Capital Structure Analysis of Oil Industry – An Empirical Study of HPCL, LOCL & BPCL (INDIA)

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Introduction:-

Capital structure is the combination of debt and equity that are used to finance companies asset. It is defined as the amount of permanent short – term debt preferred stock and common equity used t finance a firm. Financial structure is sometimes used as synonym with the capital structure. However, financial structure is more comprehensive in the sense that it refers to the aggregate amount of total current liabilities. Long – term debt preferred stock and common equity used to finance a firm. Therefore, capital structure is only the part of financial structure, which refers mainly to the pursuant study, considers the source, which do not explicitly fall under the definition of capital structure.

Decision on capital structures formulation or long term financing is influenced by multiple factors. Much of the focus, as the research on the subject pertains to the target capital structure, which the firm believes in the best in terms of the financial goals. Financial economics has made a significant progress in planning the incentives that make companies choose particular financing policies. In the last two decades, a numbers of choices have been proposed to explain the variations in the debt – equity ratio among firms. Increasingly the profession is moving beyond an examination of the basic leverage choice to the more detailed aspects of financing decision.

The term capital structure is used to represent the proportionate relationship between debt and equity. Equity includes paid – up share capital, share premium, reserve & surplus (retained earnings). Debt includes debentures and long- term loans. The estimation of capital requirements for current and future needs is important in the determining of the capital mix. Equity and debt are the two principal sources of finance for a business. "The financing decision have two components. First, to decide how much total finds are needed and second, to decide the source or their combinations to raise such finds. The total quantity of finds needed, however, depends upon the investment decision of the firm. Given that the firm has good estimates of how much capital funds are determining the best mix of different sources to be used in raising the required funds. The process that leads to the final choice of the capital structures referred as the capital structure planning."

Justification of the study:-

The financing of a capital structures decision is a efficient managerial decision. The company will initially have to plan its capital structure at the time of its promotions. Subsequent, who never funds have to be raised to finance investment, a capital structure decision is involved. "In order to rum and manage a company, funds are needed right from promotional stage up to the end. Finance plays an important role in a company's life. If funds are inadequate, the business suffers and if the funds are not properly managed, the entire organization suffers. It is therefore, necessary that a correct estimate of the current and future need of capital be made to have an optimum capital structure, which will help an organization to run its work smoothly and without any stress."

Estimation of capital requirement is necessary. Also the formation of a capital structure is important according to Gerestenbeg "Capital structure of a company refers to the composition are make –up of its capitalization and its Includes all long term capital resource such as, loans reserves, shares and bonds." The capital structure and refers to the permanent financing of a firm. It is composed of long – term debt, preference share capital and shareholders finds. Keeping this background in view, an attempt has been made by the researchers to evaluate the capital structure' of HPCL LOCL & BPCL, which are leading oil refinery distributors is the public sector in India.

1. **About the Companies :**

HINDUSTAN PETROLEUM CORPORATION LIMTED:

HPCL is one of the leading petrochemical components in India. HCCL has two refineries, one west coast in Mumbai with a capacity of 7.36 million metric toners per annual, while another is at Vishakha Pattanam on the east lost has a capacity of 9.41 million metric toners per annuals. The monitoring operations of HPCL are divided in three strategic business units retains, direct sales, comprising lubes and industrial and government sales. HPCL has a 31% market share of the lubricants in the country. The HPCL engine oil product range covers 300 brands of lubricants, greases, and other product which are related with various engines HPCL invested various subsidiaries and joint venture namely Guru Gobind Singh Refineries Ltd. Limited, private Ltd, prize petroleum company limited.

Indian Oil Corporation limited:- Beginning in 1959 as Indian oil company Ltd, Indian oil corporation Limited was formed in 1964, with the merger of Indian Refineries Ltd. (EST. in 1958) As India flagship national oil company, Indian oil accounts for 56% petroleum product market share among PSU companies, 42% national refining capacity and 69% downstream pipelines throughput capacity. Indian oil is the country target commercial enterprise, with a sales turnover of E2 2,47,547 Crore and profits of Rs 4329 Crore for financial year 2007- 08. Indian oil is Indian's No. I company in fortune prestigious history of the world 500 largest corporation ranked 189 for the year 2008 based on fiscal 2007 performance. It is also the 19th petroleum company in the world. India oil also been adjudged No.1 in petroleum trading among the national oil companies in the Asia – Pacific region, and is ranked 327th in the current forbs," Global 500" listing of the largest public companies.

BHART PETROLEUM CORPORATION LIMITED

BPCL traces its history to 1928 when the Burma shell oil storage as Distibutution Company of India was incorporated in England to enter the petroleum products business in India. Today, Bharat petroleum company is down stress oil refinery and marketing company with present revenue of Rs 1,13,936 Crore. This company is India largest recurred oil company in terms of market share. Bharat Petroleum network is spread all over India, from LPG and kerosene for domestic conjunction, to feedstock and feels for industrial applications , BPCL has 1205 LPG distributers catering to 8.03 million consumers LPG infrastructure includes 28 LPH bottling plants with a total capacity of 1032 TMTPA. BPCL was the first on the industry to awarded ISO 9002 accreditation. For an LPG bottling plant, 21 plants have been already received IAO 9002 certification.

2. Objectives of study:

This research study fulfils the following objective.

- To study the capital structure position of HPCL, LOCL and BPLL public sector companies.
- To examine the performance of debt and equity among these sample companies.
- To give suggestions for improvements of the capital structural position of sample companies.

Hypothesis of study: In this research paper we have takes the hypothesis that there is no significance difference of mean of debt and equity of HPCL, LICL and BOLC respectively.

3. Limitations of the study:

- This study is based on an analysis of the financial statement foe five financial year i.e 1998 – 99 to 2007 – 08 of HPCL, LOCL, BPCL.
- For the analysis of capital structure, only secondary data which are derived from the annual reports has been taken in this study.

4. Data and Research Methodology:

To analyze the capital structure of HPCL, IOCL, BPLL secondary collected from the annual report of the company, were used along with other published material of the companies, for the analysis of the ratios of capital structure, common size statement and trend analysis as mean growth rate and co- efficient of variations are also used in relevant areas. To make calculation much easier and logical, the data are approximated in the relevant place. For the analysis of capital structure of HPCL, the following ratio related to capital structure are used.

- Debt equity ratio
- Proprietary ratio
- Solvency Ratio
- Fixed
- Interest coverage ratio
- Financial leverage Ratio

5. Appraisal of capital structure:

The capital structure of a company consists of debt and equity securities, which provide finance for a firm. An optimum capital structure is one that maximizes the market valuation of the firms security in order to minimize the cost of its capital.

6. **Findings which detailed discussion :**

- **Debt Equity Ratio (DER):** The debt – equity ratio is calculated to measure the extent to which debt financing has been used in a business. The purpose is to get an idea of the cash available to outsiders on the liquidation of the firm, However, the capital structure analysis of the oil industry owners want to carry on their business with a maximum of outsider funds in order to reduce their risk of their investment and to increase their earning per share by paying a lower rate of interest to outsiders in case of HPCL, ratio are under debt are 50% of the equity. But in case of IBCL, overall coverage is 1.04. Lowest ratio is 0.53 in that shows their debts are equal to or more than equal to the equity.

- **Proprietary Ratio**: This ratio establish the relationship between share holders funds and the total assets of the firm, from the capital structure point of view, this ratio indicates the extent to which the assets of the company can be lost without affecting the interest of the creditors of the company in case of proprietary ratio HPCL, in HPCL ration is always between 0.40 to 0.50 with overall 0.44 while in LOCL it is between 0.41 to 0.55 with overall average of 0.48 while on BPCL it is an average 0.32 that shows shareholders are lower as average 0.32 that show shareholders are lower as compare to assets.

- **Solvency Ratio:** This ratio indicates the relationship between the total liberties of outsiders to total assets of a firm. Generally, the lower the ratio of total liabilities to total assets, the morel satisfactory of stable is the long term slavery position of a firm. In case of HPCL their solvency ratio is always between 0.95 to 0.61 with an overall average of 0.56 which shows better solvency position, while in IOCL average its 0.52 its better for HOCL. But in case of BPCL. It is always between 0.60 to 0.72 with overall average of 0.68 that shows their solvency position is weak as compare to other firms.

- **Fixed Assets Ratio:-** The ratio establish the relationship between fixed assets and shareholders fund. If the ratio is less than 100% it implies that owner's funds are more than total assets and the share- holder provide a part of the working capital. In the

case of HPLL their net worth is always more than the fixed asset except in the year 2001-2002. In case of IOCL net worth is lower than fixed assets that means they are always financed through outsider's funds and their overall average of 1.34 that shows their fixed assets are financed through outsider's funds also.

- **Interest Coverage Ratio:-** This ratio is calculated by dividing the net profit before interest and tax by fixed interest charges. It indicates the interest-paying capacity of a firm. In the case of HPCL, overage is 9.52 times that shows their sound capacity but in case of IOCL, their ratio increases regularly but laver and overall average is 5.20 times while in case of BPCL their interest coverage will decline from 6.52 to 5.12 time with over all average of 5.69 times but still it is very satisfactory.

- **Capital Gearing Ratio:-** The term capital gearing is used to describe the relationship between equity share capital, including reserve and surpluses, and preference share capital and other fixed interest bearing loans. If preference share capital and other fixed interest – bearing loans exceed the equity share capital including reserves the firm is said to be highly geared, In case of HPCL capital gearing position is almost near about the 2.00 with overall average of 2.24 times. On the other hand in case of IOCL overall average is 1.00 that means equity and loans both are same during the study period, while in BPCL it is always more than one with overall average of 1.24 times that means BPC is also lower geared company.

- **Financial Leverage:-** The term financial leverage refers to the use of fixed charge, such as debenture and the use of variable charges or severities, such as equity shares, in the financial structure and total assets of the firm. So, the financial leverage refers to the presence of a fixed charge in the income statement of the firms This fixed charge is fixed in amount and does not very with the changes in the EBIT, where, as the return available to the equity share – holders, which is residual balance, is affected by the changes in EDIT. This ratio has been increasing since 1999 to 2001 then after it has decreased upto 2002-03, IOCL having more financial cost. The financial cost has increase in the year 2001-04 and reaching years it is continuously decreasing. While the position of BPCL, also showed financial cost and it has been continuously increasing upto 2003 except the year of 2001 and 2002.

7. **Analysis of capital structure of oil companies:-** Capital structure of HPCL, IOCL and BPCL consist three main components they are equity share, Reserve funds and secured loans including debentures.

HPCL:- The position of share capital in total capitalization shows that constant increasing trued till 2003 then after proportion of equity share capital has been continuously decreases up 1.24% in the year 2008. The position of loan capital also shows decreasing treads except in the year of 2003 buy after contribution of loan capital is increasing upto 61.38 in the year 2008.

IOCL:- In case of IOCL main components of capital structure are same as HPCL, equity share contributed approx. 2% to 3% of the total capitalization in each year. Contribution of reserves funds are between 45-50 percent, and loan capital is also between 45% to 50% of total capitalization but in the last fine year proportion of loan capital always less than 50% of the total capitalization

BPCL:- In BPCL contribution of equity share is varying between 3.20 to 1.35% in total capitalization especially in the last five years it is regularly upto 1.35% contribution of resaves funds are regularly decreasing from 61% to 42.38% between 1999-2008. Contribution of loan capital is regularly increasing from 35.55% to 56.27% which is major changes in their capital structure.

Findings:- after the analysis of capital structure of oil Industries especially BPCL, HPCL, and IOCL. It was revealed that all these companies are doing their businesses on trading on equity. The capital structure pattern of oil companies are share capital, reserves funds and loans. In the study period it was revealed that capital structure of HPCL have share capital constant but reserves funds is decreasing since 1998-99 to 2001-02 and then afterward it started decreasing and unsecured loan has been increasing upto 2001-02 then it started increasing. The capital structure position of BPCL show constant share capital during the study period, the reserves had been continuingly increasing upto 2002-03 but secured loan and unsecured loan has been decreasing. The position of HPCL, IOCL and BPCL indicate that rate of return are greater that cost of capital (R>K) in this situation company enjoys through implementing of more and more debt capital in there business. The overall position of financial leverage is satisfactory amarg these companies but BPCL have used debt capital is very systematic and technical manner as a result of it, debt capital has

increased continuity and also there reserve funds has been increasing in their faster rate as comparison to IOCL and HPCL.

Suggestions:- In present situation whenever these companies have required capital in their business. It is better for these companies they should manage their capital by debt capital rather that share capital, because all of three companies i.e. HPCL, IOCL and BPCL having high rate of earnings and reserves as compared to rate of interest i.e. (R>K) which will leads maximize the value of the shares holders or firm.

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