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Trend Analysis Of Capital Structure In Indian Two Wheeler Automobile Companies

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Abstract:

In recent years, the contribution of the automobile sector is increasing and it is playing important role in the national economy. The main purpose of the research was to analyze the automotive industry and its trend in India. Many factors contributing to the automotive sector like government regulations, road conditions, purchasing power of the people, lack of skilled manpower and shortage of capital etc…

To address these issues secondary data has been used and analyzed the collected data for the result which is summarized into positive and negative aspects. The findings of the study reveal that the ratios of Bajaj Auto Ltd are better than that of Hero Honda Motors Ltd. The capital structure of both the companies shows that they have reached 'Saturation Point in the segment'. On the whole, it may be concluded that the capital structure (looking to their position) of both the selected companies are satisfactory, Bajaj Auto Ltd is more consistent in its performance than that of Hero Honda Motors Ltd.

Introduction:

The automotive Industry in India is now working in terms of the dynamics of an open market. Many joint ventures have been set up in India with foreign collaboration, both technical and financial with leading global manufacturers. Also a very large number of joint ventures have been set up in the auto-components sector and the pace is expected to pick up even further. The Government of India is keen to provide a suitable economic, and business environment conducive to the success of the established and prospective foreign partnership ventures. $5.7 billion is the investment envisaged in the new vehicles projects.

India is the second largest producer and manufacturer of two-wheelers in the world. It stands next only to Japan and China in terms of the number of two-wheelers produced and domestic sales respectively. Indian two-wheeler industry has got spectacular growth in the last few years. Indian two-wheeler industry had a small beginning in the early 50's. The Automobile Products of India (API) started manufacturing scooters in the country. The industry had a smooth ride in the

50s, 60s and 70s when the Government prohibited new entries and strictly controlled capacity expansion. The industry saw a sudden growth in the 80s. The industry witnessed a steady growth of 14% leading to a peak volume of 1.9mn vehicles in 1990.

In 1990, the entire automobile industry saw a drastic fall in demand. This resulted in a decline of 15% in 1991 and 8% in 1992, resulting in a production loss of 0.4mn vehicles. Barring Hero Honda, all the major producers suffered from recession in Financial Year 93 and 94. Hero Honda showed a marginal decline in 1992. The reasons for recession in the sector were the incessant rise in fuel prices, high input costs and reduced purchasing power due to significant rise in general price level and credit crunch in consumer financing. Factors like increased production in 1992, due to new entrants coupled with the recession in the industry resulted in company either reporting losses or a fall in profits.

Objectives Of The Study:

The main objective of study is to examine the development of the Indian automotive industry and its contribution to overall economy in general.

The specific objectives are:

1) To evaluate the impediments faced by the sector from achieving its peak in growth.
2) To scrutinize the overall performance and contribution of automobile industry.
3) To assess the prospect of the automotive industry in the near future.
4) To recommend measures to be taken for accelerating the growth of the sector.
5) To know the impact of recent capital structure on company's profitability, liquidity and solvency.
6) To know about the different ratios and its impact.

Period Of The Study:

The Period covered for the analysis is from 1999-2000 to 2009-2010.

Key Players In The Two-Wheeler Industry:

There are many two-wheeler manufacturers in India. Major players in the 2-wheeler industry are Hero Honda Motors Ltd (HHML), Bajaj Auto Ltd (Bajaj Auto) and TVS Motor Company Ltd (TVS).

The other key players in the two-wheeler industry are Kinetic Motor Company Ltd (KMCL), Kinetic Engineering Ltd (KEL), LML Ltd (LML), Yamaha Motors India Ltd (Yamaha), Majestic Auto Ltd (Majestic Auto), Royal Enfield Ltd (REL) and Honda Motorcycle & Scooter India (P) Ltd (HMSI).

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Profile Of Hero Honda Motors Ltd:

The joint venture between India's Hero Group and Honda Motor Company, Japan has not only created the world's single largest two wheeler company but also one of the most successful joint ventures worldwide.

During the 80s, Hero Honda became the first company in India to prove that it was possible to drive a vehicle without polluting the roads. The company introduced new generation motorcycles that set industry benchmarks for fuel thrift and low emission. Hero Honda has consistently grown at double digits since inception; and today, every second motorcycle sold in the country is a Hero Honda. Hero Honda's mission is to strive for synergy between technology, systems and human resources, to produce products and services that meet the quality, performance and price aspirations of its customers. At the same time maintain the highest standards of ethics and social responsibilities. This mission is what drives Hero Honda to new heights in excellence and helps the organization forge a unique and mutually beneficial relationship with all its stake holders.

Profile Of Bajaj Auto Ltd :

Bajaj Auto Ltd. (BAL) is one of the oldest and the largest manufacturer of automobiles in India and has been the market leader in scooters. In 1990s, the near monopolistic market structure, perhaps, lulled the company into being complacent and they gave way to the competitors like Hero Honda and TVS. Bajaj Auto is the flagship of the Bajaj Group of Companies. Bajaj is currently India's largest two- and three-wheeler manufacturer and one of the biggest in the world. Bajaj has long left behind its annual turnover of Rs. 72 million (1968), to currently register an impressive figure of Rs. 81.06 billion. BAL has significant presence in all the three basic segments - Price Segment, Value Segment and Performance Segment - and has been showing increased sales in all the segments over years.

Besides this, BAL is a market leader in two-wheeler exports and it consists a great chunk of there overall revenues. Currently, BAL is selling over 1 lac motorcycles annually in Sri Lanka, further, they are commanding 50% market share in Central America. Hero Honda and TVS Suzuki tied up with foreign majors to bring in the latest in terms of aesthetics and technology, and Bajaj failed to gauge the changing tastes of consumers. In 1990s, there was a marked shift in customer preference from scooters to motorcycles. Bajaj found itself at a loss here, as this was largely an unchartered territory. The demand shift from scooters to motorcycles in the 1990s was without parallel in any comparable product category in India. This was mainly attributed to the change in customers' preference towards fuel-efficient and aesthetically appealing models, which scooter manufacturers failed to provide. The delayed launch of new, advanced scooter models, fear of four-stroke scooters being prone to increased skidding risks and vibrations, and the difficulty of maintenance also contributed to this shift.

Trend Analysis Of Financial Statements:

Trend analysis, also known as index of financial statements analysis, is a simplified form of horizontal analysis, trend only calculates the percentage increase or decrease the absolute amount is not listed in columns. Trend analysis is by observing the successive phases of the accounting

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statements, comparing the amount of the related projects, analyze changes in some indicators of change, on this basis, determine trends, which may occur in the future to anticipate the results of an analytical method. The use of trend analysis, report users can learn the basic trend of changes in the project to determine whether or not this favorable trend of change, and to predict the future development of enterprises.

Two-Wheeler Automobile Industry

Two-wheeler sale of Indian players is dominated by the domestic market and, within it, by motorcycles. After growing at a sharp clip from the late 1990s, motorcycle sales witnessed a 7.8% drop in volume in 2007-08, due to falling domestic demand as a result of rising interest rates and many private sector banks reducing their retail lending exposures. 2008-09 saw a modest increase in motorcycle sales of 4%, driven largely by growth in cash sales. Even so, sales of motorcycles (both domestic and exports) in 2008-09 has been lower than what it was in 2006-07, before the slowdown hit this sector.

The major players in the industry are given in the table which contains the market capitalization, sales turnover, net profit and total assets. Hero Honda is the market leader in the industry and Bajaj is the main competitor to Hero Honda. Hero Honda has a market share of around 57% and Bajaj has a market share of 28%. Other companies taken together have the remaining 15% market share. Other major players in the industry are TVS & Maharashtra scooter.

Companies	Market Cap. (Rs. cr.)	Sales Turnover	Net Profit	Total Assets
Hero Honda	32167.66	12319.12	1281.76	3879.24
Bajaj Auto	17860.46	8932.26	656.48	3439.69
TVS Motor	1225.72	3736.67	31.08	1719.11
Mah Scooters	182.91	2.7	10.87	199.46
Kinetic Motor	45.2	141.38	-114.82	-5.18

(Source: www.moneycontrol.com)

Ratio	Hero Honda	Bajaj Auto	TVS Motor	Mah Scooters	Industry Average
Debt Equity Ratio	**0.0206512**	0.930983	1.227948	0	**0.475817**
Proprietary Ratio	**0.9797667**	0.517871	0.448844	1.00005	**0.748819**
Net Profit	**10.405**	7.35	0.831757	402.5926	**8.877**

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ROI	**33.041524**	20.15975	1.890764	5.449714	**12.80473**
Earning per share	**64.184276**	45.36835	1.308632	0.951006	**23.33849**
Dividend pay out ratio	**31.16028**	48.49196	53.49099	578.2889	**50.99147**
Long Term Debt To Total Capital Ratio	**0.0202333**	0.482129	0.551156	0	**0.251181**
Return on Net Worth	**0.3372387**	0.389281	0.042125	0.054494	**0.195867**

Comparison With The Industry Average:

To compare the ratios of the firm with that of the industry, we have to find the industry average. For that purpose, the market leaders of the industry are taken and the median of their ratios is taken as the industry average. The median has been chosen here as average because the average, otherwise, will be affected by the extreme figures giving unfair view of the industry averages.

In the above ratios, we see that Hero Honda is quite below the industry average in the debt-equity ratio and the long term debt to total capital ratio. This is because it is having very small amount of loan in its capital. This is a good sign for the company because company need not bother about paying fixed interests to the lenders and debenture holders. Considering the profitability ratios like the net profit ratio, ROI, EPS and return on net worth, Hero Honda is quite above the industry average and that shows that the company is doing well in the market earning handsome amount of profits. Only thing in which Hero Honda is lacking is the Dividend Payout ratio because it is below the industry average. That shows the company is not paying dividend according to the profits it is making in the market. It is distributing only 31.16% of the earnings per share as dividend.

Suggestions:

Hero Honda can issue debentures and raise some loans in order to increase the earnings per share and to save tax also by paying interest rather than paying taxes and then paying dividends. When the company is making good profits it should go for the loan raising. This is called as *Trading on Equity*. As the firm will earn more profits on the new loan capital the earnings per share will increase and with that the share prices of the company will also increase in the market.

TREND ANALYSIS AND COMPARISON WITH THE COMPETITOR:

Trend analysis tells us how the company's balance sheet and profit and loss account. We can identify whether the financial position is improving or deteriorating with time through trend analysis. Taking the year 2005 as base, we can find out the later figures in the percentage of the base year's figure.

When we plot them all on graphs, we observe the following things:

- ✓ Equity share capital of Hero Honda is the same through out the period but Bajaj goes for further issue of capital.

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- ✓ The reserves and surplus of Bajaj increases very rapidly over the years but the growth rate declines during 08-09. Whereas for Hero Honda the growth is constant but lower than Hero Honda.
- ✓ Net assets for Bajaj increases very rapidly because of the capital issue by the firm. But Hero Honda does not increase in terms of its assets significantly.
- ✓ Similarly in case of working capital and investments, Bajaj makes some rapid moves and significant changes occur in the company but Hero Honda does nothing noticeable in this regard.

Overall, the capital structure and investments of Hero Honda changes at a very small rate except in reserves and surplus but Bajaj changes its capital structure significantly.
In profit and loss account items:

- ✓ Bajaj is way ahead in terms of operating income and PBDIT growth as compared to Hero Honda.
- ✓ Cost of sales for Hero Honda increases much significantly but for Bajaj it turns out to more than 600%.
- ✓ In terms of profits before and after tax Hero Honda makes some good increases especially over the last 2 years. But Bajaj declines in the year 2008, though it picks up growth again in the year 2009.

Trend analysis only tells us about the growth made over a period. But it doesn't give us the fair picture of the comparison of the two companies. It does not compare the actual figures of the two companies. As far as growth is concerned Bajaj is growing very rapidly and it is a point of concern for Hero Honda.

ANALYSIS OF HERO HONDA:

There is 27% increase in the reserves and surplus of the company. Hero Honda has paid its loan and has reduced its debt by 40%. Net block of assets has increased by 36%. Company has written off all its pending allocations and has also increased its investments by 31%.
Company has increased its sales by 19% and there is significant increase in the profits of the company b y almost 29%. This is a good sign for the company. Over past one year the changes in the figures of profits and reserves and surplus shows a good sign for the future expansions of the company.

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Ratio Analysis And Comparison With Bajaj:

	Hero Honda	Bajaj
Liquidity Ratios		
Current Ratio	0.49	0.95
Quick Ratio	0.33	0.81
Capital Structure Ratio		
Debt Equity Ratio	0.02	0.93
Long Term Debt To Total Capital Ratio	0.02	0.48
Proprietary Ratio	0.98	0.52
Interest Coverage Ratio	57.23	46.60
Profitability Ratio		
Net Profit	10.40	7.35
Gross Profit	29.04	23.39
Cost Of Good Sold	70.96	76.61
Operating Ratio	86.12	90.30
ROI	33.04	20.16
ROCE	49.80	30.78
RO Net worth	0.34	0.39
Earning per share	64.18	45.37
Dividend pay out ratio	31.16	48.49
Turnover Ratios		
Stock Turnover	27.15	18.78
Fixed Asset Turnover	6.40	4.64
Capital Turnover	2.40	2.03

1. Current Ratio: This ratio is also known as working capital ratio. It shows the relationship between current assets and current liabilities. It is a measure of general liquidity and is most widely used to make the analysis of a short-term financial position or liquidity of a firm. The ideal ratio is 2. But in this case the ratios are pretty low. And for Hero Honda it is not a good ratio which is even lower than Bajaj.
2. Quick Ratio: It is also known as acid test ratio or liquid ratio. The term 'liquidity' refers to the ability of a firm to pay its short-term obligations as and when they become due. The ideal ratio is 1.

Interpretation: Bajaj has a comparatively better short term liquidity position as compared to Hero Honda. This is clear through its ratios. Bajaj has a quick ratio of 0.81 which is very close to the ideal ratio but in case of Hero Honda it is very low.

3. Capital Structure Ratios: The debt-equity ratio is calculated to measure the extent to which debt financing has been used in a business. It has an important implication from the view point of the creditors, owners and the firm itself. A high ratio shows large share of financing by the creditors of the firm, a low ratio implies a smaller claim. For a high ratio the creditor's risk is high as owner's funds are less in assets and they may behave irresponsibly. Moreover, a high ratio is also not good for the firm as the creditors will interfere in the activities of the business and more interest has to be paid.

   Here in this case, Hero Honda has a very small ratio but Bajaj has a ratio which is almost equal to 1. Hero Honda is also warning good profits so as started earlier; it can go for debt issue and can increase the earning per share by trading on equity.
4. Similarly, the long term debt to total capital ratio also is very less for Hero Honda.
5. Proprietary Ratio: This ratio establishes a relationship between equity shareholders' funds to total assets of the firm. It serves to an important purpose of determining long-term solvency of a firm. Higher the ratio better it is. In this case hero Honda has a very good ratio of almost 1 but Bajaj has a smaller ratio which is not good.
6. Interest coverage ratio: interest coverage ratio tells us how many times our total profits are to the interest payable by the firm. If the firm is not able to pay interest on the loans it creates a solvency problem for it. Here the ratio is quite satisfactory for both the companies.
7. Net profit and Gross profits ratio: They tell us what percent of sales is our gross profit and what percentage is the net profit. Hero Honda is better in both the cases making higher profits than Bajaj.
8. Operating ratio and cost of goods sold ratio: This ratio establishes a relationship between the expenses and the net sales. Lower the ratio the better it is. Hero Honda in this case has a better ratio as compared to Bajaj because it is incurring lesser expenses and making better profits.
9. Return on investment and return on capital employed: These ratios tell us the returns earned on the investment made and the total capital employed. As it is obvious the profit is the motive of the firm, the higher the ratio the better it is. Hero Honda is earning a better return as compared to its competitor Bajaj because both these ratios are more than the ratios of Bajaj.
10. Earning per share: This ratio is very important from the investor's point of view because they want returns on their investments. This ratio tells us the earnings made per share. Hero Honda, though is not trading on equity, is having better EPS than Bajaj. Bajaj even though have raised loans and has debt equity ratio of 0.93, is not able to give better

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returns to the equity shareholders. But hero Honda is doing this with very small amount of loan. So it is definitely performing better.

11. Dividend Pay out ratio: This is another ratio of major concern of the investors. This ratio tells us what part of the Earning per share is actually given to the shareholders as dividend. The more it is the better it is. In this case Hero Honda is paying less to the shareholders than Bajaj. But seeing the capital structure of Hero Honda it must be paying more to the shareholders because it is not having much of fixed cost capital also. Bajaj even though has debt is paying handsome dividend and has comparatively better ratio.
12. Turnover ratios tells us the number of times the sales have been with respect to some other object like stock, capital employed, etc. Higher ratio indicated that sales are very high and the object has been turned to sales more than once. Hero Honda is having better turnover ratios as compared to Bajaj in all the cases.

Conclusions And Suggestions:

- ✓ Hero Honda is having less debt which it can raise and earn better profits and increase earning per share.
- ✓ Hero Honda can distribute more amount as dividend to the shareholders.
- ✓ Improve on the short term liquidity which is very small and the working capital is negative. It indicated bad management of short term assets and liabilities.

Workings Of The Ratios:

	Hero Honda (In crores)	Bajaj (In Millions)
Current Assets	1009.55	23246.8
Current Liabilities	2052.82	24,375.60
Quick Assets	682.72	19,858.40
Quick Liabilities	2052.82	24,375.60
EBIT	1813.14	9791
Interest	31.68	210.1
Gross Profit	3577.11	19,734.70
Net Sales	12319.12	84369.4
Operating Cost	10609.4	76182.7
Average Inventory	321.965	3442.25
Working Capital	-1039.33	-1122.9
Average Fixed Assets	1364.985	13920.55
Average Capital	3640.575	31808.1

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Employed		
Cost of Goods Sold	8742.01	64,634.70

To find out the current assets we have to exclude the debtors which are due for more than 6 months. Schedules to the balance sheets of both the companies give us the figures. There is no bank overdraft in the balance sheets of both the companies so the quick liabilities are same as the current liabilities. To calculate the quick assets we have to exclude the inventory and prepaid expenses from the current assets. EBIT can be found by adding back the interest expenses to the EBT given in the profit and loss accounts of the companies. Gross Profit is found by subtracting the Cost of goods sold from the Net sales. Cost of goods sold is taken from the schedules of the company's reports.

Calculations		
Current Assets	1013.49	23252.7
Less: Debtors Due for more than 6 months	3.94	5.9
Net Current Assets	**1009.55**	**23246.8**
Current Assets	1009.55	23246.8
Less: Stock	326.83	3,388.40
Quick Assets	**682.72**	**19858.4**
EBT	1781.46	9580.9
Add: Interest	31.68	210.1
EBIT	**1813.14**	**9791**
Sales	**12319.12**	84369.4
Less: Cost of Good Sold	8742.01	64,634.70
Gross profit	**3577.11**	**19734.7**

Formulae Used:

Liquidity Ratios	
Current Ratio	Current Assets/Current Liabilities
Quick Ratio	Quick Assets/Quick Liabilities
Capital Structure Ratio	
Debt Equity Ratio	Total Debt/Shareholder's Fund
Long Term Debt To Total Capital Ratio	Total Debt/Total Capital Employed
Proprietary Ratio	Proprietor's Fund/Total Asset
Interest Coverage Ratio	EBIT/Interest
Profitability Ratio	
Net Profit	Net Profit/Net sales
Gross Profit	Gross Profit/Net Sales

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Cost Of Good Sold	Cost of Goods Sold/Net Sales
Operating Ratio	CoGS + Administrative expenses +Sales expenses/Net Sales
ROI	PAT/Average Total Assets
ROCE	EBIT/Average Capital Employed
RO Net worth	PAT/Total Equity Shareholder's Funds
Earning per share	PAT-Preference Dividend/Number of Equity Shareholders
Dividend pay out ratio	Dividend Per share/EPS*100
Turnover Ratios	
Stock Turnover	CoGS/Average Inventory
Working Capital Turnover	CoGS/Net Working capital
Fixed Asset Turnover	CoGS/Average Fixed Assets
Capital Turnover	CoGS/Average Capital Employed

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