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A Study on Capital Structure Analysis of ICICI Bank Limited

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Abstract

The capital structure means managing the debt and equity capital of the company. It allows a company to understand what type of funding the company uses to finance its overall activities and growth. It is therefore important to take decision regarding fixing the level of debt and equity. The paper examines the impact of capital structure on the performance of the company. In order to evaluate the capital structure of ICICI Bank Limited, a study had been conducted with the help of secondary data for the period of 5 Years (i.e. 2013 to 2018). Generally the performance is measured through financial tools such as, ratio analysis and leverage. The ratios and leverages are the most significant and reliable indicators to evaluate the financial performance of a company. By analyzing financial performance of the company it helps management in financial decision making. There are various determinants which affect the decision making of capital structure like cost of capital, control and flexibility. Consequently, decision regarding capital structure is critical decision which should be taken by all businesses. Hence, Future of the business is depends on positive and negative effects of this capital structure decision.

Keywords: capital structure, debt and equity capital, ratio, leverage

Introduction

Capital is the most important part of all type of business activities, which are decided by the nature and size of the business concern. Long term Capital can be raised with the help of various means of sources. Like equity shares, debentures, long term loans, preference share and retain earnings etc. If the company maintains appropriate and sufficient level of capital, it will earn high profit and they can provide more dividends to its shareholders.

Capital structure refers to the kinds of securities and the proportionate amount that make up capitalization. It refers to the relationship between the various long-term sources financing such as equity capital, preference share capital and debt capital.

Deciding the appropriate capital structure is the significant decision of the financial management as it is directly related to the value of the firm. Capital structure is the everlasting financing of the company represented primarily by long-term debt & equity.

Research Problem

The study is to find the different determinant of capital structure in the banking industry as it affects the whole form of the organization. So it is very important to have a clear idea about these factors and cost of different sources in the banking industry. So the problem in the study is to find out effective determinant of capital structure.

Objectives of the study

- To assess the changes in proportion of the debt and equity.
- To know the proportion of debt & equity in capital structure.
- To determine the capital structure of ICICI bank during the study period.

Research Methodology

For the research study ratio analysis and leverage has been used to analyze the data. Therefore the study is based on the secondary data which have been collected from various sources. Such as, published annual reports & statements of the organization, websites, journals etc. for ratio analysis the period of 2013 to 2018 taken and for the leverage analysis the period of 2015 to 2018 taken.

Review of Literature

Bhatasana (1999) (Bhatasana, 1999) conducted a research on SBI financial performance of year 1980 to 1995. His study mainly focused on productivity & profitability of SBI. He identified progress in deposits, adequacy of capital fund, expansion of branches in rural areas and comparatively less borrowing from RBI in his period of study about SBI. He observed that SBI improved the productivity and profitability among public sector banks.

Gitman (2003) (Gitman, 2003) According to this study, it is normally believed that the value of a firm is maximized when its cost of capital is minimized. The kind of mixture of debt and equity that will reduce the firms cost of capital and hence maximizes the firm's profitability and market value is the most favorable capital structure. Unfortunately, financial managers do not have a clear-cut method that for taking decision on optimal capital structure.

Martin Hovey (2007) (Hovey, 2007) made an attempt to determine the capital structure of listed firms in China. He examined liquidity, profitability and ownership structure. To find the correlation between the variables such as liquidity, profitability and ownership structure regression analysis was used during the periods of 1997 to 2005. The study accomplished that leverage has a significant correlation with profitability.

Singla (2008) (Singla, 2008) in his paper studied that how financial management was significantly important tool for growth of banks. It is related with investigating the position of profitability of 16 selected bank's index for duration of 6 years (2001-2006). The outcome of the study stated that position of profitability was rational during the period of investigation as an when compared with the preceding years. Banks can build strong position when there was a strong Capital position and balance sheet to deal with and absorb the economic stable over a period of time.

Azhagaiah & Govoury (2011) (Govoury, 2011) studied the impact of capital structure on the profitability of IT firms. Business revenue and Asset size are the two attributes based on research has been conducted. The study proves that profitability reduces significantly with reduction in spending of Business Avenue or reduces in debt content in the capital structure. In additional words as per the study increase in use of debt tends to decrease the profitability of firm.

A. M Goyal (2012) (Goyal, 2013) this research focuses on the correlation between capital structure & profitability of listed Indian public sector banks. A research was conducted to determine the effect of capital structure on profitability of Indian public sector banks over a period of 2008- 2012. The study found that strong positive dependence of short term debt to capital (STDTC) on all profitability measures (ROA, ROE and EPS). Long term debt to capital (LTDTC) is having a negative correlation with ROA (return on assets), ROE (return on equity) and EPS (earnings per share).

Dr. V. N. Sailaja and Dr. N. Bindu Madhavi (2015) (Madhavi, 2015) the key objective of this research was analyze the relationship between capital structure and profitability of the public and private sector banks. To examine the relationship various ratios are used which include debt equity ratio, cost of equity, cost of debt, overall cost of capital, ROA, ROE and EPS and multivariate regression analysis. They found that the overall performance of private sector banks is fine during the study period reason was to determine the debt to equity of public sector banks is high as compared to the private sector banks which can be overloaded with the banks to pay high amount of interest out of the profits. Furthermore too much interest on debt reduces the EPS. In context to the low profitability, the banks are exposed to high amount of risk. They also observed that in public sector banks capital structure affects the EPS as per the outcome showed in regression analysis.

Data Analysis and Interpretation

Ratio analysis

A ratio is a simple arithmetical expression of the relationship of one number to another. It may be defined as the indicated quotient of two mathematical expressions. A ratio analysis is a quantitative analysis of information contained in a company's financial statements.

Ratio of reserves to equity capital

This ratio creates relationship between the reserves and equity share capital. It shows the amount retained by the firm for future development. Higher the ratio better will be the position of the firm.

$$\text{Ratio of Reserves to Equity Capital} = \frac{\text{Reserves}}{\text{Equity share capital}}$$

Table 1: Ratio of Reserves to Equity Capital (In crores)

Year	Reserves (Rs.)	Equity Capital (Rs.)	Ratio (In times)
2013-14	65,547.84	1,153.64	56.81
2014-15	72,051.71	1,155.04	62.38
2015-16	79,262.26	1,159.66	68.34
2016-17	88,565.72	1,163.17	76.14
2017-18	98,779.71	1,165.11	84.78

(***Source***: www.moneycontrol.com)

From the above table, it is noted that the ratio of reserves to equity capital is high in the year 2017-18 with 84.78 times, whereas, it is low in the year 2013-14 with 56.81 times. The ratio has been increasing trend during the research period. The higher ratio shows better position of the ICICI bank. Hence, the reserves and equity capital has to be raised more to a certain extent in order to maintain an increasing trend in future.

Current assets to proprietor's fund

The purpose of this ratio is to calculate the percentage of shareholders' funds invested in current assets. There is no 'rule of thumb' for this ratio. Depending upon the nature of the business there may be different ratios for different firms.

$$\text{Current assets to proprietor's fund} = \frac{\text{Current assets}}{\text{Shareholder's fund}}$$

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Table 2: Current assets to proprietor's fund (In crores)

Years	Current assets (Rs.)	Proprietor's fund (Rs.)	Ratio (In times)
2013-14	360553.96	66,705.96	5.40
2014-15	412940.99	73,213.33	5.64
2015-16	454823.74	80,429.36	5.65
2016-17	552706.39	89,735.58	6.15
2017-18	602479.69	99,951.07	6.02

(***Source***: www.moneycontrol.com)

From the above table, it is found that the current assets to proprietor's fund ratio show a fluctuating trend. The trend has occurred because the ratio is higher in the year 2016-17 with 6.15 times and it is lower in the year 2013-14 with 5.40 times. The value of proprietor's fund had been remained more or less same during the research study. Therefore, the value of current assets should be increased and kept constant in order to overcome the fluctuating trend and to have a good financial performance in future.

Fixed assets turnover ratio

This ratio measures the company's return on their investment in property, plant and equipment by comparing its net sales with fixed assets. It is the relationship between sales or cost of goods sold and fixed/capital asset employed in the business.

$$\text{Fixed assets turnover ratio} = \frac{\text{Cost of goods sold or sales}}{\text{Fixed asset/capital}}$$

Table 3: Fixed assets turnover ratio (In crores)

Year	Sales (Rs.)	Fixed assets (Rs.)	Ratio (In times)
2013-14	48,421.30	4,647.06	10.41
2014-15	54,606.02	4,678.14	11.67
2015-16	61,267.27	4,725.52	12.96
2016-17	68,062.48	7,576.92	8.98
2017-18	73,660.76	7,805.21	9.43

(***Source***: www.moneycontrol.com)

From the above table, it is depicted that the fixed assets turnover ratio is increasing in the year 2015-16 with 12.96 times whereas decreasing in the year 2016-17 with 8.98 times. It has been found during the study that the ratio fluctuates. Hence, there had been a poor performance of ICICI bank for the last two years, as it has not properly utilized its fixed assets in generating the revenue.

Debt equity ratio

Debt Equity ratio, is also known as External – Internal Equity ratio which is calculated to measure the relative claims of outsiders and the owners (i.e. shareholders) against the firm's asset. The two basic components of the ratio are outsider's funds (external equities) and shareholder's funds (internal equities).

$$\text{Debt equity ratio} = \frac{\text{Outsiders fund}}{\text{Shareholders}}$$

Table 4: Debt equity ratio (In crores)

Year	Outsider's Fund (Rs.)	Shareholders fund (Rs.)	Ratio (In times)
2013-14	145,341.49	66,705.96	2.17
2014-15	154,759.05	73,213.33	2.11
2015-16	172,417.35	80,429.36	2.14
2016-17	174,807.38	89,735.58	1.94
2017-18	147,556.15	99,951.07	1.47

(***Source***: www.moneycontrol.com)

From the above table, it is found that the debt equity ratio shows a fluctuating trend. The ratio is increasing in the year 2013-14 with 2.17 times and it is decreasing in the year 2017-18 with 1.47 times. There had been a sudden change in the value of outsider's fund and shareholders fund in the year 2017-18 when compared to other years of the study. Hence, the expected debt equity ratio will depends upon the future borrowings of the ICICI bank.

Earnings Per Share

EPS is used measure the profitability is on a shareholder basis. Earnings per share are the same as any profitability or market prospect ratio. Higher earnings per share are always better than a lower ratio because this means the company is more profitable and the company has more profits to distribute to its shareholders. EPS is figured by subtracting preferred dividends from net income and dividing by the average common shares outstanding.

Table 4: Earnings per share (Ratio)

2013-14	2014-15	2015-16	2016-17	2017-18
72.17	84.94	19.28	16.73	16.83

(***Source***: www.moneycontrol.com)

From the above table, it is found that the EPS shows a decreasing trend. The ratio is higher in the year 2013-14 with 72.17 and it is decreasing in the year 2017-18 with 16.83. It shows that profitability of bank is decreasing from several years. Hence, the EPS will depend upon the future earnings and profitability of the ICICI bank.

Spread Ratio

Bank spread is the difference between the interest rate that a bank charges a borrower and the interest rate a bank pays a depositor. Also called the net interest spread, the bank spread is a percentage that tells someone how much money the bank earns versus how much it gives out. Spread ratio can be calculated by dividing interest earned by interest paid. Spread is generally a Bread & Butter ratio for banks.

2013-14	2014-15	2015-16	2016-17	2017-18
7.82	7.35	7.04	6.83	6.58

(***Source***: www.moneycontrol.com)

From the above table, it is found that spread ratio is shows decreasing trend. The ratio is higher in the year 2013-14 with 7.82 and it is decreasing in the year 2017-18 with 6.58. It indicates that bank earnings from interest are less compared to its paid interest. A high spread equates to a higher profit margin, since the difference between interest earned and interest paid out is high.

Leverage

The term leverage is commonly used to describe the firm's ability to use fixed cost assets or funds to increase the return to its owners i.e. equity shareholders. It is the power and relationship between two inter-related variables and these variables can be of output, sales, cost and profit.

Financial leverage

Financial Leverage is known as trading on equity and it is used to magnify the earnings of the shareholders. Financial leverage is associated with financial activities and it results from the presence of fixed financial charges in the income with the firm's EBIT.

$$= \frac{\text{Earnings before interest and tax (EBIT)}}{\text{Earnings before tax (EBT)}}$$

Table 7: Financial leverage (In crores)

Year	EBIT (Rs.)	EBT (Rs.)	Ratio (In Times)
2015-16	49771.44	19719.91	2.52
2016-17	55378.92	23863.53	2.32
2017-18	58905.70	26486.74	2.22

(***Source***: www.moneycontrol.com)

From the above table, it is noted that the financial leverage is higher in the year 2015-16 with 2.52 times and it is lower in the year 2017-18 with 2.22 times. It had been found during the study that the financial leverage show a decreasing trend. It because of interest earnings are decreased against the tax. Hence, ICICI bank has to increase the financial leverage in order to lower the financial risk in the future.

Operating leverage

Operating leverage may be defined as "the firm's ability to use operating costs to magnify the effects of changes in sales on its earnings before interest and taxes".

$$= \frac{\text{Sales}}{\text{Earnings before interest and tax}}$$

Table 8: Operating leverage (In crores)

Year	Sales	EBIT (Rs.)	Ratio (In times)
2015-16	61,267.27	49771.44	1.23
2016-17	68,062.48	55378.92	1.22
2017-18	73,660.76	58905.70	1.25

(***Source*:** www.moneycontrol.com)

From the above table, it is found that the operating leverage is increasing in the year 2017-18 with 1.25 times and it is decreasing in the year 2016-17 with 1.22 times. It has been found from the study period that the operating leverage shows a fluctuating trend. Hence, in the future, ICICI bank should use the maximum level of operating costs in order to meet the future effects of changes in sales on its earnings before interest and taxes.

Combined leverage

Both financial and operating leverage magnify the revenue of the firm. Since, both these leverages are closely related with the ascertainment of the firm's ability to cover fixed charges (fixed operating cost in the case of operating leverage and fixed financial costs in the case of financial leverage), the sum of them gives the total leverage or combined leverage.

= Operating leverage X Financial leverage

Table 9: Combined leverage

Year	Financial leverage	Operating leverage	Ratio (In times)
2015-16	2.52	1.23	3.09
2016-17	2.32	1.22	2.83
2017-18	2.22	1.25	2.77

(***Source*:** www.moneycontrol.com)

From the above table, it is depicted that the combined leverage shows a decreasing trend. The decreasing trend shows weak side of the management. Therefore, the future of combined leverage may be expected to increase or decrease depending on the future performance of operating and financial leverage of ICICI bank.

Findings and Suggestions of the Study

- In line with the results of this study banks management should pay greater attention to those significant variables in determining their optimal capital structure and optimize level of profitability of their core business operations and hence, wealth of shareholders.
- Cost of capital should have to maintain according to the requirement of the firm.
- To get financial strength firm need to manage the assets properly.
- Leverage are the indicators of liquidity, hence it is need to more focus on leverage also.

Conclusion

Every concern has the aim to frame the optimum capital structure to its business as maximizing the value of the firm and minimizing the cost of capital. The study is aimed to analyze the capital structure of ICICI bank for the period of 2013-14 to 2017-18. The study has given the knowledge about the application of financial tools, its importance and its usefulness in determining the capital structure of ICICI bank. The study has concluded that the optimum capital structure of ICICI bank could be ascertained by using various ratios and leverage. The overall results of the study have shown that the equity and reserves of the firm should be sufficient to meet out the fixed bearing expenses and it has to lower the degree of financial leverage in order to overcome the financial risk in future. Thus, the capital structure of the ICICI bank shows a satisfactory position.

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