structure" is sought to be limited to long-term sources of funds, viz., share capital, retained earnings and long-term borrowings. The term 'Capital Structure', therefore, has been generally defined to include only long term debt and total shareholders' investment (Walker, E.W, 1976).

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 maximize its overall value. When companies don't have debt in their capital structure, then they are unlevered while on the other hand if the companies have debt in their capital structure then they are called leveraged firms. Unlevered company's total assets are always equal to total equity and it is the total value of the company. 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.

OBJECTIVES

In order to study the capital structure of IREI, it is proposed to cover the following:

- Assessment of Long-term Solvency through debt-equity ratio.
- Impact of financial leverage on the earnings of shareholders.
- Justification for the use of debt through interest coverage ratio.

METHODOLOGY

A multi-stage purposive sampling technique is adopted in selecting the sample companies for the present study. In the first stage, 36 Indian Real-Estate Companies which are listed in the Bombay Stock Exchange are considered as universe for the study. In the second stage 16 companies whose turnover is Rs. 10,000 millions or more are identified. In the third and final stage, 6 companies are selected based on Return on Capital Employed (ROCE) as sample for the present study.

ASSESSMENT OF LONG-TERM SOLVENCY

The long term solvency of a firm can be judged by using leverage or capital structure ratios. The relationship between borrowed funds and owners' funds is a popular measure of the long term financial solvency of a company. This relationship is shown by the debt-equity ratio. This is a vital ratio to determine the efficiency of the financial management of a business undertaking (Choudhary, A.B.R, 1970). This can be expressed as:

$$\textbf{Debt–Equity Ratio} = \frac{\textbf{Long Term Debt (LTD)}}{\textbf{Shareholders' Equity}}$$

DEBT-EQUITY RATIO (DER) OF SAMPLE COMPANIES OF IREI

The Debt-equity ratio is a financial ratio indicating the relative proportion of debt and shareholders' equity used to finance a company's assets. The two components are often taken from the firm's balance sheet or statement of financial position. A high debt-equity ratio generally means that a company has been aggressive in financing its growth with debt. This can result in volatile earnings as a result of the additional interest expense. A low debt-equity ratio usually means that a company has been friendly in financing its growth with debt and more aggressive in financing its growth with equity. A relatively high debt-equity ratio is observed in case of Omaxe with an average of 1.29, DLF with 0.96 and Sobha with 0.90 which are above the industry average of 0.74 times. A low debt-equity ratio is observed in Indiabulls and Vascon with 0.10 and 0.18 times respectively. Brigade with 0.74 times resembled in the industry average. The CV of debt-equity ratio of Omaxe and Brigade are standing at 56.53 and 62.18 in the order which are less than the CV of the Industry. It shows more consistency in employing the debt in their capital structure. Lower variability in the debt-equity ratio of these two companies indicates stable management of debt-equity. A high CV is found in Indiabulls with 150.90 implying less consistency.

TABLE – 1: DEBT-EQUITY (LTD ONLY) RATIO OF SAMPLE COMPANIES OF IREI

Year	DEBT-EQUITY RATIO (DER)						
	DLF	VASCON	SOBHA	OMAXE	BRIGADE	INDIABULLS	INDUSTRY
2006-07	2.59	0.05	0.67	2.60	1.63	0.00	1.68
2007-08	0.41	0.03	1.46	1.38	0.32	0.00	0.43
2008-09	0.55	0.27	1.73	1.30	0.43	0.01	0.52
2009-10	0.63	0.27	0.85	1.11	0.64	0.00	0.52
2010-11	0.85	0.37	0.67	0.87	0.69	0.28	0.70
2011-12	0.70	0.08	0.02	0.45	0.77	0.28	0.57
Mean	**0.96**	**0.18**	**0.90**	**1.29**	**0.75**	**0.10**	**0.74**
Standard Deviation	**0.81**	**0.14**	**0.61**	**0.73**	**0.46**	**0.14**	**0.47**
C.V	**85.27**	**79.97**	**68.23**	**56.53**	**62.18**	**150.90**	**63.87**

TESTING OF HYPOTHESIS OF DEBT - EQUITY RATIO

Null Hypothesis : There is no significant difference between the DER of select companies and IREI.
Alt. Hypothesis : There is significant difference between the DER of select companies and IREI.

TEST STATISTICS

Name	Mean	Industry Mean	t - Value	Sig (2 tailed)	P - Value
DLF	**0.96**	**0.74**	**1.5504**[NS]	**2.5705**	**0.1817**[NS]
VASCON	**0.18**	**0.74**	**2.568**[NS]	**2.5705**	**0.0502**[NS]
SOBHA	**0.9**	**0.74**	**0.4590**[NS]	**2.5705**	**0.6654**[NS]
OMAXE	**1.29**	**0.74**	**3.0900**[*]	**2.5705**	**0.0271**[*]
BRIGADE	**0.75**	**0.74**	**0.1979**[NS]	**2.5705**	**0.8509**[NS]
INDIABULLS	**0.1**	**0.74**	**3.0499**[*]	**2.5705**	**0.0284***

*significant at the 0.05 level (2 – tailed)

After testing the statistical hypothesis, it is confirmed that, the null hypothesis that there is no significant difference between the DER of sample companies and the industry is accepted for DLF, Vascon, Sobha and Brigade and the alternate hypothesis for Omaxe and Indiabulls.

DEBT–EQUITY RATIO [LONG TERM DEBT (LTD) + SHORT TERM DEBT (STD)]

Another method to express the debt-equity ratio is to relate the total debt i.e., long term and short term borrowed funds to the shareholders' equity. This can be expressed as:

$$\textbf{Debt–Equity Ratio} = \frac{\textbf{Total Debt}}{\textbf{Shareholders' Equity}}$$

DEBT – EQUITY RATIO (LTD+STD) OF THE SELECT COMPANIES OF IREI

The debt-equity ratio (LTD+STD) is a financial ratio indicating the relative proportion of debt and shareholders' equity used to finance a company's assets. When compared with the industry average of 1.43 times, this ratio is above in DLF, Sobha, Omaxe and Brigade. A high debt-equity ratio is observed in Omaxe with 2.27 times which means Omaxe is aggressive in financing its growth with debt. The lowest ratio of 0.70 times is observed in Indiabulls followed by Vascon with 1.10 times which indicates that these two companies are friendly in financing their growth with debt. The CV of the industry is 52.02. When compared with the industry, the CV of Vascon is registered at 18.55 which shows more consistency in the debt financing with the inclusion of short term debt, the CV of Brigade in the highest unlike when long term debt alone was considered. Lower variability in the debt-equity ratio of Vascon indicates stable management of its debt.

TABLE – 2: DEBT-EQUITY (LTD+STD) RATIO OF THE SAMPLE COMPANIES OF IREI

Years	Debt-Equity Ratio (LTD + STD)						
	DLF	VASCON	SOBHA	OMAXE	BRIGADE	INDIABULLS	INDUSTRY
2006-07	4.10	0.93	1.49	4.24	3.86	0.66	2.92
2007-08	1.15	1.46	2.41	2.03	0.76	0.92	1.20
2008-09	1.03	1.19	2.36	1.83	0.93	0.50	1.02
2009-10	1.03	0.92	1.27	1.73	1.12	0.44	0.94
2010-11	1.43	1.02	1.11	1.72	1.35	0.98	1.32
2011-12	1.23	1.06	1.11	2.06	1.38	0.69	1.17
Mean	**1.66**	**1.10**	**1.63**	**2.27**	**1.57**	**0.70**	**1.43**
Standard Deviation	**1.20**	**0.20**	**0.61**	**0.98**	**1.15**	**0.22**	**0.74**
C.V	**72.44**	**18.55**	**37.24**	**43.06**	**73.32**	**31.12**	**52.02**

TESTING OF HYPOTHESIS OF DER (LTD+STD) RATIO

Null Hypothesis: There is no significant difference between the DER (LTD + STD) of the select companies and that of IREI.
Alt. Hypothesis: There is significant difference between the DER (LTD + STD) of the select companies and that of IREI.

TEST STATISTICS

Name	Mean	Industry Mean	t - Value	Sig (2 tailed)	P- Value
DLF	**1.66**	**1.43**	**1.22**[NS]	**2.5705**	**0.28**[NS]
VASCON	**1.10**	**1.43**	**0.97**[NS]	**2.5705**	**0.38**[NS]
SOBHA	**1.63**	**1.43**	**0.47**[NS]	**2.5705**	**0.66**[NS]
OMAXE	**2.27**	**1.43**	**7.02****	**2.5705**	**0.00****
BRIGADE	**1.57**	**1.43**	**0.74**[NS]	**2.5705**	**0.49**[NS]
INDIABULLS	**0.70**	**1.43**	**2.37**[NS]	**2.5705**	**0.60**[NS]

*significant at the 0.05 level (2 – tailed)

After testing the statistical hypothesis, it is confirmed that the null hypothesis, that there is no significant difference between the DER (LTD+STD) of sample companies and the industry is accepted with the exception of Omaxe.

EFFECT OF FINANCIAL LEVERAGE ON THE SHAREHOLDERS' EARNINGS

The primary motive of a company in using financial leverage is to magnify the shareholders earnings under favourable economic conditions. The role of financial leverage in magnifying the earnings of shareholders is based on the assumption that the fixed charges funds (debt carrying fixed rates of interest) can be obtained at a cost lower than the company's rate of return on its assets. Thus, when the difference between the earnings generated by assets financed by the fixed charges funds and costs of these funds is distributed to the shareholders, they get additional earnings without increasing their own investments. Consequently, the earnings per share or the rate of return on the common shareholders' equity increases. However, earnings per share (EPS) or the rate of return on equity will fall if the company obtains the fixed charges funds at a cost higher than the rate of return on the company's assets. The earnings per share and the rate of return on equity are important figures for analyzing the impact of financial leverage. (I.M.Pandey 1979)

DEGREE OF FINANCIAL LEVERAGE (DFL) IN THE SAMPLE COMPANIES OF IREI

The DFL at a particular EBIT (Earnings before Interest and Taxes) level is measured by the percentage change in (EPS) relative to the per cent change in EBIT. The following equation can be used to determine the degree of financial leverage.

$$DFL = \frac{EBIT}{EBT}$$

FAVOURABLE AND UNFAVOURABLE FINANCIAL LEVERAGE

The effect of financial leverage may be favourable or unfavourable. Positive or favourable leverage occurs when the earnings per share increases due to the use of debt in the capital structure and vice versa.

The impact of financial leverage on earnings per share as well as, return on equity of all the sample companies and industry are shown in Table 5.17. The trends in the degree of financial leverage of the industry has shown an uptrend from 100 to 196, but the trends in the ROE fell a steeply from 100 to 9. Similarly, the trend in EPS also has declined from 100 to 49 during the study period. Hence, it is therefore, evident that the increase in the degree of financial leverage has not impacted favourably either the ROE or EPS.

The trends in the degree of financial leverage of DLF and Vascon have moved up from 100 to 216, and 100 to 223, whereas the trends in ROE slided down from 100 to 8 and 100 to 10 respectively. Similarly EPS also has fallen from 100 to 50 and 100 to 21 in both the companies during the study period. It is a clear indication that the degree of financial leverage could neither increase the ROE nor EPS in these two companies which means that the impact of financial leverage is unfavourable.

The inclination in the degree of financial leverage in Sobha, Omaxe and Brigade has advanced from 100 to 109, 100 to 193, and 100 to 164, where as the trends in ROE declined from 100 to 53, 100 to 9 and 100 to 12 in the order. Similarly, EPS has fallen from 100 to 87, 100 to 31 and 100 to 12 with fluactions in between. Therefore, there is no favourable impact of financial leverage in these three companies also.

The trend in the DFL of Indiabulls has shown a fluctuating trend, which however, raised from 100 to 165. But, the trends in ROE reported an increase from 100 to 260, EPS also has depicted a similar trend. The DFL though has shown a favourable impact on ROE and EPS, may expose the stakeholders to the higher degree of risk in this company, in view of volatility in EPS.

TABLE – 3: TRENDS IN THE DEGREE OF FINANCIAL LEVERAGE, RETURN ON EQUITY AND EARNIGS PER SHARE

Particulars	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
	DLF					
DFL (%)	112.12	103.25	110.79	144.12	185.20	242.22
Trends	(100)	(92)	(99)	(129)	(165)	(216)
ROE (%)	54.36	39.68	18.50	5.96	5.86	4.44
Trends	(100)	(73)	(34)	(11)	(11)	(8)
EPS (Rs.)	12.75	46.98	26.24	10.13	9.66	7.07
Trends	(100)	(368)	(206)	(79)	(76)	(55)
	VASCON					
DFL (%)	105.40	115.99	182.08	130.65	129.13	234.66
Trends	(100)	(110)	(173)	(124)	(123)	(223)
ROE (%)	20.34	19.89	5.49	7.90	8.93	2.12
Trends	(100)	(98)	(27)	(39)	(44)	(10)
EPS (Rs.)	7.06	8.71	4.50	6.71	7.20	1.49
Trends	(100)	(123)	(64)	(95)	(102)	(21)
	SOBHA					
DFL (%)	125.76	122.02	171.55	141.82	117.64	136.68
Trends	(100)	(97)	(136)	(113)	(94)	(109)
ROE (%)	19.81	23.36	10.11	8.12	9.97	10.50
Trends	(100)	(118)	(51)	(41)	(50)	(53)
EPS (Rs.)	24.26	31.29	15.07	14.63	18.49	21.00
Trends	(100)	(129)	(62)	(60)	(76)	(87)
	OMAXE					
DFL (%)	109.22	109.53	313.54	198.73	181.71	210.46
Trends	(100)	(100)	(287)	(182)	(166)	(193)
ROE (%)	54.99	33.38	2.80	7.12	5.53	5.11
Trends	(100)	(61)	(5)	(13)	(10)	(9)
EPS (Rs.)	16.63	28.23	2.38	6.48	5.34	5.21
Trends	(100)	(170)	(14)	(39)	(32)	(31)
	BRIGADE					
DFL (%)	115.40	102.74	105.61	119.20	113.57	189.76
Trends	(100)	(89)	(92)	(103)	(98)	(164)
ROE (%)	41.92	10.97	3.83	4.53	7.27	4.90
Trends	(100)	(26)	(9)	(11)	(17)	(12)
EPS (Rs.)	27.77	10.31	3.42	4.22	10.74	5.07
Trends	(100)	(37)	(12)	(15)	(39)	(18)
	INDIABULLS					
DFL (%)	121.11	109.22	117.57	123.93	119.87	199.54
Trends	(100)	(90)	(97)	(102)	(99)	(165)
ROE (%)	0.90	9.55	1.24	0.07	1.93	2.34
Trends	(100)	(1,061)	(138)	(8)	(214)	(260)
EPS (Rs.)	0.03	17.24	0.16	(0.87)	3.75	3.73
Trends	(100)	(57,467)	(533)	2,900	(12,500)	(12,433)
	INDUSTRY					
DFL (%)	112.65	104.46	114.78	144.88	167.52	220.49
Trends	(100)	(93)	(102)	(129)	(149)	(196)
ROE (%)	69.95	46.15	19.66	7.13	8.14	6.43
Trends	(100)	(66)	(28)	(10)	(12)	(9)
EPS (Rs.)	14.75	23.79	8.63	6.88	9.20	7.26
Trends	(100)	(161)	(58)	(47)	(62)	(49)

Note: DFL : Degree of Financial Leverage
ROE : Return on Equity
EPS : Earnings per Share

Source: (i) Appendices I & II & (ii) Annual Reports of Select Companies

The use of debt in any business undertaking is justified, provided the coverage of fixed interest charges is adequate. The ICR is used to determine how comfortably a company can pay interest on outstanding debt. The ICR is calculated by dividing a company's earnings before interest and taxes of one period by the company's interest expenses of the same period. The lower the ratio, the more the company is burdened by debt expenses. When a company's ICR is lower its ability to meet interest expenses becomes questionable and it indicates that the company is not generating sufficient revenues to satisfy the interest expenses. The ICR is a measure of the number of times a company could make the interest payments on its debt with its earnings before interest and taxes. The lower the ICR, higher is the company's debt burden, and the greater the possibility of bankruptcy or default. 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 management efficiency ([S.K.R.Paul 2002]). The universal standard for ICR is around 7 to 8 times.

INTEREST COVERAGE RATIO OF SAMPLE COMPANIES OF IREI

An analysis of the contents of the Table - 4 reveals that the ICR of Brigade and DLF exceeded the norm of 7-8 times and also and industry average of 7.94 times. Therefore, these two companies are comfortable with regard to the discharge of fixed interest charges. The creditors of these companies are safely placed. Further, it implies that these two sample firms have shown better managerial efficiency. The rest of the sample enterprises recorded a lower ICR as against the universal standard and also industry average. But, these enterprises too are able to pay off their fixed obligations well. However, an improvement in the ICR of these firms is desirable. The CV of ICR of DLF and Vascon is more than the CV of the industry indicating less consistency in using the debt in these two companies.

TABLE – 4: TIMES

Year	INTEREST COVERAGE RATIO						
	DLF	VASCON	SOBHA	OMAXE	BRIGADE	INDIABULLS	INDUSTRY
2006-07	9.25	19.51	4.88	11.84	7.49	5.74	8.90
2007-08	31.81	7.25	5.54	11.49	37.53	11.84	23.41
2008-09	10.27	2.22	2.40	1.47	18.82	6.69	7.76
2009-10	3.27	4.26	3.39	2.01	6.21	5.18	3.23
2010-11	2.17	4.43	6.67	2.22	8.37	6.03	2.48
2011-12	1.70	1.74	3.73	1.91	2.11	2.00	1.83
Mean	**9.75**	**6.57**	**4.44**	**5.16**	**13.42**	**6.25**	**7.94**
Standard Deviation	**11.41**	**6.63**	**1.56**	**5.05**	**13.05**	**3.19**	**8.12**
C.V	**117.13**	**101.01**	**35.14**	**97.90**	**97.20**	**51.11**	**102.32**

TESTING OF HYPOTHESIS OF INTEREST COVERAGE RATIO

Null Hypothesis: There is no significant difference between the ICR of the sample companies and the Industry.
Alt. Hypothesis : There is significant difference between the ICR of the sample companies and the Industry.

TEST STATISTICS

Name	Mean	Industry Mean	t - Value	Sig (2 tailed)	P - Value
DLF	**9.75**	**7.94**	**1.31**^{NS}	**2.7505**	**0.25**^{NS}
VASCON	**6.57**	**7.94**	**0.38**^{NS}	**2.7505**	**0.72**^{NS}
SOBHA	**4.44**	**7.94**	**1.09**^{NS}	**2.7505**	**0.33**^{NS}
OMAXE	**5.16**	**7.94**	**1.26**^{NS}	**2.7505**	**0.26**^{NS}
BRIGADE	**13.42**	**7.94**	**2.20**^{NS}	**2.7505**	**0.08**^{NS}
INDIABULLS	**6.25**	**7.94**	**0.77**^{NS}	**2.7505**	**0.48**^{NS}

*significant at the 0.05 level (2 – tailed)

After testing the hypothesis, it is concluded that for the sample companies the null hypothesis is accepted. Hence, there is no significant difference between the ICR of sample companies and the industry.

CONCLUSION

Long term funds constitute the major source of financing the investments in the Indian Real-Estate Industry. Owners' funds are more significant than the long term borrowed funds. Equity base of the industry is enlarged primarily because of substantial retention of profits. The improvement in the internally generated funds shows a move towards self reliance of the industry. Long term funds are sufficient to finance entire fixed assets component as these assets on an average formed only 36.81 per cent of total assets. In other words, long term funds are adequate to finance the fixed assets and also a major chunk of current assets. The interest of long term creditors is well protected because the size of ownership funds is large enough and even if the assets value decline by cent per cent, creditors need not worry. The industry in spite of its efforts could not improve the profits to the desired level. The increase in the degree of financial leverage has not favourably impacted either the ROE or EPS of the industry

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