A STUDY ON CAPITAL STRUCTURE – ULTRATECH CEMENT

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ABSTRACT

A project work is a mandatory requirement for the Business Management Programe. This type of study aims at exposing the young prospective executive to the actual business world. This project gives me knowledge about the capital structure and theory analysis.

Financing decisions involve raising funds for the firm. It is concerned with formulation and designing of capital structure or leverage. The most crucial decision of any company is involved in the formulation of its appropriate capital structure. The best design or structure of the capital of a company helps the management to achieve its ultimate objectives of minimizing overall cost of capital, maximizing profitability and also maximizing the value of the firm.

It is very effective way to judge a company's cash flow prospects, as cash is like blood life for any company. The report initially begins with the company profile, followed by the detailed analysis of company, like businesses of the company, products offered by the company, financials of the company, etc. The report involves a lot of research to understand what exactly capital structure of the company should be that, why companies require appropriate capital structure.

The purpose is to develop an action plan that creates such a capital structure that will upgrades and standardize the quality of business analysis.

I. INTRODUCTION

Capital structure of the firm can also be explained in terms of the tax benefits associated with the use of debt. Green, Murinde and Suppakitjarak (2002) observe that tax policy has an important effect on the capital structure decisions of firms. Corporate taxes allow firms to deduct interest on debt in computing taxable profits. This suggests that tax advantages derived from debt would lead firms to be completely financed through debt. This benefit is created, as the interest payments associated with debt are tax deductible, while payments associated with equity, such as dividends, are not tax deductible. Therefore, this tax effect encourages debt use by the firm, as more debt increases the after tax proceeds to the owners (Modigliani and Miller, 1963; Miller, 1977). It is important to note that while there is corporate tax advantage resulting from the deductibility of interest payment on debt, investors receive these interest payments as income. The interest income received by the investors is also taxable on their personal account, and the personal income tax effect is negative. Miller (1977) and Myers (2001) argue that as the supply of debt from all corporations expands, investors with higher and higher tax brackets have to be enticed to hold corporate debt and to receive more of their income in the form of interest rather than capital gains. Interest rates rise as more and more debt is issued, so corporations face rising costs of debt relative to their costs of equity. The tax benefits arising from the issue of more corporate debt may be offset by a high tax on interest income. It is the trade-off that ultimately determines the net effect of taxes on debt usage (Miller, 1977; Myers, 2001).

These behaviours by the stakeholders effectively reduce the value of the firm. Therefore, firms that have high distress cost would have incentives to decrease outside financing so as to lower these costs. Warner (1977) maintains that such bankruptcy costs increase with debt, thus reducing the value of the firm. According to Modigliani and Miller (1963), it is optimal for a firm to be financed by debt in order to benefit from the tax deductibility of debt. The value of the firm can be increased by the use of debt since interest payments can be deducted from taxable corporate income. But increasing debt results in an increased probability of bankruptcy. Hence, the optimal capital structure represents a level of leverage that balances bankruptcy costs and benefits of debt finance. The greater the probability of bankruptcy a firm faces as the result of increases in the cost of debt, the less debt they use in the issuance of new capital (Pettit and Singer, 1985).

Financial management is one of the TRIUM VARIANT functions of a business. The other two are manufacturing and marketing. Finance is an important integral part of modern economic life. Financing decision plays a vital role. It involves rising as well as utilization of funds for the company. It is concerned with the designing of capital structure. The financial decision should be shaped in such a way it should support the company's capital structure. Capital structure should be examined from the viewpoint of its impact on the value of the firm. The firm should select the financing - mix in such a way that it maximizes the shareholder's wealth. The combination of debt and equity determines it. If the company opts for more debt, they may trigger off a high Interest burden. devour profits and depress earnings per share and, above all, endanger the very survival of the firm. On the other hand, a conservative policy may deprive the company of its advantage in terms of magnifying the rate of return to its equity owners as higher equity component results in low earnings per share. The finance manger should consider various factors while deciding the choice of debt and equity. Apart from risk return financial considerations, the

financial manager also considers nonfinancial factors. When equity shareholders are more in numbers; they have access to control the company. But when debts Owings are more than equity, finance manager's consideration is more on debt then equity.

Financial crisis may arise in the firm due to two main reasons. They are

• Unexpected decline in operating profit.

• Requirement for increased funds. Nonpayment of interest or principal amount to lenders at specified time will have to be recovered through liquidations in the company. At the same time the non – use of debt prevents the firm from availing an opportunity to have the advantage on rate of return to its shareholders.

A firm's capital structure is the composition or 'structure' of its liabilities. For example, a firm that has \$20 billion in equity and \$80 billion in debt is said to be 20% equity-financed and 80% debt-financed. The firm's ratio of debt to total financing, 80% in this example, is referred to as the firm's leverage.^[1] In reality, capital structure may be highly complex and include dozens of sources of capital.

Leverage (or gearing) ratios represent the proportion of a firm's capital that is obtained through debt which may be either bank loans or bonds.

In the event of bankruptcy, the seniority of the capital structure comes into play. A typical company has the following seniority structure listed from most senior to least:

- Senior debt
- Subordinated (or junior) debt
- Preferred stock
- Common stock

The Modigliani–Miller theorem, proposed by Franco Modigliani and Merton Miller in 1958, forms the basis for modern thinking on capital structure, though it is generally viewed as a purely theoretical result since it disregards many important factors in the capital structure process factors like fluctuations and uncertain situations that may occur in the course of financing a firm. The theorem states that, in a perfect market, how a firm is financed is irrelevant to its value. This result provides the base with which to examine real world reasons why capital structure *is* relevant, that is, a company's value is affected by the capital structure it employs. Some other reasons include bankruptcy costs, agency costs, taxes, and information asymmetry. This analysis can then be extended to look at whether there is in fact an optimal capital structure: the one which maximizes the value of the firm.

OBJECTIVES OF THE STUDY

The main objectives of the study are:

- 1. To study the mix of permanent and borrowed capital in the total composition of capital structure;
- 2. To find specific cost of each source of finance;
- 3. To compute weighted average cost of capital; and
- 4. To present the relationship between capital structure and cost of capital
- 5. To understand the capital structure of company
- 6. To find debt ratio, debt-equity ratio and interest coverage ratio of the company
- 7. EBIT-EPS Analysis to find the right capital mix

FACTORS EFFECTING CAPITAL STRUCTURE



II. LITERATURE REVIEW

According to Modigliani and Miller (1963), it is optimal for a firm to be financed by debt in order to benefit from the tax deductibility of debt. The value of the firm can be increased by the use of debt since interest payments can be deducted from taxable corporate income. But increasing debt results in an increased probability of bankruptcy. Hence, the optimal capital structure represents a level of leverage that balances bankruptcy costs and benefits of debt finance. The greater the probability of bankruptcy a firm faces as the result of increases in the cost of debt, the less debt they use in the issuance of new capital (Pettit and Singer, 1985).

The concept of optimal capital structure is expressed by Myers (1984) and Myers and Majluf (1984) based on the notion of asymmetric information. The existence of information asymmetries between the firm and likely finance providers causes the relative costs of finance to vary among different sources of finance. For example, an internal source of finance where the funds provider is the firm will have more information about the firm than new equity holders, thus these new equity holders will expect a higher rate of return on their investments. This means it will cost the firm more to issue fresh equity shares than to use internal funds. Similarly, this argument could be provided between internal finance and new debt-holders

III. RESEARCH METHODOLGY SORCES OF DATA

Primary Data:

Primary data is data that is collected by a research from first hand sources using method like surveys, experiments, research, projects in mind, directly from primary sources.

Secondary data:

The secondary data is collected from the published reports like profit and loss

account and balance sheet of the company. **PERIOD OF THE STUDY**

The period of the research is three months and five years data is considered **IV. CONCLUSIONS**

For entire study period the company is even geared. The company has large accumulated reserves this leads to increase in weighted average cost of capital. The company can increase debt capital to enjoy trading on equity that financial leverage. The company so much sloughing lack of profits to meet future expansion needs. The company has no preference share capital. The cost of secured loans is less than that of un secured loans.

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