CHAPTER 1

RESEARCH DESIGN

1 . 1 . INTRODUCTION :

With the liberalisation of Indian economy in 1991 the conditions in which a business is done have been changing slowly.The changes in the economy threw up new opportunities to be seized and new forms of funds raising.The policy of Industrial licensing and the policy of restricting the expansions by the industries were done away with gradually.The import tariff and the direct as well as the indirect tax rates were brought down over a period of 5 years.These changes coupled with changes in FERA,MRTP Act,Direct & Indirect Taxes made things easier for corporates to do business in India.These changes were expected to help the domestic companies to expand beyond the boundaries of India & increase the share of India in world trade.One noticeable change took place in the forms of raising funds.With removal of the office of Controller of Capital Issues more & more companies started raising finance by way of issue of shares and debentures to the general public.A whole lot of new forms of debt raising came into vogue.The companies can now avail the following new forms of financing quite easily :

1.Public issue of shares,debentures etc.

2.Leasing & Hire purchase

3.External Commercial Borrowings

4.Euro issue of Securities

5.Raising of foreign currency loans

Even though some of the above forms of fund raising were not so new they could be easily raised since many administrative controls were abolished.All these relaxations were expected to result in lower cost of financing for the domestic industry.

The present study was undertaken against this economic back ground & aimed to study the changes taking place in the capital structure & profitability of KULKARNI POWER TOOLS LTD.Shirol 416 103 Dist.Kolhapur

The capital structure of a company is the basis upon which sound financial management is built.The components of capital structure and their proportion to the total requirements of funds are two important factors for identifying and planning the right kind of capital structure of a company.The capital structure should be planned is such a manner that the resources of the company are utilised for the maximisation of the shareholders' wealth.Any decision on the capital structure of a company has long term implications on the finances of a company.Any wrong decision can affect the future fund raising capacity of the company e.g. where a project is financed by raising loans instead of issue of fresh shares & utilisation of internal generation the company incurs the cost of interest and repayment obligation over a long period of time viz.five to seven years.The raising of loans also results in increasing the financing & business risks for the company.Where excessive reliance is placed on loans in the formulation of capital structure the firm may end up in heavy losses if the business does not grow as expected.Therefore while deciding on the capital structure long term considerations and requirements of the company have to be kept in mind.

On the other hand if no loans are raised to finance the business needs the company will pay higher taxes which will reduce the amount available to distribution to shareholders. This is because the liability for tax will increase since the interest on loans is dedcutible for income tax purposes. Thus the company will have to arrive at the proper mix of capital structure at any given point of time.No uniform and fixed capital structure can be prescribed for any company since the requirements of funds of the company change with time and with the fortunes of the company.A company has to consider various options and factors while deciding on any sort of capital structure.Among the many factors to be taken into account the most important factor is the profitability of the company and the maximisation of the wealth of the shareholders.The aim of any company is to maximise the wealth of the owners of the company and optimum utilisation of the resources of the company.

As stated above the profitability of the company to a large extent depends upon good financial management.Any changes in the capital structure of the company will either result in increase or decrease in the profits of the company.Where excessive loans are taken it will result in higher interest & lower profits.

The determination of optimum capital structure of any company is not an easy process.The existing capital structure of the company is the result of many past factors and many future expectations.Therefore it is impossible to lay down any set method or formula for determination of the optimum capital structure.

Against the backdrop of the changes in the economy an attempt has been made in this thesis to identify the factors affecting the capital structure of any company and in particular to study the changes in the capital structure and the consequent changes in profitability of KULKARNI POWER TOOLS LTD.AT POST SHIROL,DIST. : KOLHAPUR - 416 103.

1 . 2 . RESEARCH DESIGN :

With the above object in mind the following research design was adopted.

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1 . 2 . A. SELECTION OF TOPIC :

The topic selected for research is entitled " CHANGES IN CAPITAL STRUCTURE AND PROFITABILITY : A CASE STUDY OF KULKARNI POWER TOOLS , SHIROL. DIST. : KOLHAPUR " This topic was selected since the capital structure of a company affects the profitability of the company and also its long term growth.Similarly it is a prerequisite for a company to have a sound capital structure relevant to its size and expansion needs in order to show gwowing & consistent profits.

1 . 2 . B . LOCATION OF THE COMPANY :

The registered office of the company is situated at Post Shirol 416 103 Dist. Kolhapur.This company was selected since :

i) It is one of the oldest and large companies around Kolhapur

ii) The company is a listed company on the Mumbai Stock Exchange.The company had foreign technical collaboration for manufacture of tools.It was considered by me that these factors would show new forms of financing & a balanced capital structure.

iii) In addition the registered office of the company being near to my residence I thought I could visit the company frequently for collection of data.

1 . 2 . C . OBJECTIVES OF THE STUDY :

The objectives of the study were as under :

i)To understand the nature of changes taking place in the forms of borrowings and the new financial instuments through which funds were raised.

ii)To study the capital structure of Kulkarni Power Tools Ltd.Shirol Dist. : Kolhapur and changes that took place since 1991.

iii)To study whether the company was able to counter the business risks with the capital structure decisions.

iv)To study the impact of capital structure decisions on profitability.

1 . 2 . D . COLLECTION OF DATA :

For the purposes of the study only secondary data was required.The data was collected from the Annual Reports of the company,company publications and financial publications. Similarly the existing literature on the subject was reviewed.

1 . 2 . E . PROCESSING OF DATA :

The data collected was processed on computer for presentation and for arithmetic calculations.Statistical tools like classification,tabulation and computation of relevant ratios were used for analysis of the data.

1 . 2 . F . PRESENTATION OF DATA :

The data has been presented over the period of eight years beginning from 1989 to 1996.While presenting data the use of tables and ratios has been made.Whereever necessary the graphs have been enclosed

1 . 2 . G . ANALYSIS OF DATA :

The analysis of data was done on the basis of following broad criteria :

i)The capital structure of the company.

ii)Profitability of the company.

iii)Ratio Analysis.

iv)Computation of Earning Per Share.

v)Computation of Financial and Operating Leverage.

1 . 2 . H . CHAPTER SCHEME :

While presenting the research the following chapter scheme was followed :

i) CHAPTER 1 :

Chapter 1 is entitled as " INTRODUCTION AND RESEARCH DESIGN "

This chapter sets out in brief the reasons for undertaking the topic of the research and the methodology adopted for the study.

ii) CHAPTER 2 :

Chapter 2 is entitled as " PROFILE OF THE COMPANY "
This chapter sets out the in general information about the company selected for study and information about its management,organisation chart,products, exports etc. in particular.

iii) CHAPTER 3 :

Chapter 3 is entitled as " THEORETICAL BACKGROUND OF THE SUBJECT "
The existing literature on the concept of capital structure,leverage and cost of capital is reviewed in detail in this chapter.The concepts & principles to be applied to the company under study have been discussed and their limitations have been explained.

iv) CHAPTER 4 :

CHAPTER 4 is entitled as " CHANGES IN CAPITAL STRUCTURE "
In this chapter the data relating to the capital structure,changes therein during the stipulated period and the calculation of ratios is analysed.

For this purpose the following ratios were computed :

$$\text{a. DEBT EQUITY RATIO} = \frac{\text{LONG TERM DEBT}}{\text{OWNED FUNDS}}$$

$$\text{b. FIXED ASSETS RATIO} = \frac{\text{FIXED ASSETS}}{\text{OWNED FUNDS}}$$

v) CHAPTER 5 :

Chapter 5 is entitled as " CHANGES IN PROFITABILITY "

In this chapter the data relating to the profits of the company,changes therein during the stipulated period and calculation of ratios is analysed.

For this purpose the following ratios were computed :

$$\text{a. FINANCIAL LEVERAGE} = \frac{\text{EARNINGS BEFORE INTEREST AND TAX (EBIT)}}{\text{PROFIT BEFORE TAX (PBT)}}$$

$$\text{b. OPERATING LEVERAGE} = \frac{\text{SALES - VARIABLE COSTS}}{\text{EBIT}}$$

c. RETURN ON CAPITAL EMPLOYED

$$= \frac{\text{EBIT}}{\text{CAPITAL EMPLOYED}}$$

d. EARNING PER SHARE (EPS)

$$= \frac{\text{NET PROFIT}}{\text{NUMBER OF SHAREHOLDERS}}$$

e. OPERATING PROFIT RATIO

$$= \frac{\text{PROFIT BEFORE TAX}}{\text{SALES}}$$

f. NET PROFIT RATIO

$$= \frac{\text{NET PROFIT}}{\text{SALES}}$$

g. EBIT TO SALES

$$= \frac{\text{EBIT}}{\text{SALES}}$$

h. NET PROFIT TO NET WORTH

$$= \frac{\text{NET PROFIT}}{\text{NET WORTH}}$$

i. INTEREST COVERAGE

$$= \frac{\text{PROFIT BEFORE INTEREST AND DEPRECIATION}}{\text{INTEREST}}$$

vi) CHAPTER 6 : CONCLUSION AND SUGGESTIONS

In this chapter the conclusions based on the findings of the study are stated.Further the limitations of the study have been described and the suggestions within the framework of conclusions and the limitations are made.