International Journal of Humanities Social Science and Management (IJHSSM)
Volume 3, Issue 2, Mar.-Apr. 2023, pp: 1255-1263 www.ijhssm.org

A Study on Capital Structure Analysis on ADML, Coimbatore

Ms. B. HINTHUJA[1], Mr. K. IYYAPPAN[2]
DEPARTMENT OF MANAGEMENT STUDIES,
KARPAGAM COLLEGE OF ENGINEERING,
COIMBATORE – 641 032.

Date of Submission: 10-04-2023 Date of Acceptance: 25-04-2023

ABSTRACT
The capital structure of an organisation is examined in this study. We analyse the capital structure of the organisations using information from financial statements and other sources, including their use of debt and equity funding. We also look at how several elements, like industry, business size, profitability, and future growth prospects, influence capital structure choices. According to our findings, a number of variables affect capital structure decisions, with certain industries relying more heavily than others on loan funding. Furthermore, we observe that whereas smaller businesses are more reliant on equity funding, larger businesses often have a more diversified capital structure. The study strengthens the body of understanding on capital structure by offering a thorough analysis of the factors that influence capital structure and how they affect the company's financial results.

Keywords: *Capital, organization, statements, loan, equity, financial result.*

I. INTRODUCTION OF THE STUDY

The combination of share capital and other long-term obligations is referred to as capital structure. Although we are aware that each shareholder's liability in the corporation is restricted, it is crucial to consider how big the total liability of each shareholder will be. By selecting the best capital structure, it can be decided. We include equity share capital, preference share capital, debenture, and long-term debt in the capital structure. Consider a financial structure for our company that includes 50% equity share capital, 30% preferred share capital, and 20% debt. However, not all organisations will have the same capital structure because different businesses require different types of capital structures that are suitable for their needs.

It's determined by the ratio of debt to equity. If the corporation chooses to take on more debt, they run the risk of creating a large interest burden, consuming profits, lowering earnings per share, and, most importantly, putting their very survival in jeopardy. On the other hand, a cautious approach may rob the company of its opportunity to increase the rate of return to its equity owners since a large equity component leads in low earnings per share. When deciding between debt and equity, the financial manager should take many aspects into account. The financial manager takes non-financial elements into account in addition to risk return.

Modern economic life includes finance as a crucial component. The choice of financing is crucial. Fundraising for the business is involved. The designing of the capital structure is a concern. The financial decision must be constructed to support the capital structure of the business. From the perspective of how it affects the firm's value, capital structure should be investigated. In order for maximum shareholder wealth, the company should choose the funding mix.

A few businesses aspire to develop their intelligence. They gradually reduce equity share capital and overly raise loans, which may be quite problematic because the firm in question must manage the loan's eventual repayment as well as the fixed cost of interest. The solvency of it might be jeopardized by a mistake. Thus, a company's choice in capital structure is crucial.

There are two basic reasons why a financial crisis might occur in the company. Unexpected reduction in operational profit and the need for more money are the two of them. Failure to pay interest or principle to lenders by the deadline will necessitate corporate liquidations in order to make up the difference. In addition, not using debt deprives the company of the chance to benefit from a higher rate of return for its shareholders.

STATEMENT OF THE PROBLEM

- The report examines Applied Digital Micro Logics India Pvt Ltd.'s capital structure.

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- Funds are required to operate and manage a business. Finance is a crucial component of a company's life from the beginning to the finish. The firm suffers whether funding is sufficient or insufficient. As a result, it's critical to accurately forecast both the present and future capital requirements.
- The capital structure aids in determining the ratio of debt to equity and how it impacts the firm's worth. Maximum market valuation and lowest cost of capital result from capital structure. In order for the business to run smoothly and to best serve the interests of its creditors and investors, it is necessary to keep a good balance between profitability and liquidity. Because of this, it's important for the business to periodically assess its situation with regard to liquidity and profitability.
- As the choice of the debt-to-equity capital mix has grown in importance. I've made the decision to research Applied Digital Micro Logics India Pvt Ltd's capital structure.

OBJECTIVES OF THE STUDY

The reduction of WACC cost is the goal of capital structure analysis.

PRIMARY OBJECTIVES

Applied Digital Micro Logics India Pvt Ltd's capital structure is being analyzed as one of the study's main goals.

SECONDARY OBJECTIVES

- The study is specially aimed to attain the following objectives.
- To assess the capital structure of the company.
- To determine the long-term profitability of the company.
- To assess the change in proportion of debt and equity.
- To offer suitable suggestions for framing

SCOPE OF THE STUDY

The Applied Digital Micro logics India Pvt Ltd. (ADML) has been the sole subject of the study. This study is being undertaken to learn more about how capital structures affect MSME's and their benefits, as well as to get more specific details about the businesses both before and after the analysis. Various MSME unit types have been included, regardless of the nature of their activity. The study assesses the current methods of financial management used by ADML (Applied Digital Micro logics India Pvt Ltd), Coimbatore.

The evaluation of a company's combination of debt and equity funding is known as capital structure analysis. To ascertain the ratios of debt and equity in a company's financial statements, including its balance sheet, income statement, and cash flow statement in its capital structure.

Comparing a company's capital structure to that of its competitors: When examining a company's capital structure, it is possible to compare its debt-to-equity ratio, interest coverage ratio, and other pertinent metrics to those of its competitors in the same industry. In comparison to its rivals, this might serve to highlight any areas where the firm may be over- or under-leveraged.

Evaluating the risks associated with a company's capital structure: Capital structure analysis may also involve assessing the dangers involved with a company's financing options, such as the risk of default, the effects of interest rate changes, and the potential for changes in the company's credit rating.

LIMITATIONS OF THE STUDY

- The analysis mostly relies on secondary data obtained from the annual report and internal corporate records.
- The financial statement's historical data was used for analysis; the time worth of money was not considered.
- The study is limited to a five-year time frame. This would not accurately reflect the company's situation.
- The findings obtained via the use of statistical techniques are predictions rather than actualities. Every business will have its unique circumstances and factors.
- The study's conclusions may only be used as general suggestions and cannot be directly applied to other businesses in the same sector.

II. REVIEW OF LITERATURE

Neely (1999), when referring to the numerous contributions on the topic, talks about the Performance Measurement Revolution. Performance Information, its implementation, and its presentation to the end users, which directly refers to the subject of performance measurement (PM), has gained increasing interest and recognition in the general management literature over the last two decades. He showed that only 3615 publications on performance assessment were published between 1994 and 1996. The financial sector has been paying persistent attention to PM at that time. The agency hypothesis was first proposed by Berle and Means (1932), who contended that a decline in equity ownership causes a widening of the gap between ownership and control of large enterprises. In this specific circumstance,

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managers have a platform to prioritize their personal interests over generating shareholder value. In principle, a company's shareholders are its only owners, and senior management should have the only responsibility of seeing to it that the interests of shareholders are served. In other words, senior managers have a responsibility to run the business in a way that maximizes shareholder returns while also raising profit margins and cash flows (Elliot, 2002). However, managers do not always manage the company to optimize profits to shareholders, according to Jensen and Meckling (1976). They used this justification to build their agency theory, which included the principal-agent dilemma as a crucial element in determining the firm's success.

The interplay between the two debt agency issues, according to Mao X Connie (2003), has not been thoroughly explored. He creates a straightforward model that accounts for both the underinvestment and risk shifting issues. The terminal firm value is a random variable in the model, and its mean and volatility depend on the magnitude of the investment. A business must make a discretionary investment choice. Risk shifting and underinvestment incentives will therefore have a similar or different impact on a leveraged firm's investment choice, and the overall agency cost of debt will depend on how the two incentive issues are traded off.

For this reason, several scholars developed further justifications for this statement and shown how capital structure influences a firm's performance and value. Preventive assumptions did not hold true in the real world. After Jensen and Meckling's (1976) study showed that the amount of leverage in a capital structure caused an agency issue between shareholders and managers, stakeholders began to exert more pressure on managers to behave in their best interests. This led to changes in managers' actions and choices. It signifies the amount of leverage in the capital structure had an impact on the firm's performance and value.

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Additionally, investing in companies with high debt levels carries higher risk because these companies typically have a poor or low rating from rating organizations. It goes without saying that a poor rating would often turn off investors.

According to Modigliani and Miller (1958), issues with capital structure theories and their connections to business performance have been raised in the literature on accounting and corporate finance. It was further stated that under preventative capital market assumptions, capital structure is inappropriate for assessing the performance or worth of a corporation. This objective state that actual assets rather than a combination of the securities the company issues define the worth of the company.

III. RESEARCH METHODOLOGY

The procedure through which we methodically address the research problem is known as the research methodology. It is regarded as a science that studies how scientific research is conducted. The researcher must be knowledgeable about methodology in addition to research methodologies and procedures. Most vocations engage in some form of research. It is a method of evaluating your work. Examining the different facets of your professional job critically is more than just a set of abilities; it is a style of thinking. It is a practise to constantly ask yourself why you do what you do, and to systematically examine the facts you see to get the answers you need to implement the necessary modifications for a more successful professional service.

SOURCES OF DATA

AREA OF STUDY:

The investigation was conducted at CUMI, Chennai's finance division.

DATA COLLECTION

All the data used in the study are secondary.

SECONDARY DATA

Secondary data were gathered using the company's manuals, annual report, and balance sheets.

DATA ANALYSIS TECHNIQUES

In order to analyse the capital structure and dividend policy of the company the following statistical tools are used.

- Leverage analysis
- Cost of capital analysis
- Ratio analysis
- Net income approach

RATIO ANALYSIS

A. DEBT-EQUITY RATIO

A calculation that determines a company's financial leverage by dividing its total liabilities by the value of its stockholders' equity. It reveals the ratio of equity to debt that the business is employing to fund its assets.

$$\text{Price – earnings ratio} = \frac{\text{Market price of share}}{\text{Earnings per share}}$$

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Sometimes all liabilities are not utilised in the computation but merely interest-bearing, long-term debt. This ratio, sometimes called the Personal Debt/Equity Ratio, may be used to analyse both personal and business financial records.

B. GEARING RATIO

The broad phrase used to describe a financial ratio that contrasts some type of capital (or owner's equity) with borrowed money. A measure of financial leverage called gearing shows how much of a company's operations are financed by owner money as opposed to creditor funds.

$$\text{Capital Gearing Ratio} = \frac{\text{Equity share capital (+) reserves and surplus}}{\text{Long term Debt}}$$

C. INTEREST COVERAGE RATIO

A ratio used to gauge a company's ease of paying interest on outstanding debt. By dividing a company's profits before interest and taxes (EBIT) from one period by its interest costs from that same period, the interest coverage ratio is determined.

D. RATIO OF FIXED ASSETS TO FUNDED DEBT

The debt to assets ratio, also known as the debt to asset ratio, is a measure of how much of a company's assets are financed by debt as opposed to equity. A ratio above one implies that a sizeable part of assets is supported with debt, whereas a ratio below one shows that equity accounts for the majority of asset funding.

Lenders may impose limits on alternate uses of funds, restrictive covenants that compel excess cash flow towards debt repayment, or demands that investors contribute more stock to the business as solutions to this issue. Divide total liabilities by total assets to find the debt-to-assets ratio.

C. PRICE-EARNINGS RATIO/EARNING YIELD RATIO

The earnings yield/earnings price ratio and the price earnings ratio are closely connected. Actually, it is the opposite of the latter. This ratio is a summary metric that primarily considers variables including growth prospects, risk profile, shareholders' orientation, company image, and liquidity level.

D. RETURN ON SHARE HOLDER'S INVESTMENT OR NET WORTH

One of the most crucial ratios for gauging a company's overall effectiveness is this one. It demonstrates the connection between the proprietor's money and net earnings (after interest and taxes). For both current and potential shareholders as well as the company's management, this ratio is extremely important.

FINANCIAL LEVERAGE

ar	Earnings before interest and tax (in Thousands)	Profit before tax (in Thousands)	Financial Leverage (times)
2017-2018	492	349	1.41
2018-2019	471	358	1.32
2019-2020	425	309	1.38
2020-2021	529	455	1.16
2021-2022	445	402	1.11

INTERPRETATION:

It demonstrates that the financial leverage was highest in 2017–2018 (1.41 times) and lowest in 2021–2022, (1.11 times). We may infer from this that a low rate of financial leverage corresponds to low interest outflow and, as a result, lesser borrowing.

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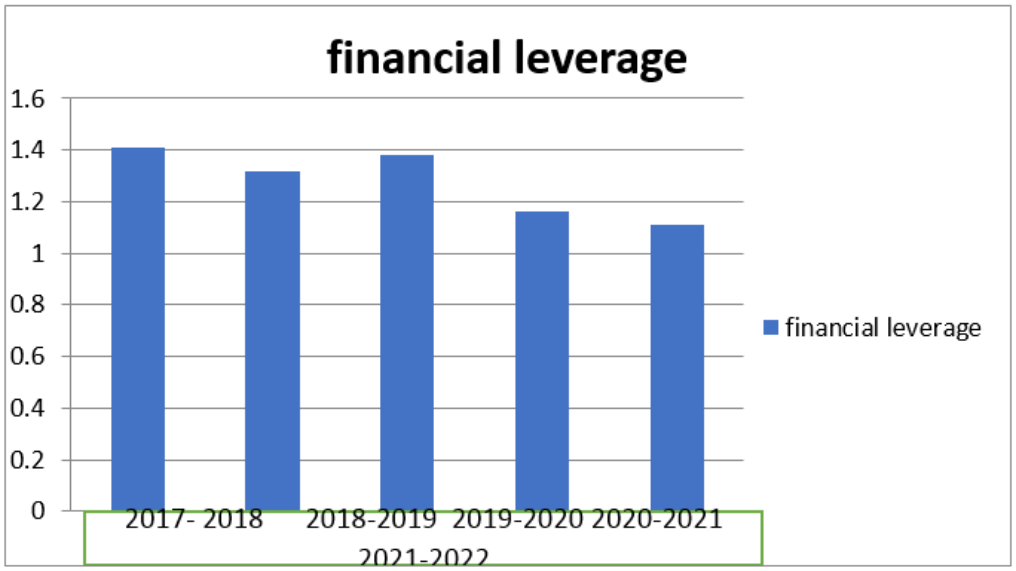
Financial Leverage's Ratio



OPERATING LEVERAGE:

Year	Earnings before interest and tax (in Thousands)	Profit before tax (in Thousands)	Operating Leverage (times)
2017-2018	1376.40	492	2.79
2018-2019	1934.20	471	4.11
2019-2020	1600.00	425	3.77
2020-2021	1480.28	529	2.79
2021-2022	1663.50	445	3.74
AVERAGE			3.44

INTEPRETATION

Operating leverage is shown to have been higher in the years 2018–2019 (4.11 times) and lower in the years 2017–2018 and 2020–2021 (2.79 times). operational leverage is, on average, 3.44 times.

COMBINED LEVERAGE

	Operating leverage	Financial leverage	Combined leverage
2017-2018	7.9	1.41	3.93
2018-2019	4.11	1.32	5.43
2019-2020	3.77	1.38	5.20
2020-2021	2.79	1.16	3.24
2021-2022	3.74	1.11	4.15

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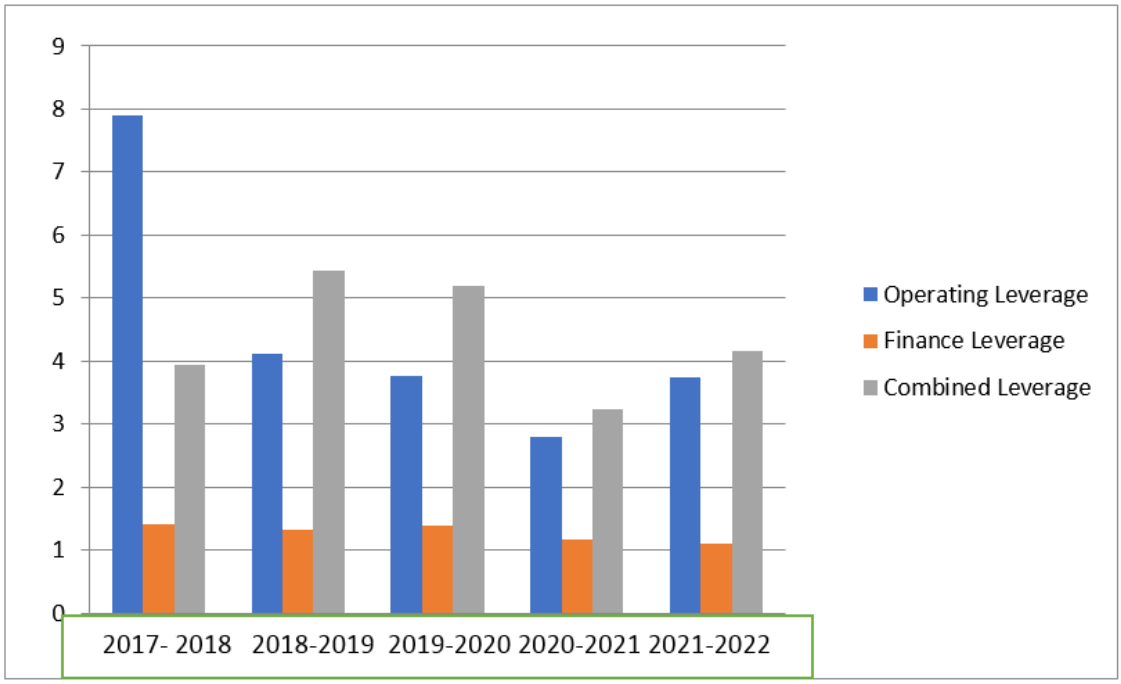
INTERPRETATION

It shows that the combined leverage is high in 2018-2029 with 5.43 times and low in the year 2020-2021 with 3.24 times. Since the total risk is high in 2018-2019 the company can increase its equity to reduce the risk.

Combined Leverage's Ratio



COST OF EQUITY

Year	Dividend per share (%)	Market price per share (rs)	Cost of equity capital (%)
2017-2018	6.0	106	5.66
2018-2019	7.0	90	7.78
2019-2020	7.5	77	9.74
2020-2021	10.0	105	9.52
2021-2022	12.5	172	7.27

INTERPRETATION

The cost of equity capital was high in the years 2019–2020 (9.74%) and low in the years 2017–2018 (5.66%), according to this data. Throughout the years, the market price changed. The Indian economic system's recession was the cause of the market price fall.

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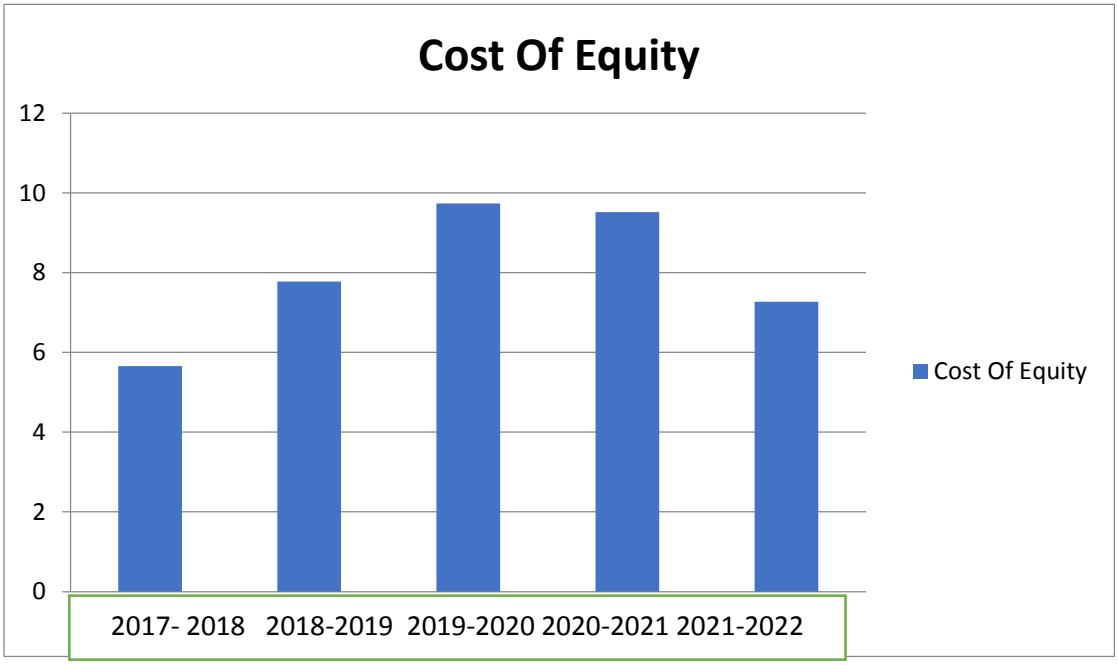
Cost of equity



COST OF DEBT

Year	Interest in (Rs)	Debt in Rs	Cost of Debt
2017-2018	143	780.44	18.32
2018-2019	113	964.66	11.71
2019-2020	116	1012.10	11.46
2020-2021	74	650.69	11.37
2021-2022	43	395.78	10.86

INTERPRETATION

According to this statistic, the cost of equity capital was lowest in the years 2017–2018 (5.66%) and highest in the years 2019–2020 (9.74%). The market price fluctuated over time. The decline in market prices was brought on by the recession in the Indian economic system.

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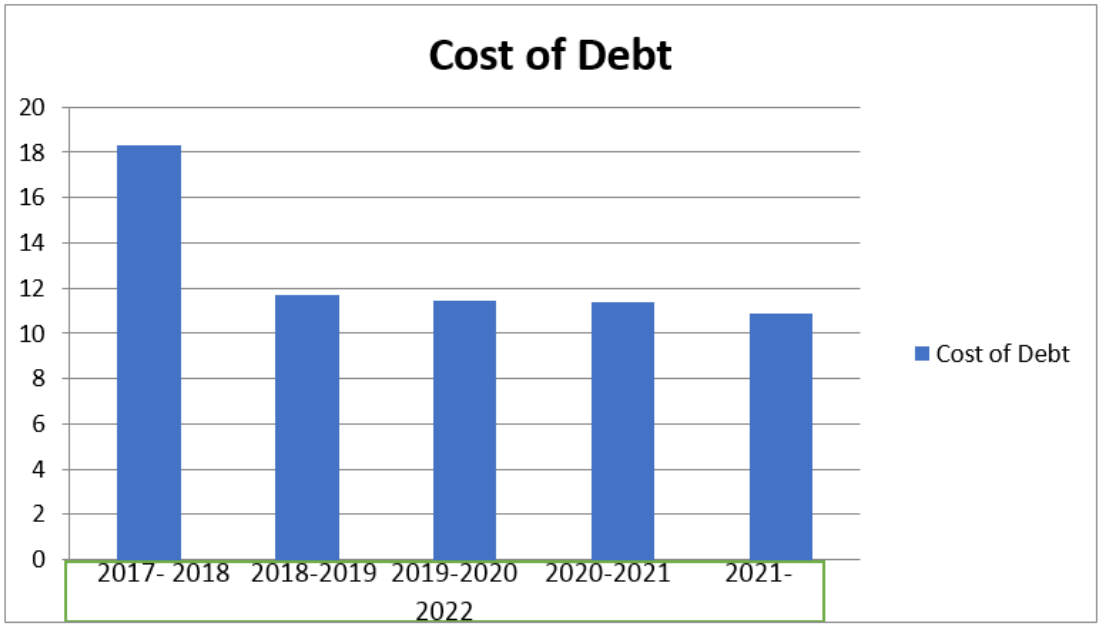
Cost of Debt



IV. FINDINGS

- Financial leverage shows a decreasing trend except in 2019-2020 (Table No.3.1). This indicates that a low rate of financial leverage was due to low interest outflow and consequently lower borrowings.

- The operating leverage has been increased from 2.79 to 3.74 in the five years (Table No.3.2). This indicates that the company had effectively used its variable operating cost.

- The combined leverage shows a decreasing trend except in 2020-2021 (TableNo.3.3). This indicates that the total risk is decreasing year by year.

- The cost of equity was lower in 2017-2018 and was higher in 2019-2020(tableNo.3.4). The market price was very low, so the cost of equity was very high in that particular year.

- The cost of debt has shown a decreasing trend in the five years (Table No.3.5). Due to high rate of interest, cost of debt was higher in 2017-2018 with 18.33.

V. SUGGESTIONS

The company has to maintain the same proportion of debt-equity ratio. In future the company can use equity capital for long-term obligations and debt capital for the short-term obligations as equity capital is best suited for long run and debt capital is best suited for day-today activities. The company must give special attention to increase the earnings per share to safeguard and improve the welfare of its shareholders. The company can reduce operating expenses and financial burdens by reducing the manpower strength. The company should take necessary steps to minimize the cost of capital to earn high return in the future.

VI. CONCLUSION

According to the capital structure and dividend policy of ADML Pvt Ltd. in India, the company's leverage analysis shows that both operating and financial risk are little posed by the business, and operating expenses are used extremely effectively. According to the firm's cost of capital study, the company made efforts to reduce its cost of capital and was successful in doing so. It demonstrates how efficiently they had spent the money. The company's financial performance is likewise strong, and they are sustaining it. Every year, capital structure decisions change. Overall, the capital structure of the business is ideal. The analysis advises the business to generate a larger return in the future.

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