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AN ANALYSIS OF CAPITAL STRUCTURE OF LEADING IT COMPANIES IN INDIA

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Abstract

Capital structure plays a vital role on financial performance of the company. It affects both risk and return of equity owners of corporate enterprises. If a firm issues too much of debt then it is increasing the risk for both equity shareholders and other investors of the company and thereby making its capital structure risky. In contrast to this less use of debt capital reduce the risk of shareholder's but increases cost of capital. Debt is considered to be a cheaper source of finance as it is deductible before tax and the benefit of it could be given to equity shareholders. This paper aims to find out the pattern of capital structure of top leading IT companies in India and their profit margin percentage. For this four companies are selected- Tata Consultancy Service , Wipro Ltd., HCL Technologies, Infosys Limited. Secondary data is collected from the annual reports of the respective companies where ratio analysis is applied on it.

Keyword- Capital Structure, Debt- equity ratio, Financial performance, MM Approach

Introduction

Capital structure plays a vital role on financial performance of the company. It affects both risk and return of equity owners of corporate enterprises. If a firm issues too much of debt then it is increasing the risk for both equity shareholders and other investors of the company and thereby making its capital structure risky. In contrast to this less use of debt capital reduce the risk of shareholder's but increases cost of capital. Debt is considered to be a cheaper source of finance as it is deductible before tax and the benefit of it could be given to equity shareholders. Thus the firm need to maintain a balance between debt and equity so that it could create an optimum capital structure for the company.There has been different theories like Net Income Approach, Net Operating Income Approach, Traditional Approach and MM approach propagating different kind of capital structure with their own specific assumptions, trading off between risk and return. A firm even need to look upon the homogeneous firm's operating in the same industry.

Objective

This paper aims to find out the pattern of capital structure of top leading IT companies in India and their profit margin percentage. For this four companies are selected- Tata Consultancy Service , Wipro Ltd., HCL Technologies, Infosys Limited. It is considered that companies in the same industry follow the same financial pattern. For example if the companies are paying dividend in the industry then a new company entering into the same industry have to follow the same pattern as the investors carry the same rationale before investing into a particular industry.

Research Methodology

Secondary data is collected from the annual reports of the respective companies where ratio analysis is applied on it. After that a comparative analysis is done to study the debt equity ratio and profit margin of the companies.

Review of Literature

The Modigliani-Miller theorem (M&M)1958, states that the market value of a company is correctly calculated as the present value of its future earnings and its underlying assets, and is independent of its capital structure.At its most basic level, the theorem argues that, with certain assumptions in place, it is irrelevant whether a company finances its growth by borrowing, by issuing stock shares, or by reinvesting its profits. Developed in the 1950s, the theory has had a significant impact on corporate finance.

Recent empirical research suggests a growing interest in the financial management practices among businesses in less developed countries and emerging markets (e.g. Booth et al., 2001; Aivazian et al., 2003; Delcoure, 2007).

Ross, 1977, Leland & Pyle, 1977, Myers, 1984, and Myers & Majluf, 1984 explain the effect of financing choice on firm value is due to. They suggest that when there is an information asymmetry between managers or inside owners and outside investors, the choice of, or adjustments to, the financing mix can influence the market's perception of the future stream of cash flows and affect the value of the firm. According to Ross, 1977, managers could use debt financing (beyond that which an "unsuccessful" firm could sustain) to credibly signal their optimism with regard to the firm's prospects.

Myers, Stewart, C. 2001., Research on capital structure attempts to explain how corporations finance real investment, with particular emphasis on the proportions of debt vs. equity financing. There is no universal theory of the debt-equity choice, and no reason to expect one. But three useful conditional theories are reviewed in this paper. The tradeoff theory says that firms seek debt levels that balance the tax advantages of additional debt against the costs of possible financial distress. The pecking order theory says that the firm will borrow, rather than issuing equity, when internal cash flow is not sufficient to fund capital expenditures. Thus, the amount of debt will reflect the firm's cumulative need for external funds. The free cash flow theory says that dangerously high debt levels will increase value, despite the threat of financial distress. Each of these theories "works" for some firms in some circumstances. More general theories will require a deeper understanding of the financial objectives of corporate managers.

Rajagopal S.2011, stated that the received theories of capital structure have traditionally been tested in the context of firms in developed economies. Taking India as a case study, the present study contributes to this body of literature by testing whether the model of capital structure is portable to an emerging market. India suggests itself as a candidate for such a study because it has experienced significant economic liberalization and financial sector reform since the early 1990s. The process of reform in India has certainly not brought its financial system yet to the levels of competition, efficiency and relative transparency found in developed countries, but it is plausible that such reform has fostered optimizing behavior that might be revealed in the pattern of firms' choice of capital structure.

Companies Profile

Tata Consultancy Services (TCS) is an Indian multinational information technology (IT) services and consulting company with its headquarters in Mumbai. It is a part of the Tata Group and operates in 150 locations across 46 countries. In July 2022, it was reported that TCS had over 600,000 employees worldwide. TCS is the second largest Indian company by market capitalization and is among the most valuable IT service brands worldwide. In 2015, TCS was ranked 64th overall in the *Forbes* "World's Most Innovative Companies" ranking, making it one of the highest-ranked IT services companies and a top Indian company. As of 2018, it is ranked eleventh on the Fortune India 500 list.[14] In September 2021, TCS recorded a market capitalization of US$200 billion, making it the first Indian IT tech company to do so. In December 2022, the market cap was Rs. 11,71,481.89 crore.

Wipro Ltd was incorporated in the year 1945 at Karnataka by Azim H Premji who is promoter and chairman of the company. The company started as an edible oil producer and then transformed itself into leading player in Fast Moving Consumer Goods and IT services & Products business. Wipro Ltd is India's one of the leading tech-companies providing IT Services including Business Process Outsourcing (BPO) services globally. The company provides comprehensive IT Solutions and Services including Systems Integration Information Systems Outsourcing IT Enabled Services Package Implementation Software Application development and maintenance and Research and Development Services to corporations globally.

HCL Technologies Limited, formerly Hindustan Computers Limited is an Indian multinational information technology (IT) services and consulting company headquartered in Noida. It emerged as an independent company in 1991 when HCL entered into the software services business.[7] The company has offices in 52 countries and over 210,966 employees. HCL Enterprise was founded in 1976. The first three subsidiaries of parent HCL Enterprise were:HCL Technologies – originally HCL's R&D division. It emerged as a subsidiary in 1991, HCL Infosystems, HCL Healthcare.

Infosys Limited is an Indian multinational information technology company that provides business consulting, information technology and outsourcing services. The company was founded in Pune and is headquartered in Bangalore. Infosys is the second-largest Indian IT company. Infosys was founded by seven engineers in Pune, Maharashtra, India. Its initial capital was $250. It was registered as Infosys Consultants Private Limited on 2 July 1981. In 1983, it relocated to Bangalore, Karnataka.

The company changed its name to Infosys Technologies Private Limited in April 1992 and to Infosys Technologies Limited when it became a public limited company in June 1992. It was renamed Infosys Limited in June 2011.

Table 1.1 (Figures in crores) Tata Consultancy Service

	Mar-22	Mar-21	Mar-20	Mar-19	Mar-18
Equity Share Capital	366	370	375	375	191
TOTAL SHARE CAPITAL	366	370	375	375	191
Reserves and Surplus	76,807.00	74,424.00	73,993.00	78,523.00	75,675.00
TOTAL RESERVES AND SURPLUS	76,807.00	74,424.00	73,993.00	78,523.00	75,675.00
TOTAL SHAREHOLDERS FUNDS	77,173.00	74,794.00	74,368.00	78,898.00	75,866.00
NON-CURRENT LIABILITIES					
Long Term Borrowings	0	0	0	0	39
Deferred Tax Liabilities [Net]	129	365	347	339	424

Other Long Term Liabilities	6,060.00	5,697.00	6,234.00	1,367.00	643
Long Term Provisions	0	0	0	0	26
TOTAL NON-CURRENT LIABILITIES	6,189.00	6,062.00	6,581.00	1,706.00	1,132.00
Ratio Analysis					
Total Debt/Equity (X)	0	0	0	0	0
Return on Capital Employed (%)	60.23	52.75	52.79	50.71	41.5
Net Profit Margin (%)	23.81	22.77	25.33	24.4	25.92

Table 1.2 (Figures in crores) Infosys

	Mar-22	Mar-21	Mar-20	Mar-19	Mar-18
Equity Share Capital	2,103.00	2,130.00	2,129.00	2,178.00	1,092.00
TOTAL SHARE CAPITAL	2,103.00	2,130.00	2,129.00	2,178.00	1,092.00
Reserves and Surplus	66,597.00	69,029.00	59,808.00	60,533.00	62,410.00
TOTAL RESERVES AND SURPLUS	66,597.00	69,029.00	59,808.00	60,533.00	62,410.00
TOTAL SHAREHOLDERS FUNDS	69,306.00	71,531.00	62,234.00	62,711.00	63,502.00
NON-CURRENT LIABILITIES					
Long Term Borrowings	0	0	0	0	0
Deferred Tax Liabilities [Net]	841	511	556	541	505
Other Long Term Liabilities	4,264.00	4,275.00	3,031.00	248	208
Long Term Provisions	0	0	0	0	0
TOTAL NON-CURRENT LIABILITIES	5,105.00	4,786.00	3,587.00	789	713
Total Debt/Equity (X)	0	0	0	0	0
Return on Capital Employed (%)	38.46	32.23	31.28	31.38	31
Net Profit Margin (%)	20.43	21	19.66	20.11	26.08

Table 1.3 (Figures in crores) Wipro

	Mar-22	Mar-21	Mar-20	Mar-19	Mar-18
Equity Share Capital	1,096.40	1,095.80	1,142.70	1,206.80	904.8
TOTAL SHARE CAPITAL	1,096.40	1,095.80	1,142.70	1,206.80	904.8
Reserves and Surplus	53,254.30	44,145.80	45,311.00	48,185.20	41,357.80
TOTAL RESERVES AND SURPLUS	53,254.30	44,145.80	45,311.00	48,185.20	41,357.80
TOTAL SHAREHOLDERS FUNDS	54,350.70	45,241.60	46,453.70	49,392.00	42,262.60
NON-CURRENT LIABILITIES					
Long Term Borrowings	5.7	14.1	25.1	22	72.4
Deferred Tax Liabilities [Net]	0	130.5	0	10.4	46.3
Other Long Term Liabilities	2,788.60	2,129.20	2,170.50	1,309.50	1,085.30
Long Term Provisions	64.1	88.5	213.3	119.6	168.8
TOTAL NON-CURRENT LIABILITIES	2,858.40	2,362.30	2,408.90	1,461.50	1,372.80
Ratio Analysis					
Total Debt/Equity (X)	0.14	0.13	0.11	0.1	0.11
Return on Capital Employed (%)	27.32	27.49	23.62	20.44	23.87
Net Profit Margin (%)	20.36	20	17.22	15.82	17.27

Table 1.4 (Figures in crores) HCL Technologies Ltd.

	Mar-22	Mar-21	Mar-20	Mar-19	Mar-18
Equity Share Capital	543	543	543	271	278
TOTAL SHARE CAPITAL	543	543	543	271	278
Reserves and Surplus	42,048.00	43,010.00	36,753.00	30,168.00	27,285.00
TOTAL RESERVES AND	42,048.00	43,010.00	36,753.00	30,168.00	27,285.00

SURPLUS					
TOTAL SHAREHOLDERS FUNDS	42,591.00	43,553.00	37,296.00	30,439.00	27,563.00
NON-CURRENT LIABILITIES					
Long Term Borrowings	164	207	160	32	33
Deferred Tax Liabilities [Net]	0	0	0	0	0
Other Long Term Liabilities	667	716	1,343.00	53	58
Long Term Provisions	958	866	775	553	471
TOTAL NON-CURRENT LIABILITIES	1,789.00	1,789.00	2,278.00	638	562
Ratio Analysis					
Total Debt/Equity (X)	0.01	0	0	0	0
Return on Capital Employed (%)	30.14	27.76	28.84	32	32.52
Net Profit Margin (%)	26.75	24.5	27.5	31.46	33.35

Analysis

By studying Table 1.1 for Tata Consultancy Service it could be found that there is an increasing trend in issuing equity capital. TCS show an increase of 91 % in equity capital. In march 2018 it was 191 cr. and in the year March 2022 it was 366 cr.. long term borrowing is 0 whereas it relies on other long term loan. Net profit margin% ranges between 20 to 25% and it tries to maintain a steady rate of return.

In contrast to this Infosys is having 4 times equity share capital as compared to TCS. Table 1.2 shows there is a 50% increase of total capital from year 2018 to 2022. It is also not dependent on long term borrowings due to which its debt/equity ratio is 0 for all the consecutive five years. There is decrease in Net profit margin% from 26% to 20.43% in March, 2022.

Table 1.3 shows the financial statement for Wipro where they have maintained a constant equity capital for a period of 5 years. There is a small increase from 904.8 cr to1096.4 cr from 2018 to 2022. Company has continuously decreased its long term borrowings from 72.4 cr. to 5.7 cr.. Wipro is continuously maintaining it Debt/ Equity ratio of 0.11 and there is small change of 0.14 in the ratio in year 2022. Wipro tries to increase net profit margin% from 17.27% to 20.36%.

As TCS , HCL Technologies is also maintaining a low level of equity capital in comparison to other companies. In March, 2018 it was 278 cr. and in March, 2022 it is 543 cr. There is an increase in long term borrowing for all the consecutive years from Rs.33 cr. to 164 cr.. There is a debt- equity ratio of 0.01 in the year March,2022. There is a decrease in Net profit margin% from 33 % to 26.75% from the year 2018 to 2022.

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