



## **Capital Structure Analysis of Software Company with Special Reference to TCS**

**Dr. Kavitha Shanmugam**

Professor, Management Studies,  
J. J. College Of Engineering & Technology,  
Ammapettai, Trichy - 09

**J.Tamilselvi**

B.Com,M.B.A,M.Com,M.Phil,D.Co.Op.,  
Research Scholar,  
Research And Development Center,  
Bharathiyaar University,  
Coimbatore 46

### **Abstract**

*This paper analysed the “Capital Structure Pattern of Tata Consultancy Services”. A study on long-term solvency, assessment of debt-equity, debt to total fund and justification for the use of debt in Tata Consultancy Services through the application of ratio analysis and statistical test has been undertaken. The time period considered for evaluating the study is four years i.e. from 2011 to 2014. It is revealed that the long term funds had contributed more on an average 77.25 percent of total funds when compared to short term funds (17.57 percent) in Tata Consultancy Services. Long term funds had apportioned nearly two-third of total funds. Shareholders’ funds had occupied on an average 75.33 percent major chunk of the total funds when compared to the borrowed funds (1.91 percent).*

*The Tata Consultancy Services had shown an inclination in strengthening long term funds consisting of both shareholders funds as well as long term borrowed funds in order to finance its assets requirement. Tata Consultancy Services mostly depended on equity financing. So, the financial risk of the company is low, but it could fail to enjoy the advantages of financial gearing. Tata Consultancy Services should raise the debt funds to bring the optimum capital structure for improving the financial performance of the company. A higher interest coverage ratio is desirable, but too high ratio is some of the years of the study indicate that the Tata Consultancy Services is very conservative in using debt, and it is not using debt to the best advantage of the shareholders.*

**KEYWORDS:** *Debt-equity ratio, Debt to total fund ratio, Interest coverage ratio and Quantum and structure of total funds Tata Consultancy Services.*

### **Introduction**

One of the most critical areas of the finance function is to make decisions about the firm's capital structure. Capital is required to finance investments in plant and machinery, inventory, accounts receivable and so on. Capital structure is the part of financial structure, which



represents long term sources. It is the permanent financing of the company represented primarily by shareholders' funds and long term debt and excluding all short-term credit. To quote Walker, "The term capital structure is generally defined to include only long term debt and total stockholders' investment" (Walker). It refers to the capitalisation of long term sources of funds such as debentures, preference share capital, long term debt and equity share capital including reserves and surplus (retained earnings).

### **Tata Consultancy Services**

Established in 1968, Tata Consultancy Services a member of the Tata Group has grown to its current position as the largest IT services firm in Asia based on its record of outstanding service, collaborative partnerships, innovation, and corporate responsibility. It was founded by Jamsetji Tata in 1848 and it is one of India's most respected institutions today. Their mission reflects the Tata Group's longstanding commitment to providing excellence. To help customers achieve their business objectives by providing innovative, best-in-class consulting, IT solutions and services, and to actively engage all stakeholders in a productive, collaborative, and mutually beneficial relationship.

### **Review of Literature**

According to Bogen, "The capital structure may consist of a single class of stock, or it may be complicated by several issues of bonds and preferred stock, the characteristics of which may vary considerably"(Bogen). In other words, "capital structure refers to the composition of capitalisation i.e., to the proportion between debt and equity that make up capitalisation" (Philips).

Capital structure decision is a significant managerial decision. The market value of the share may be affected by the capital structure decision (Pandey). The selection of the capital structure will obviously depend on the bearing that it has on the firm's objective of maximisation of shareholders' wealth (Khan and Jain).

Estimation of requirement of capital is necessary, but the formation of capital structure is most important (Sharma and Gupta). Harry Gouthmann and Herbert E. Dougall stated that the phrase capital structure may be used to cover any long term debts like mortgages and long-term loans as well as total stockholders' investment including retained earnings as well as original investment (Gouthmann and Dougall).

Hunjra et al., (2011) in their study entitled "Patterns of Capital Structure and Dividend Policy in Pakistani Corporate Sector and their Impact on Organization Performance", analyzed the determined of patterns of capital structure decisions and dividend policy as well as their level of application in Pakistani corporate sector and also checked the impact of capital structure and dividend policy on organization performance. The study concluded that capital structure decisions were being properly practiced while dividend policy was a major concern in most of the organizations. The study also concluded that there was a significant and positive relationship between capital structure decision, dividend policy and organization performance.



## **Objectives**

The present research paper aims at endeavouring the following objectives:

- To analyse the capital structure Pattern;
- To assess of long-term solvency; and
- To ascertain the justification for the use of debt.

## **Tools of Analysis**

The data drawn from the annual reports of Tata Consultancy Services have been carefully analysed, tabulated and interpreted by using well established financial tools. The analysis of data is carried out through capital structure ratios such as debt-equity ratio, debt to total fund ratio and interest coverage ratio. Statistical tools like mean, standard deviation, coefficient of variation and coefficient of correlation are also applied. Graphs and diagrams are presented to illuminate the facts and figures.

## **Scope and Coverage**

The present study is confined to Tata Consultancy Services. This study is restricted to assess the pattern of capital structure in Tata Consultancy Services with the help of the ratio analysis. The time period considered for evaluating the study is four years i.e. from 2011 to 2014.

## **Capital Structure – Planning**

A company should plan its capital structure to maximise the use of funds. The primary objective of every capital structure planning is to minimise the cost of capital and to maximise the share value of the firm. Proper planning of capital structure also helps companies to enlarge their area for getting funds as well as creates the mobility of sources of the funds. But a range can be determined on the basis of empirical study.

The quantum and structure of total funds in Tata Consultancy Services is shown in **Table – 1.**

**Source: Compiled from Annual Reports of Tata Consultancy Services.**

Note: Figures in parentheses represent common size percentages considering total funds for the respective years equal to hundred.



	Particulars	Mar' 14 12 months		Mar'13 12 months		Mar'12 12 months		Mar ' 11 12 months		Average	
		Rs	%	Rs	%	Rs	%	Rs	%	Rs	%
	Share capital	195.87	0.34	295.72	0.69	295.72	0.72	295.72	0.92	270.76	0.62
	Reserves	43856.01	76.13	32266.53	75.33	29283.51	71.71	24209.09	75.13	32403.79	74.71
	Share holder's funds-I	44051.88	76.47	32562.25	76.02	29579.23	72.43	24504.81	76.05	32674.54	75.33
	Borrowed fund- II	1286.61	2.23	772.98	1.80	791.48	1.94	472.03	1.46	830.78	1.91
A	<b>Long term funds (I+II)</b>	<b>45338.49</b>	<b>78.71</b>	<b>33334.98</b>	<b>77.82</b>	<b>30370.71</b>	<b>74.37</b>	<b>24976.84</b>	<b>77.51</b>	<b>33505.26</b>	<b>77.25</b>
B	<b>Short term funds</b>	<b>12265.70</b>	<b>21.29</b>	<b>9498.81</b>	<b>22.18</b>	<b>10465.01</b>	<b>25.63</b>	<b>7246.03</b>	<b>22.49</b>	<b>7618.89</b>	<b>17.57</b>
C	<b>TOTAL FUNDS (A+B)</b>	<b>57604.19</b>	<b>100</b>	<b>42833.79</b>	<b>100</b>	<b>40835.72</b>	<b>100</b>	<b>32222.87</b>	<b>100</b>	<b>43374.14</b>	<b>100</b>

### Assessment of Long-Term Solvency

Leverage ratios indicate the extent to which the firm has used its long-term solvency by borrowing funds. As a general rule, there should be an appropriate mix of debt and owner's equity in financing the firm's assets. The leverage or capital structure ratio include for the purpose of analysis:

- Debt-equity ratio
- Debt to total fund ratio
- Interest coverage ratio

### Debt - Equity Ratio

The main object of calculating the debt-equity ratio is to measure the relative interest of owners and creditors in the firm. From the creditor's point of view, it measures the extent to which their interest is covered by owned funds. A standard debt-equity norm for all industrial units is neither desirable nor practicable. Different standard debt-equity ratios are used for different industry groups. The generally accepted standard norm of debt-equity ratio is 2:1. Debt - equity ratio is calculated by using the following Formula: **Debt – Equity Ratio = Long Term Debt / Net Worth.**

**The debt - equity ratio of Tata Consultancy Services is presented in Table - 2 and Figure - 1.**

Year	Long Term Debt (Rs. In Crores)	Net Worth (Rs. In Crores)	Ratio (In Times)
Mar'14	1286.61	44051.88	0.03
Mar'13	772.98	32562.25	0.02
Mar'12	791.48	29579.23	0.02



Mar'11	472.03	24504.81	0.02
<b>Mean</b>	<b>830.78</b>	<b>32674.54</b>	<b>0.02</b>
Standard Deviation	337.32	8282.15	0.005
C.V(%)	1137.89	685939.67	0.00003
Co-efficient of correlation between debt and equity (r) = 0.98			

Source: Compiled from Annual Reports of Tata Consultancy Services

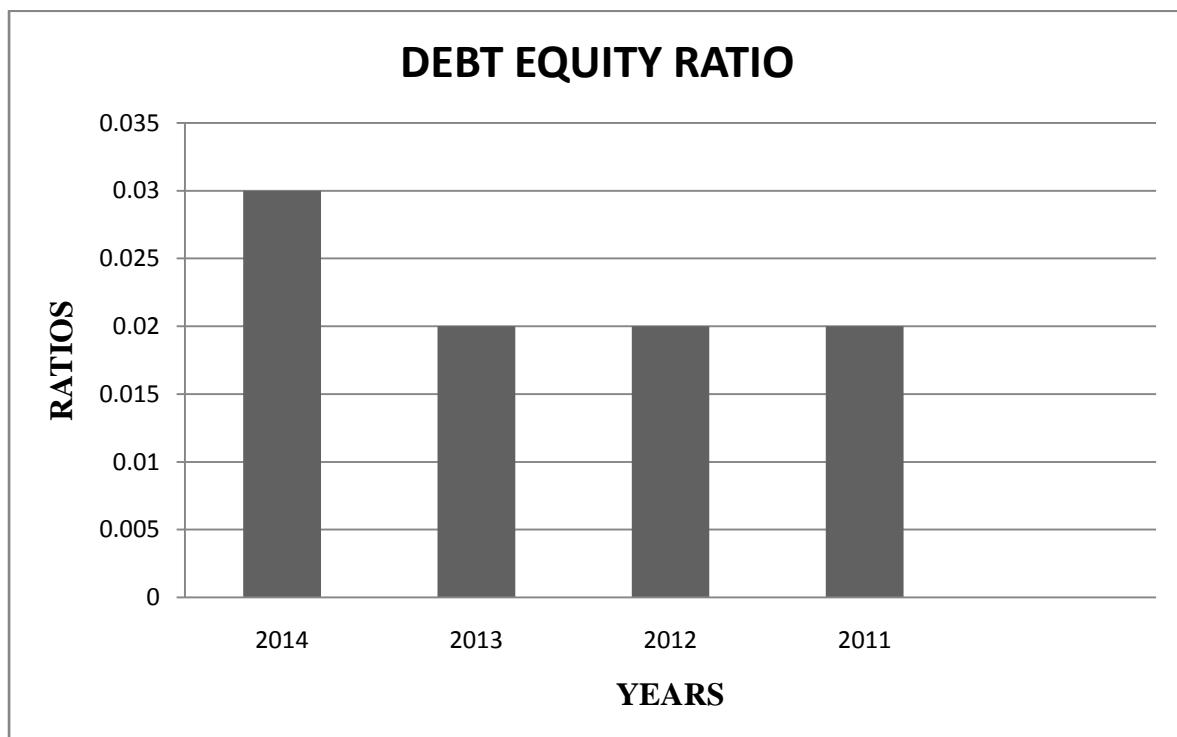


FIGURE – 1

Table - 2 shows debt-equity ratio of Tata Consultancy Services. The debt-equity ratio is calculated by dividing the long term debt with net worth. It is evident that long term debt of the company had increased remarkably from Rs. 472.03crores in 2011 to Rs. 1286.61crores in 2014. Net worth had gradually moved from Rs. 24504.81 crores to Rs. 44051.88 crores over the study period. Debt-equity ratio had varied from the lowest of 0.02 times in 2011 to the highest of 0.03 times in 2014. The ratio is well below than the standard ratio of 2:1. It means that the debt employed by the company was low from the point of view as the standard ratio. However, the interest of the debt-holders of the company was well protected. The coefficient of correlation between debt and equity in Tata Consultancy Services was 0.98 and thereby indicating that there was highly positive relation between debt and equity. It may be concluded that the Tata Consultancy Services could still mobilize the debt funds in order to reap the benefits of financial leverage. It increases the earning per share of company.



### Debt to Total Fund Ratio

Several debt ratios may be used to analyze the long-term solvency of a firm. The firm m may be interested in knowing the proportion of the debt in the financial structure. It may, therefore, compute debt to total fund ratio by dividing total debt by total fund. Total debt will include short-term funds plus long-term debt i.e. borrowed funds. Debt to total fund ratio is calculated by using the following formula: **Debt to Total Fund Ratio = Total Debt / Total Fund.** **The debt to total fund**

TABLE – 3: DEBT TO TOTAL FUND RATIO

Year	Total Debt (Rs.in Crores)	Total Fund (Rs. In crores)	Ratio (In times)
Mar'14	13552.31	57604.91	0.24
Mar'13	10271.79	42833.79	0.24
Mar'12	11256.49	40835.72	0.28
Mar'11	7718.06	32222.87	0.24
<b>Mean</b>	<b>10699.66</b>	<b>43374.32</b>	<b>0.25</b>
Standard Deviation	2416.66	10545.16	0.02
C.V (%)	58402.27	1112003.97	0.0004

Co-efficient of correlation between debt and equity(r) = 0.95

Source: Compiled from Annual Reports of Tata Consultancy Services

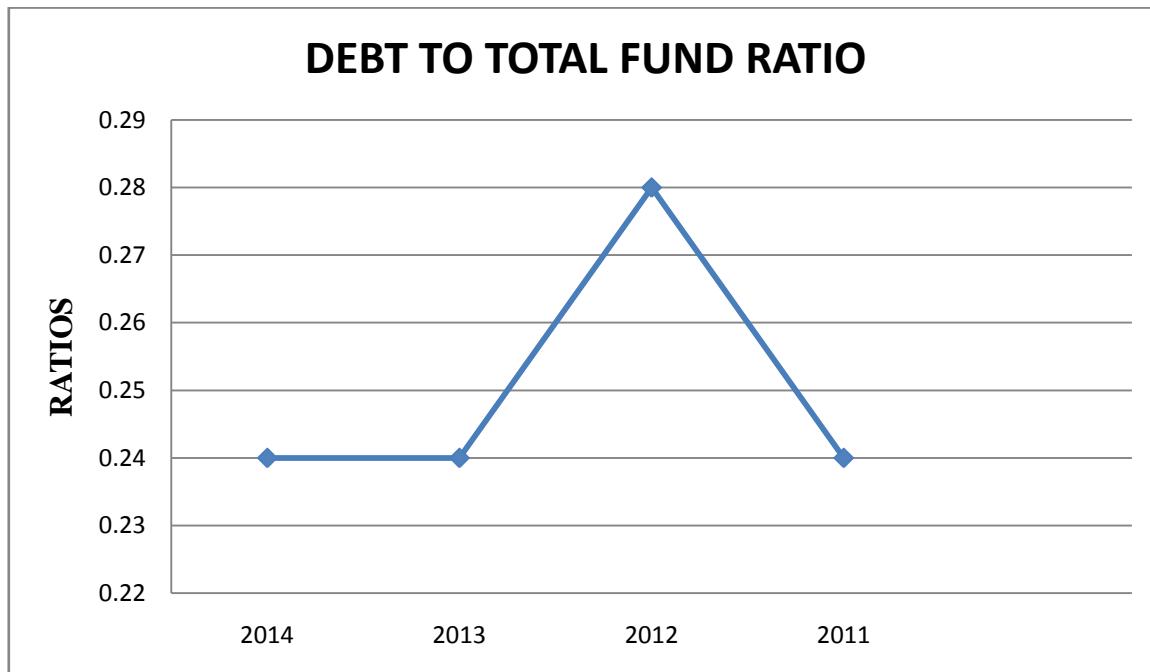


FIGURE – 2



Table - 3 provides the debt to total fund ratio. The financial variables considered for the computation of debt to total fund ratio include total debt and total fund. Total fund had jumped from Rs. 32222.87 crores in 2011 to Rs. 57604.91 crores in 2014. The total fund had exceeded over the total debt during the entire period of the study. The ratio is less than the unity. The debt to total fund of Tata Consultancy Services had a positive relationship as the coefficient of correlation is very high i.e., 0.95 that means almost all one. It may be concluded that the financial risk of the company is low. But the company could fail to enjoy the advantages of financial gearing.

### **Interest Coverage Ratio**

The interest coverage ratio shows the number of times the interest charges are covered by funds that are ordinarily available for their payment. The lender will be interested in finding out whether the business would earn sufficient profits to pay the interest charges and interest being paid periodically. In order to accomplish this objective, the interest coverage ratio of the Tata Consultancy Services is computed. The higher the coverage, the better will be the position of debenture holders or loan creditors regarding their fixed payment of interest, the greater will be the profitability, and the better will be the position of debenture holders or loan creditors regarding their fixed payment of interest, the greater will be the profitability, and the better will be the management efficiency (Paul). The universal standard of Interest Coverage Ratio is around 7 to 8 times. The ratio indicates the extent to which the earnings may fall without causing any embarrassment to the firm regarding the payment of fixed interest charges.

Interest coverage ratio is calculated by using the following formula:

**Interest Coverage Ratio = EBIT / Interest.**

**The interest coverage ratio of Tata Consultancy Services presented in Table – 4**

<b>YEAR</b>	<b>RATIO</b>
2014	1006.74
2013	513.84
2012	816.02
2011	435.80
<b>Mean</b>	<b>693.1</b>
<b>Standard Deviation</b>	<b>265.72</b>
<b>C.V (%)</b>	<b>706.06</b>

**Source: Compiled from Annual Reports of Tata Consultancy Services.**

This ratio is used to determine how easily a company can pay interest on outstanding debt. Interest coverage ratio is calculated by dividing the earnings before interest and taxes with interest charges. It is clear those earnings before interest and taxes and interest charges as shown an increasing trend over the study period. The highest interest coverage ratio was recorded at 1006.74 times in 2014 and the lowest being 435.80 times in 2011. The mean, standard deviation and co-efficient of variation (C.V) of interest coverage ratio in Tata



Consultancy Services are 693.1 times, 265.72 times and 706.06 percent respectively. It may be observed that the behaviour of the ratio was so erratic indicating ups and downs over the period under the reference.

It is evident that the interest charges are fully covered by the earnings before interest and taxes. A higher ratio is desirable, but too high ratio is some of the years of the study indicate that the Tata Consultancy Services is very conservative in using debt, and that it is not using debt to the best advantage of the shareholders. From the point of view of the creditors safety, the larger the coverage, greater the ability of the firm to handle fixed charges and more assured the payment of interest. In contrast, a low ratio is a danger signal indicating that firm uses excessive thereby a firm is indicating inability to honour the assured payment of interest to the creditors.

### **Conclusion**

Foregoing analysis reveals that long term debt of the company had increased remarkably from Rs. 472.03crores in 2011 to Rs. 1286.61crores in 2014. Long term funds had apportioned nearly two-third of total funds. The Tata Consultancy Services had shown an inclination in strengthening long term funds consisting of both shareholders funds as well as long term borrowed funds in order to finance its assets requirement. Tata Consultancy Services mostly depended on equity financing. So, the financial risk of the company is low. But the company could fail to enjoy the advantages of financial gearing. Rising of funds through debt is relatively cheaper than equity in terms of cost of issue and interest cost. The company could still mobilize the debt funds. It means that the company could raise the external funds to bring the optimum capital structure i.e. minimise the cost of capital and maximise the share value of the firm. It is due to the tax deductibility of the interest paid on debt. So, these benefits of financial leverage shall be reaped for improving the financial performance of the company. The behaviour of the interest coverage ratio was so erratic. The interest charges are fully covered by the earnings before interest and taxes. A higher interest coverage ratio is desirable, but too high ratio is some of the years of the study indicate that the Tata Consultancy Services is very conservative in using debt, and it is not using debt to the best advantage of the shareholders. Hence, it is suggested that Tata Consultancy Services shall tap the debt funds optimally to maintain the balanced capital structure.

### **References**

1. Bogen, J.I., "Financial Hand Book", New York: The Ronald Press, 1957, P893.
2. Childs, J.F., "Long-Term Financing", Eaglewood Cliffs, New Jersey: Prentice Hall Inc., 1961, P9.
3. Harry G., Guthmann and Herbert E. Dougall, "Corporate Financial Policy", New Jersey: Prentice Hall Inc., 1955, P76.
4. Khan, M.Y., and Jain, P.K., "Financial Management Text, Problems and Cases", Sixth Edition, New Delhi: Tata McGraw Hill Education Private Limited, 2011, P18.1.
5. Pandey, I.M., "Financial Management", Ninth Edition, New Delhi: Vikas Publishing House Pvt. Ltd., 2004, P289.



6. Paul S.K.R., "Management Accounting", New Central Book Agency (P) Ltd., Calcutta, 2002, P331.
7. Philips, F.C. Jr., "The Economics of Regulation – Theory and Practice", Home Wood, Illinois: Ricard D.Irwing Inc., 1970, P.167.
8. Roy Choudhary, A.B., "Analysis and Interpretation of Financial Statements Through Financial Ratios", Calcutta: Orient Longmans, 1st Edn., 1970, P31.
9. Sharma, R.K. and Gupta S.K., "Management Accounting – Principles and Practices", Kalyani Publishers, 1996, P.16.1.
10. Walker, E.W., "Essentials of Financial Management", New Delhi: Prentice Hall of India Pvt. Ltd., 1978, P81.