International Journal of Advanced Research and Development
ISSN: 2455-4030
Impact Factor: RJIF 5.24
www.advancedjournal.com
Volume 3; Issue 2; March 2018; Page No. 83-87

An analysis of capital structure of ITC limited

[1] B Navaneetha, [2] R Nithya Lakshmi, [3] K Manjushree
[1] Assistant Professor, Department of B. Com (PA), PSGR Krishnammal College for Women, Coimbatore, Tamil Nadu, India
[2, 3] III B. Com (PA), Department of B. Com (PA), PSGR Krishnammal College for Women, Coimbatore, Tamil Nadu, India

Abstract
ITC limited (Indian tobacco Company) is the one of the leading Fast Moving Consumable Goods companies in India. This Study is based on the secondary data extracted from the annual reports of the company. The financial statements of ITC have been collected over a period of 5 years from 2013 to 2017. Ratios and leverages have been used to know the capital structure i.e., (debt & equity proportion) of the firm. To know the relationship between the various long-term forms of financing ratios and leverage have been used and also to identify the firm's ability to use fixed cost assets or funds to increase return to its owners (i.e., equity shareholders). The study highlights that leverages remain same throughout the study period.

Keywords: leverage, capital structure, ratios

1. Introduction

ITC was incorporated on August 24, 1910 under the name Imperial Tobacco Company of India Ltd. As the company's ownership progressively Indianised the name of the company was changed from Imperial Tobacco Company of India Ltd to India Tobacco Company Ltd in the year 1970 and then to I.T.C. Ltd in the year 1974. In recognition of the company's multi-business portfolio encompassing a wide range of businesses - Cigarettes & Tobacco Hotels Information Technology Packaging Paperboards & Specialty Papers Agri-business Foods Lifestyle Retailing Education & Stationery and Personal Care - the full stops in the company's name were removed effective September 18, 2001.

ITC Ltd is one of India's foremost private sector companies. ITC has a diversified presence in Cigarettes Hotels Paperboards & Specialty Papers Packaging Agri-Business Packaged Foods & Confectionery Information Technology Branded Apparel Personal Care Stationery Safety Matches and other FMCG products. While ITC is an outstanding market leader in its traditional businesses of Cigarettes Hotels Paperboards Packaging and Agri-Exports it is rapidly gaining market share even in its nascent businesses of Packaged Foods & Confectionery Branded Apparel Personal Care and Stationery. ITC's wholly owned Information Technology subsidiary ITC InfoTech India Ltd provides IT services and solutions to leading global customers. ITC InfoTech has carved a niche for itself by addressing customer challenges through innovative IT solutions. ITC's production facilities and hotels have won numerous national and international awards for quality productivity safety and environment management systems. ITC was the first company in India to voluntarily seek a corporate governance rating.

Capital structure is a mixture of a company's debts includes debentures, long term loans, common equity and preferred equity. The most crucial decision of any company is involved in the formulation of its appropriate capital structure. The design or structure of the capital of a company helps the management to achieve its ultimate objectives of minimising overall cost of capital, maximising profitability and also maximising the value of the firm. Optimum capital structure is that the capital structure or combination of debt and equity that leads to the maximum value of the firm. Leverage has been used and also to identify the firm's ability to use fixed cost assets or funds to increase return to its owners (i.e., equity shareholders). The capital structure ratio is those financial ratios which measures the long term stability and structure of the firm.

1.1 Objectives of the study

- To study the financial condition of ITC Ltd., through leverages.
- To analyse the proportion of capital structure of ITC Ltd., through ratios.

1.2 Limitations of the study

- The study is based on secondary data.
- The results of the study may not be applicable to other business of similar nature.

1.3 Scope of the study

- To determine the capital structure practices followed by ITC ltd.
- To know the various financial instruments or borrowed capital of the ITC ltd.

1.4 Statement of the problem

Capital structure helps to find the proportion of debt and equity and in which way it affects the shareholder's wealth. Capital structure leads to maximise the value of the firm and minimise the cost of capital. Leverage analysis is used to know how capital is raised by ITC Ltd. Ratio analysis is used to evaluate various aspects of ITC company's operating and financial performance during the study period. This study depicts the problem faced by the company in choosing the optimal capital structure.

1.5 Review of literature
Sekar, Gowri and Ramya *et al*. (2014) [1] have made a study on "Capital structure and leverage of Tata Motors Ltd: Its role and future prospectus". The study is based on secondary data. This study examines the influence of capital structure on the performance of the company. It is measured using EBIT-EPS analysis. The value of the company is increased due to investment decision and balanced capital structure. Analysis is done with an objective to study the capital structure, its determinants, and nexus with the value of the firm and moreover the capital structure decision on the performance of the Tata Motors Limited. Net worth of the company started increasing throughout the study period. Since it has an optimal capital structure it will have positive effect in its future business.

Zahoor Hussain Javed, Huma *et al.* (2015) [2] have made a study on "Effect of Financial Leverage on performance of the firms: Empirical evidence from Pakistan". The study is based on secondary data. The data has been obtained from various publication of SB of Pakistan. The study highlighted that to find the impact of leverage on the efficiency of textile sector. The panel data methodology is used for estimation. It has been suggested that the total debt and long term debt are negatively related to return on asset and return on equity. The pecking order theory suggests that firms get minimum amount of borrow and earn maximum. The firm tend to borrow less because firms maintain the sufficient amount of funds internally.

Vinod Bhatnagar (2016) [3] has made a study on "Effect of change in capital structure on Profitability of FMCG Sector Companies". The study was based on secondary source of data. Data was calculated from moneycontrol.com, radiffmoney.com and also applied linear regression to find out the effect of change in capital structure on profitability. The main objective was to find out the impact of capital structure on profitability. The study was empirical in nature. This study is a useful contribution to understand the capital structure and can be used by different researches for further research. It has been done by taking only sample of FMCG companies it is suggest to take other sector. Analysis is done by considering Net profit only one can also use profit before tax and profit before depreciation & tax. Hence he concluded that there was significant relationship between capital structure and profitability.

Ayan Chakraborty (2017) [4] has made a study on "Impact of Leverage & Coverage Ratios On ITC Ltd". The financial statements of ITC have been collected over a period of six years (2011-2016). The explanatory research design is adopted in this study which employs secondary data. The research evidence of the study indicates that the degree of operating leverage is statistically significant positive correlation with the EPS. The financial performance of ITC is satisfactory. The analysis has shown that ITC has financed its activities mainly from its reserve & surplus and the amount of debt has fallen over the years it is suggested that must increase its debt funding to take the advantage of tax shield. The objective of the study is to know the overall operating efficiency and performance of the firm through financial analysis and also to measure the growth of the company. The study concludes that the firm has to use a correct mixture of both the leverages to take the fullest possible advantage of growing business opportunity.

1.6 Period of study
The study period is five years i.e., from 2013 to 2017 for the analysis of capital structure of the firm.

1.7 Source of data
The study is based on secondary data which have been obtained from the annual report of the company from 2013 to 2017.

1.8 Tools and techniques used
Capital structure ratios & Leverages have been used to analyse the data for ITC Ltd from the period of 2013 to 2017.

1.9 Leverage
There are basically two types of leverages, Operating leverage, and financial leverage. The leverage associated with the employment of fixed cost assets is referred to as operating leverage, while the leverage resulting from the use of fixed cost/return source of funds is known as financial leverage. In addition to these two kinds of leverages, one could always compute 'Combined leverage' to determine the combined effect of the leverages.

1.9.1. a. Financial leverage
Financial leverage is the amount of debt that an entity uses to buy more assets**.** The aim of the financial leverage is to increase the revenue available for equity shareholders using the fixed cost funds. The financial leverage is used to magnify the shareholder's earnings. Financing the firm's assets is a very crucial problem in every business and as general rule there should be proper mix of debt and equity capital.

Financial leverage = Earnings before interest / Earnings before tax

Table 1: Financial Leverage (Rs in crores)

Year	Ebit (Rs)	EBT (Rs)	Ratio (times)
2017	15548.29	15502.96	1.01
2016	14506.00	14434.07	1.00
2015	14075.97	13997.52	1.01
2014	12682.74	12659.11	1.00
2013	10790.09	10684.18	1.00
		Average	1.01

(***Source*:** computed profit.ndtv.com/stock/itc-ltd_itc/financials)

1 Sekar, Gowri and Ramya "Capital Structure and Leverage of Tata Motors Limited:Its Role and Future Prospectus". Procedia Economics and Finance 11 pp 445-458(2014)..
2 Zahoor Hussain Javed, Huma Raos, Bader Akram and Mohammad Fayyaz Nazir "Effect of Financial Leverage on performance of the firms: Empirical evidence from Pakistan".)Journal of economics and business Vol.66 Issue 1-2 pp,87 – 95 (2015).
3Vinod Bhatnagar "Effect of Capital Structure on Profitability of FMCG Sector Companies". The Futuristic Growth of India Economy. Golden Valley Publication, Agra, pp.183-193(2016).
4Ayan Chakraborty "Impact of Leverage & Coverage Ratios on ITC Ltd" International journal of current engineering and technology, Vol. 7, No.3 (2017)

From the above table 1 it is understood that during the study period (2013-2017) the financial leverage remains constant 1.01 times. It reveals that 1% change in EBIT results in 1.01% change in earnings per share. The leverage will have adverse impact on earnings if the firm suffers losses because fixed cost security will magnify the loss.

1.9.2 b. Operating leverage

The operating leverage occurs when a firm has fixed costs which must be recovered irrespective of sales volume. The fixed cost remaining same, the percentage change in operating revenue will be more than the percentage change is sales. The occurrence is known as operating leverage**.** The degree of operating leverage depends upon the amount of fixed elements in the cost structure. The fixed cost is treated as fulcrum of leverage. The changes in sales are related to changes in revenue. If a firm does not have fixed costs, then there will be no operating leverage.

Operating leverage = contribution / EBIT
Contribution = Sales – Variable cost
Operating profit = Sales - Variable cost – Fixed cost / Contribution – Fixed cost.

Table 2: Operating Leverage (Rs in crores)

Year	Contribution (Rs)	Ebit (Rs)	Ratio (times)
2017	17672.93	15548.29	1.13
2016	15759.97	14506.00	1.08
2015	14989.77	14075.97	**1.60**
2014	13955.48	12682.74	1.10
2013	11759.21	10790.00	1.08
		Average	1.19

(***Source***: computed profit.ndtv.com/stock/itc-ltd_itc/financials)

From the above table 2 it is understood that during the study period (2013-2017), the operating leverage almost remains same. The operating leverage is high in the year 2017 with 1.13 times and low in the year 2014 with 1.10 times. The fixed cost remains same and so increase in contribution results in corresponding increase in EBIT.

1.9.3. c. Combined leverage

Both financial and operating leverage magnify the revenue of the firm. Operating leverage affects the income which is the result of production. On the other hand, the financial leverage is the result of financial decisions. The composite leverage focuses attention on the entire income of the concern. The risk factor should be properly assessed by the management before using the composite leverage. The high financial leverage may be offset against low operating leverage or vice-versa.

Combined leverage = Operating leverage * Financial leverage.

Table 3: Combined Leverage (Rs in crores)

Year	Operating Leverage (times)	Financial Leverage (times)	Combined Leverage (times)
2017	1.13	1.00	1.13
2016	1.08	1.00	1.08
2015	1.60	1.01	**1.61**
2014	1.10	1.00	1.10
2013	1.08	1.01	1.09
		Average	1.2

(***Source*****:** computed profit.ndtv.com/stock/itc-ltd_itc/financials)

From the above table 3 it is understood that during the study period 2013-2017, there is no much difference in the combined leverage. This is because the financial leverage and operating leverage does not show much difference during the study period. Combined leverage is high in the year 2015 with 1.61 times and low in the year 2014 with 1.10 times.

1.10 Capital structure ratio

Structural ratio is based on the proportions of debt and equity in the capital structure of the firm. The capital structure ratio may be defined as those financial ratios which measure the long term stability and structure of the firm. These ratios indicate the mix of funds provided by owners and lenders and assure the lenders of the long term funds. When a company has issued a variety of securities at different points of time to raise funds at difficult terms, it may need to consolidate such securities to simply the financial plan as and when the market conditions are favourable.

1. Equity ratio
2. Proprietary ratio
3. Debt asset ratio

1.10.1. a. Equity ratio

The equity ratio is an investment leverage or solvency ratio that measures the amount of assets that are financed by owners' investments by comparing the total equity in the company to the total assets. The equity ratio highlights two important financial concepts of a solvent and sustainable business. The first component shows how much of the total company assets are owned outright by the investors. In other words, after all of the liabilities are paid off, the investors will end up with the remaining assets.

Equity ratio = shareholders fund / Capital Employed

Shareholder's funds = Equity & Preference share capital, Reserves surplus, Undistributed profit
Capital Employed = total asset – current liability – debentures – preference share capital

Table 4: Equity Ratio (Rs in crores)

Year	Shareholder Fund (Rs)	Capital Employed (Rs)	Ratio (times)
2017	45340.96	45340.96	1
2016	41656.43	41656.43	1
2015	30735.65	30735.65	1
2014	26262.02	26262.02	1
2013	22287.85	22287.85	1
		AVERAGE	**1**

(***Source*:** computed profit.ndtv.com/stock/itc-ltd_itc/financials)

From the above table 4 it is understood that during the study period 2013-2017, equity ratio remains constant

1.10.2. b. Proprietary ratio

This ratio shows the proportion of total assets of a company which are financed by proprietor's funds. Proprietary ratio is also known as equity ratio. It helps to determine financial strength of a company & is useful for creditors to assess the ratio of shareholders' funds employed out of total assets employed in the company. This ratio indicates the relative proportions of capital contribution by shareholders in comparison to the total assets of a company. The ratio of proprietor's funds to total funds (Proprietors + outsider's funds or total funds or total asset) is an important ratio for determining long-term solvency of a firm.

Proprietary ratio = Proprietors fund / Total assets

Table 5: Proprietary Ratio (Rs in crores)

Year	Proprietory Fund (Rs)	Total Asset (Rs)	Ratio (times)
2017	45340.96	54215.95	**0.83**
2016	41656.43	50031.28	0.83
2015	30735.65	44195.66	0.69
2014	26262.02	39229.39	0.66
2013	22287.85	34017.43	0.65
		AVERAGE	0.73

(***Source*:** computed profit.ndtv.com/stock/itc-ltd_itc/financials)

The proprietary ratio shows the contribution of shareholders in total capital of the company. A high proprietary ratio indicates a strong financial position. The ideal ratio is 0.75. The study indicates that the proprietary ratio shows a satisfactory position which means that the company is not relying upon debt capital.

1.10.3. c. Debt asset ratio

Debt to total asset ratio is the ratio indicating the percentage of total assets of the company financed from debt. It is a broad financial parameter used to measures which part of assets are served by liabilities (debt) signifying financial risk. It is one of the solvency ratios and helps in measuring how far the company is capable of meeting its long-term financial obligations.

Debt asset ratio = Total Debt / Total Assets

Table 6: Debt Asset Ratio (Rs. In crores)

Year	Total Debt (Rs)	Total Asset (Rs)	Ratio (times)
2017	7003.29	54215.29	0.12
2016	6507.42	50031.28	0.13
2015	11828.37	44195.66	0.26
2014	11670.41	39229.39	0.29
2013	10525.86	34017.43	**0.30**
		AVERAGE	0.22

(***Source*:** computed profit.ndtv.com/stock/itc-ltd_itc/financials)

From the above table 6, it is understood that the studied company's assets are less financed through debt. The ratio is very less indicating that the debt capital is much lesser than owner's capital. When compared with 2013, the debt has reduced by 3000 crores which results in decrease in ratio.

2. Findings

The leverages of ITC Ltd almost remain constant throughout the study period 2013-2017. The capital structure ratios show a satisfactory position while comparing the same to the Ideal Ratio.

3. Suggestions

1. The firm should attain the optimal Capital structure to maximize the value of company and wealth of its shareholders by issuing required Debentures or Shares.
2. The Long Term Borrowing is nil in the financial statements which shows there is no tax leverage. Hence the company should take the advantage of tax leverage.

4. Conclusion

The analysis of capital structure highlighted that the company's operating performance is in efficient manner and the sales during the study period shows increasing trend and it is expected sales can increase in forthcoming years. The study reveals that the financial performance of ITC Ltd is in satisfactory position. The study concluded that ITC Ltd's capital structure shows that maximum finance is raised through its owner's capital and the contribution of debt is reduced over the years. It is suggested that it can increase its debt finance in capital structure to take the advantage of financial leverage.

5. References

1. Shashi K Gupta, Sharma RK. Financial Management Theory and Practice. Kalyani publishers, 2016.
2. SN Maheshwari, Sharad K, Maheshwari. Financial Accounting. Vikas Publishing, 2012.
3. International journal of current engineering and

technology, Study period 2011-2016 by Ayan Chakraborty (2017) has made a study on Impact of Leverage & Coverage Ratios on ITC Ltd., 2017; 7(3).
4. Journal of economics and business study period:2006-2011 by Zahoor Hussain Javed, Huma Rao, Bader Akram and Mohammad Fayyaz Nazir (2015) on Effect on financial leverage on performance of the firms: empirical evidence from Pakistan, 2015; 65(1-2):87-95.
5. Procedia Economics and Finance study period: 2004-2013 by M. Sekar, M. Gowri and G. Ramya (2014) has made a study on capital structure and leverage of tata motors limited: its role and future prospectus, 2014; 11:445-458.
6. The Futuristic Growth of India Economy. Golden Valley Publication, Agra, 183-193. Study period 2011-2015 by Vinod Bhatnagar (2016) has made a study on Effect of capital structure on profitability of FMCG sector companies.
7. www.scribd.com
8. www.profitndtv.com
9. www.researchgate.net
10. www.emeraldinsight.com