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Capital Structure Analysis – A Comparative Study of Cement Companies

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Abstract: **Capital structure means the pattern of capital employed in the firm. It is a financial plan of the firm in which the various sources of capital are mixed in such proportion that those provide a distinct capital structure most feasible according to requirement of the firm. A company should construct such a capital structure so that it can achieve its objectives easily. A company should choose optimum capital structure. Optimum capital structure is the point where the market value of the shares is maximum and at this point the average weighted cost of capital is minimum. This paper discusses how to analyze the capital structure analysis of selected cement companies on the basis of different ratios. The selected companies have performed well and their capital structure is properly planned during the study period. Key Words: Distinct, Feasible, Optimum, Planned.**

1. INTRODUCTION

It is the permanent long-term financing that is represented by long –term debt, preference share capital, equity share capital and retained earnings. According to Lawrence D. Schall and Charles W. Haley, "The term capital structure means the proportion of different types of securities issued by a firm". For the present study two cement companies viz., Shree Cement Ltd. and J.K. Cement Ltd. have been selected and analysis has been made by using ratio analysis. The period of the study is five years i.e. from 2007-08 to 2011-12. There are some ratios through which analysis has been done as follows:

1. Debt Equity Ratio

This is the best ratio which measures the long-term financial solvency of a firm. The purpose behind calculating this ratio is to measure the relative proportion of debt and equity in financing the assets of a firm. The debt equity ratio of both the companies has been shown in the following table:

Table 1

Debt Equity Ratio (inTimes)

Name of the Companies	2007-08	2008-09	2009-10	2010-11	2011-12
Shree Cement Ltd.	1.98	1.24	1.15	0.92	0.43
J.K. Cement Ltd.	0.48	0.48	0.79	0.99	1.34

Source: Annual Reports and Accounts of the Companies from 2007-08 to 2011-12.

It is evident from the above table1 that Shree Cement Ltd. followed a decreasing trend towards debt equity ratio. It was 1.98 times in 2007-08 which finally declined to 0.43 times in 2011-12. A decreasing trend in debt equity ratio is an indicator of reducing long-term debts of the company thereby showing favourable position for long-term lenders. In J.K. Cement Ltd., the debt equity ratio registered an increasing trend. It was 0.48 times in 2007-08 and 2008-09 which finally increased to 1.34 times in 2011-12. High ratio is unfavourable from the owner's point of view. In this regard, policy of trading on equity is profitable but management should be careful because it becomes highly risky in the case of depression.

2. SOLVENCY RATIO

This ratio is used to measure long-term solvency of business. This ratio examines capital structure of business. This ratio denotes the relationship between total outsider's liabilities and total assets.

Table 2

Solvency Ratio (inTimes)

Name of the Companies	2007-08	2008-09	2009-10	2010-11	2011-12
Shree Cement Ltd.	0.66	0.55	0.53	0.37	0.20
J.K. Cement Ltd.	0.32	0.31	0.41	0.46	0.57

Source: Annual Reports and Accounts of the Companies from 2007-08 to 2011-12

From above table 2, in case of Shree Cement Ltd. the solvency ratio followed a decreasing trend which was a good sign for the company. It was 0.66 times in 2007-08 and finally came down to 0.20 times in 2011-12. In case of J.K. Cement Ltd., this ratio followed an increasing trend. It was 0.32 times in 2007-08 and then decreased to 0.31times in 2008-09 and again increased to 0.57 times in 2011-12. Higher solvency ratio is unfavourable from creditors' point of view.

3. PROPRIETARY RATIO

This ratio establishes the relationship between proprietor's funds and total assets of the firm. this ratio shows that how much capital is introduced by the owner in business.

Following table shows the proprietary ratio of both the companies under study.

Table 3

Proprietary Ratio (inTimes)

Name of the Companies	2007-08	2008-09	2009-10	2010-11	2011-12
Shree Cement Ltd.	0.34	0.45	0.46	0.40	0.46
J.K. Cement Ltd.	0.65	0.64	0.52	0.47	0.43

Source: Annual Reports and Accounts of the Companies from 2007-08 to 2011-12

It can be seen from above table 3 that proprietary ratio in Shree Cement Ltd. showed fluctuating trend. It was 0.34 times in 2007-08 and finally reached to 0.46 times in 2011-12. The low ratio shows that the company was dependent on outside sources for working capital. Proprietary ratio in J.K. Cement Ltd. showed decreasing trend. It was 0.65 times in 2007-08 and finally decreased to 0.43 times in 2011-12. Thus, it can be that capital structure of the companies under study is not sound.

4. FIXED ASSETS TO TOTAL DEBTS RATIO

This ratio is computed to find out the pattern of financing the fixed assets i.e. to what extent fixed assets has been acquired through the debts. It is calculated by dividing the fixed assets by total debts. Following table shows the fixed assets to total debts ratio of the companies under study.

Table 4

Fixed Assets to Total Debts Ratio (inTimes)

Name of the Companies	2007-08	2008-09	2009-10	2010-11	2011-12
Shree Cement Ltd.	0.57	0.42	0.36	0.64	1.28
J.K. Cement Ltd.	2.13	2.15	1.91	1.66	1.13

Source: Annual Reports and Accounts of the Companies from 2007-08 to 2011-12

It is evident from above table 4, that fixed assets to total debts in Shree Cement Ltd.showed a fluctuating . it was 0.57 times in 2007-08 and increased to 1.28 times in 2011-12. Fixed assets are more than total debts which indicates that lenders are safe.Fixed assets to total debts ratio in J.K. Cement Ltd. showed decreasing trend. It was 2.13 times in 2007-08 and finally declined to 1.13 times in 2011-12. This indicates that debts are more than fixed assets. This is not a good indication.

5. FIXED ASSETS TO NET WORTH RATIO

This ratio is a tool to find out the percentage of fixed assets financed by the owner's of the company. It is an important device for judging the margin of safety for long-term creditors. This ratio is calculated by dividing the fixed assets by net worth. Following table shows the fixed assets to net worth ratio of the companies under study.

Table 5

Fixed Assets to Net Worth Ratio (inTimes)

Name of the Companies	2007-08	2008-09	2009-10	2010-11	2011-12
Shree Cement Ltd.	1.13	0.52	0.41	0.59	0.56
J.K. Cement Ltd.	1.03	1.03	1.51	1.64	1.51

Source: Annual Reports and Accounts of the Companies from 2007-08 to 2011-12

It can be observed from above table that Shree Cement Ltd. followed a fluctuating trend during the period of the study. It was 1.13 times in 2007-08 which declined to 0.56 times in 2011-12. Thus it can be said that the company was on a sounf footing during this period. In case of J.K. Cement Ltd. this ratio showed a declining trend except in the year 2009-10. This ratio was 1.13 times in 2007-08 and finally decreased to 0.56 times in 2011-12. This shows that net worth have exceeded fixed assets during study period, this cannot be regarded as sound position.

CONCLUSIONS

This comparative study of Shree Cement Ltd. and J.K. Cement Ltd. shows that the capital structure of both the companies is equally good and both the companies are making sincere efforts to maximize the wealth of shareholders. It is very essential that the capital structure of a company should be properly planned. Success of a company depends upon the financial plan and capital structure. A company should try to construct an optimum capital structure .

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