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## A COMPARATIVE ANALYSIS OF CAPITAL STRUCTURE OF HDFC LTD. & PNB

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### ABSTRACT:

**T**his paper examines the capital structure of two Indian banks i.e. Punjab National Bank (PNB) and Housing Development Finance Corporation Ltd (HDFC Ltd.) with the help of some accounting ratios. As capital structure has impact on the shareholders wealth, so a capital structure should be selected that maximizes the value of the firm. The paper also gives a brief theoretical background of theories of capital structure. For the purpose of analyzing the capital structure, five years data has been taken i.e. from 2012-2017. The results show that the dependence of PNB is increasing more on debt while that of HDFC Ltd is increasing its share of equity more in comparison to the debt finance. Moreover it also showed that results of PNB are quite fluctuating in comparison to the results of HDFC Ltd.

**KEYWORDS:** Capital Structure, Equity, Debt.

### INTRODUCTION:

A company can obtain long-term financing in the form of equity, debt, or some combination (Brigham & Ehrhardt, 2009). Deciding the capital structure is one of the important decisions for a firm as it will ultimately affect profitability of the firm as well as will affect the stakeholders of the firm. Capital structure is the mix of long term sources of funds deployed by an enterprise and the funds could be equity shares, debentures, preference shares or long term loans etc. The capital structure is made up of debt and equity securities which comprise a firm's finance of its assets (Kulkarni, 2008). A firm should select its capital structure very carefully as it affects the shareholder's wealth and cost of capital. Capital structure is affected by lots of factors like risk, control, profitability, flexibility and many more. The optimum capital structure is the combination of long term funds that leads to maximization of the value of the firm or the stock price and which has the minimum cost of capital. The cost of capital is the rate which the firm has to pay to the parties from which the capital has been borrowed. The capital structure of firm may affect the financial or operational aspect of a firm. The capital structure of a firm



determines the financial leverage of firm. Firms use more degree of borrowed fund for increasing the wealth of shareholder of firm. The capital structure affects the earning capacity of a firm because if the firm's capital structure has more debt in proportion to other sources of finance in the total capital then a large part of profit has to be paid by the firm in the form of interest because the rate of interest is fixed on the long term debt due to which earning per share of firm will be decreased and also risk has increased in stock return of firm. And on the other side if a firm has more equity capital portion in total capital of a firm then a firm cannot take the advantage of trading on equity. The capital structure describes the liability side of a firm's balance sheet

which shows how much money has been taken from outside the business and how much has been taken from the shareholder of firms.

### THEORETICAL BACKGROUND:

There are several major contributions to the theories of capital structure. Among the more important are those of Durand, Modigliani and Miller, Donaldson, Solomon and Schwartz. Durand provided two approaches namely net income approach and net operating income approach. In his earlier theory, he suggested the use of financial leverage to reduce cost of capital while in the later one he said that there is no optimal capital structure meaning that even the use of financial leverage won't result in reduction of weighted average cost of capital. The traditional school is led by Solomon. The school believes that a judicious use of debt increases the value of firm and reduces the cost of capital and the optimum capital structure is the point at which the value of firm is highest and the cost of capital is the lowest. Modigliani and Miller have given two propositions. In one proposition MM say that the capital structure is irrelevant to the value of the firm and in the other one, they have said that use of financial leverage boosts the expected earning but that won't affect the value of the firm as the increase in earnings is compensated by change in the required rate of return.

### METHODOLOGY:

For the purpose of analyzing the capital structure of two banks i.e. PNB and HDFC Ltd. ratio analysis technique has been used. The ratios used are debt-equity ratio, proprietary ratio, interest coverage ratio, capital gearing ratio, total asset to debt ratio. The data has been taken from the official websites of banks for a period of five years from 2012 to 2017. Compound annual growth rate has been calculated for the data with the help of SPSS.

#### The ratios are calculated as follows:

##### Debt-Equity Ratio = long term loans/ net worth.

It indicates the proportion of funds which are acquired by long-term borrowings in comparison to shareholder's funds.

##### Proprietary Ratio = shareholder's fund/ total assets.

The ratio shows the extent to which the total assets have been financed by the proprietor.

##### Interest Coverage Ratio = earnings before interest and tax (EBIT)/annual interest on long term loans.

##### Capital gearing Ratio = fixed interest bearing funds/equity shareholder's fund. It measures the degree of vulnerability of earnings available for equity shareholders.

##### Total Asset to Debt Ratio = total assets / long-term debts. It measures the safety margin available to the suppliers of long-term debts.

### OVERVIEW OF PROFILES OF HDFC LTD. AND PUNJAB NATIONAL BANK:

#### Profile of HDFC Ltd.:

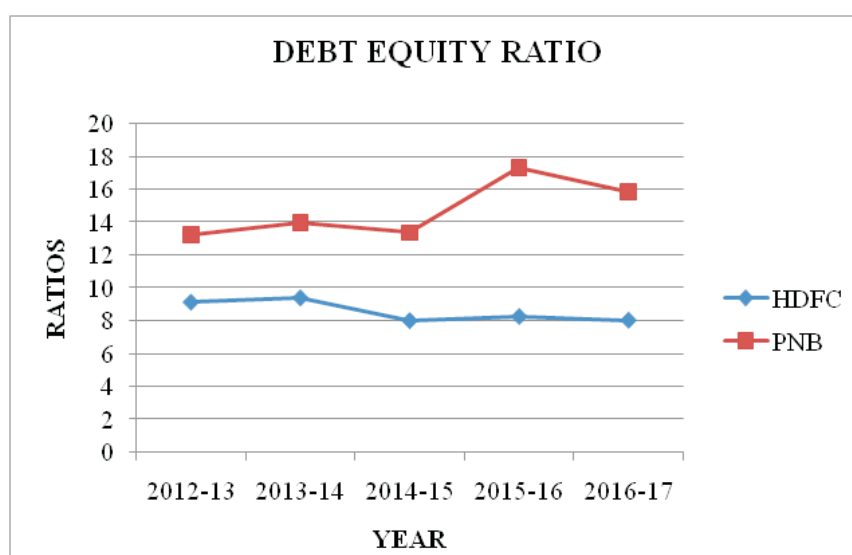
- + The Housing Development Finance Corporation Limited (HDFC) was amongst the first to receive an 'in principle' approval from the Reserve Bank of India (RBI) to set up a bank in the private sector, as part of RBI's liberalization of the Indian Banking Industry in 1994.
- + The bank was incorporated in August 1994 in the name of 'HDFC Bank Limited', with its registered office in Mumbai, India.
- + HDFC Bank commenced operations as a Scheduled Commercial Bank in January 1995.
- + Authorized capital of HDFC is 3,25,00,00,000 Equity Shares of Rs 2/- each.

**Profile of PNB:**

- + Punjab National Bank, India's first Swadeshi Bank, commenced its operations on April 12, 1895 from Lahore, with an authorized capital of Rs 2 lac and working capital of Rs 20,000.
- + It's headquarter is in Delhi.
- + Has a presence in diverse sectors of Indian financial sector, including credit cards, consumer banking, corporate banking, finance and insurance, investment banking, mortgage loans, private banking, private equity etc.
- + Authorized capital of PNB is 15,00,00,00,000 Equity Shares of Rs 2 each.

**Analysis and Results:****Debt-Equity Ratio:**

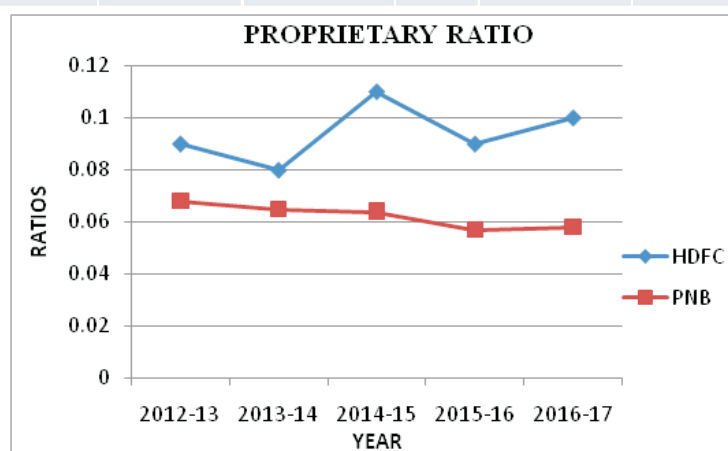
| Year                        | HDFC Ltd. DEBT(in cr.) | HDFC Ltd. EQUITY (in cr.) | Debt-Equity Ratio(HDFC) | PNB DEBT(in cr.) | PNB EQUITY( in cr.) | Debt-Equity Ratio(PNB) |
|-----------------------------|------------------------|---------------------------|-------------------------|------------------|---------------------|------------------------|
| 2012-13                     | 329,253.58             | 36,214.14                 | 9.09                    | 431,180.98       | 32,676.90           | 13.19                  |
| 2013-14                     | 406,776.47             | 43,478.63                 | 9.35                    | 499,431.16       | 35,895.32           | 13.91                  |
| 2014-15                     | 496,009.2              | 62,009.31                 | 7.99                    | 547,049.19       | 39,079.52           | 13.33                  |
| 2015-16                     | 599,442.66             | 72,677.77                 | 8.24                    | 662,167.36       | 38,310.14           | 17.28                  |
| 2016-17                     | 717,668.53             | 89,462.35                 | 8.02                    | 662,467.36       | 41,846.98           | 15.83                  |
| COMPOUND ANNUAL GROWTH RATE | 21.5%                  | 26.1%                     |                         | 12.1%            | 5.8%                |                        |



Debt-Equity ratio is computed to ascertain soundness of the long-term financial position of the firm. From the above data, it is quite visible that HDFC bank has emphasized more on net worth as compared to the borrowed fund with the gradual passage of time. On the contrary, PNB's net worth is also increasing but not to the level as there is an increase in its borrowings.

**Proprietary Ratio:**

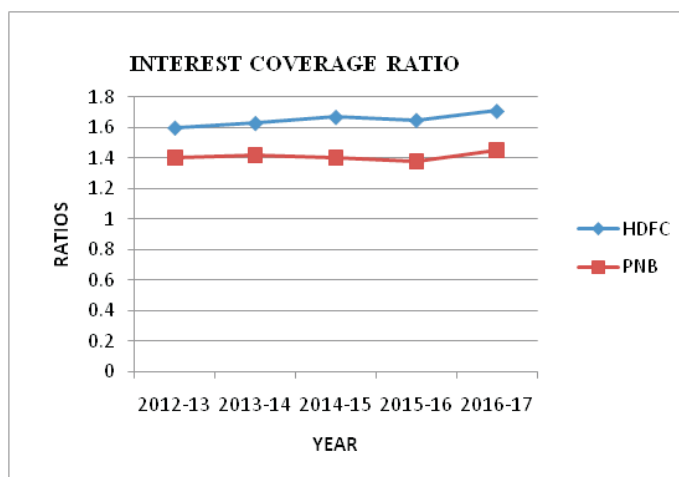
| Year                        | Shareholder's Net worth(in cr.)[HDFC] | Total Assets(in cr.)[HDFC] | Ratio [HDFC] | Shareholder's Net worth(in cr.)[PNB] | Total Assets(in cr.)[PNB] | Ratio[PNB] |
|-----------------------------|---------------------------------------|----------------------------|--------------|--------------------------------------|---------------------------|------------|
| 2012-13                     | 36,214.14                             | 4,00,331.89                | 0.09         | 32,676.90                            | 4,78,877.03               | 0.068      |
| 2013-14                     | 43,478.63                             | 4,91,599.5                 | 0.08         | 35,895.32                            | 5,50,419.92               | 0.065      |
| 2014-15                     | 62,009.41                             | 5,90,503.07                | 0.11         | 39,079.52                            | 6,03,333.60               | 0.064      |
| 2015-16                     | 72,677.76                             | 7,40,796.07                | 0.09         | 38,310.14                            | 6,67,390.45               | 0.057      |
| 2016-17                     | 89,462.40                             | 8,63,840.19                | 0.10         | 41,846.98                            | 7,20,330.55               | 0.058      |
| COMPOUND ANNUAL GROWTH RATE | 26.1%                                 | 21.5%                      |              | 5.8%                                 | 10.6%                     |            |



It shows the extent to which shareholder's own the business. The greater ratio provides more satisfaction for lenders and creditors. Proprietary ratio of HDFC Ltd is fluctuating but ultimately it increased but PNB's ratio is continuously showing a downward trend.

**Interest Coverage Ratio**

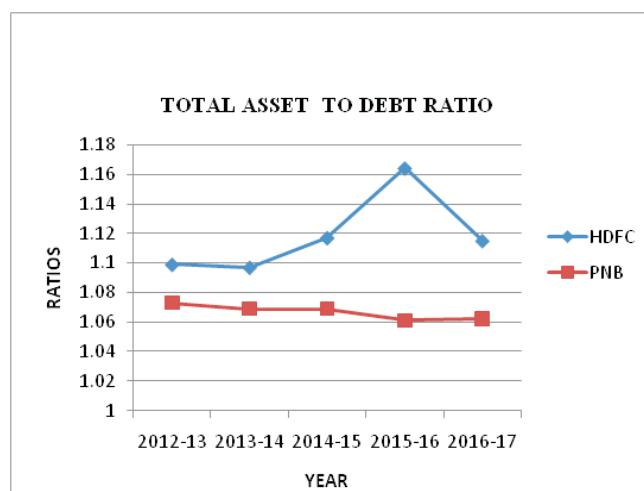
| Year                 | EBIT(in cr.)[HDFC] | Fixed Interest Charges(in cr.)[HDFC] | Ratio[HDFC] | EBIT(in cr.)[PNB] | Fixed Interest Charges(in cr.)[PNB] | Ratio[PNB] |
|----------------------|--------------------|--------------------------------------|-------------|-------------------|-------------------------------------|------------|
| 2012-13              | 30,681.38          | 19,253.75                            | 1.60        | 37,944.20         | 27,036.82                           | 1.40       |
| 2013-14              | 37,012.98          | 22,652.90                            | 1.63        | 38,461.75         | 27,077.28                           | 1.42       |
| 2014-15              | 43,478.71          | 26,074.24                            | 1.67        | 41,714.54         | 29,759.79                           | 1.40       |
| 2015-16              | 53,993.47          | 32,629.93                            | 1.65        | 44,328.92         | 32,112.57                           | 1.38       |
| 2016-17              | 61,899.11          | 36,166.73                            | 1.71        | 46,847.98         | 32,282.82                           | 1.45       |
| Compound growth rate | 19.5%              | 17.7%                                |             | 5.8%              | 5.4%                                |            |



This ratio helps to analyze the firm’s ability to service the fixed interest claim. A ratio of 3:1 is considered desirable for firms and for financial institutions 2:1 is desirable. Trend of HDFC bank as well as PNB is quite stable and doesn’t fluctuate much. HDFC and PNB have balanced earning left for the shareholders, which has shown an increasing trend.

**Total Asset to Debt Ratio:**

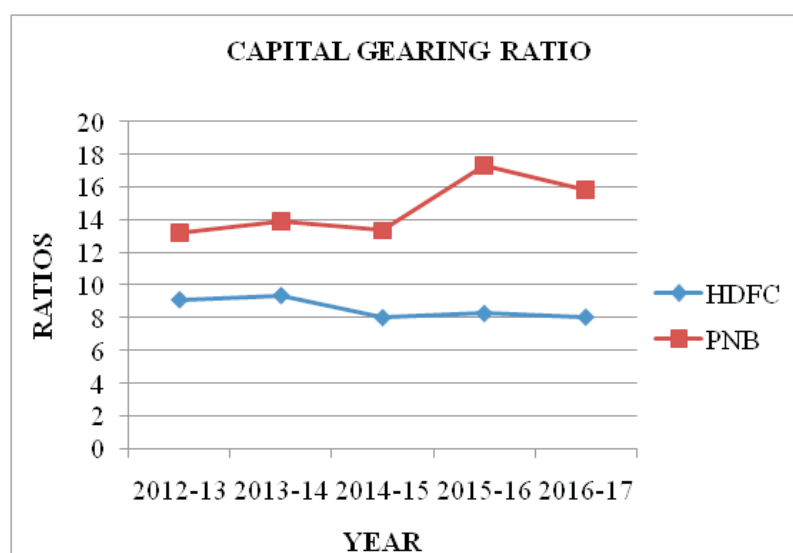
| Year                        | Total Assets[HDFC] | Total Debt[HDFC] | Ratio[HD FC] | Total Assets[PNB] | Total Debt[PNB] | Ratio[P NB] |
|-----------------------------|--------------------|------------------|--------------|-------------------|-----------------|-------------|
| 2012-13                     | 4,00,331.89        | 3,64,117.75      | 1.099        | 4,78,877.03       | 4,46,200.13     | 1.073       |
| 2013-14                     | 4,91,599.5         | 4,48,120.87      | 1.097        | 5,50,419.92       | 5,14,524.6      | 1.069       |
| 2014-15                     | 5,90,503.07        | 5,28,493.65      | 1.117        | 6,03,333.60       | 5,64,254.08     | 1.069       |
| 2015-16                     | 7,40,796.07        | 6,36,167.81      | 1.164        | 6,67,390.45       | 6,29,080.31     | 1.061       |
| 2016-17                     | 8,63,840.19        | 7,74,377.85      | 1.115        | 7,20,330.55       | 6,78,483.57     | 1.062       |
| COMPOUND ANNUAL GROWTH RATE | 21.5%              | 20.4%            |              | 10.6%             | 11%             |             |



The ratio is used to determine the financial risk of a business. This ratio measures the safety of margin available to the providers of long term debt. Greater the ratio greater is the security. So we can say that for both HDFC and PNB creditors, there is availability of enough safety of margin. With decreasing ratio, PNB is depending more on outside loan for its existence.

### Capital Gearing Ratio:

| Year                        | Fixed income bearing funds(in cr.)[HDFC] | Equity(in cr.)[HDFC] | Ratio[HDFC] | Fixed income bearing funds(in cr.)[PNB] | Equity(in cr.)[PNB] | Ratio[PNB] |
|-----------------------------|--|----------------------|-------------|---|---------------------|------------|
| 2012-13                     | 3,29,253.58                              | 36,214.14            | 9.09        | 4,31,180.98                             | 32,676.90           | 13.19      |
| 2013-14                     | 4,06,776.47                              | 43,478.63            | 9.35        | 4,99,431.16                             | 35,895.32           | 13.91      |
| 2014-15                     | 4,96,009.2                               | 62,009.41            | 7.99        | 5,47,049.19                             | 39,079.52           | 13.99      |
| 2015-16                     | 5,99,442.66                              | 72,677.76            | 8.25        | 6,62,167.36                             | 38,310.14           | 17.28      |
| 2016-17                     | 7,17,668.53                              | 89,462.40            | 8.02        | 6,62,467.36                             | 41,846.98           | 15.83      |
| COMPOUND ANNUAL GROWTH RATE | 21.5%                                    | 26.1%                |             | 12.1%                                   | 5.8%                |            |



This ratio indicates the firm which is trading on equity. It is also a measure of financial leverage. The more is the ratio more will be the leverage as well as the financial risk.

Both HDFC & PNB are highly geared.

### CONCLUSION

Capital structure decision is very crucial decision for every entity. The study employs ratio analysis technique from which it can be concluded that the dependence of HDFC Ltd has increased more on owned fund and that of PNB has increased on outsider fund comparatively. It can be concluded that HDFC Ltd is still using relatively more debt in their structure so it's weighted average cost of capital decreases thereby increasing the returns to shareholders. PNB had NPA's so its ratios are showing a decreasing trend.

**LIMITATIONS:****The study conducted has certain limitations:**

- The time period of the study conducted was limited.
- Only two banks have been taken for the purpose of study.
- Only a few ratios have been used for the purpose of study.

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