COMPARATIVE ANALYSIS OF CAPITAL STRUCTURE: BANKING INDUSTRY

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ABSTRACT

Since the liberalization of Indian economy, there has been a continuous research on company financing activities, particularly aimed at understanding how and why companies finance their activities. In the present scenario several alternatives are available for collecting the funds. The finance managers uses different combinations of debt & equity to meet the various financial requirements of the company at least cost & risk. Small and Big organizations used the way of collecting funds according to their paying capacity, degree of risk, size of capital, working system of the business etc. Therefore, the present paper is an attempt to study the comparative analysis of capital structure and its impact on profitability of PNB & HDFC Bank & determine the bank having effective capital mix and analyse the effect of changes in capital structure over the period of time on the performance of banks.

The data in study relates from 2014 & 2015. Lastly, some suggestions have been given which the banks can follow. Hence, the research may contribute in providing a new way to the banks for capital structure decision.

INTRODUCTION

Capital Structure refers to the mix of various components of Capital of a Company. Estimation of requirement of capital is necessary, but the formation of capital structure is most important. The term capital structure is used to represent the

1. Proportionate relationship between debt and equity
2. Determination of optimal capital structure is an important task in financial management
3. Capital structure decisions are important to maximize the earnings of the companies.

The factors influencing the capital structure decision are: (i) Financial leverage or “trading on equity” (ii) Growth and stability of sales (iii) Cost of capital (iv) Cash flow ability to service debt (v) Nature and size of a firm (vi) Control (vii) Flexibility (viii) Cost of floatation (ix) Capital market conditions (x) Marketability and (xi) Government policy. The structural composition of the capital of a company organization will have an impact on its profit earning capacity. Capital structure decisions are taken by considering the factors like
profitability, solvency and control. The relationship between debt, equity and profitability is examined and an attempt is made to understand this relationship among them.

RESEARCH PROBLEM
The study is to find the different determinant of capital structure in the banking industry and also to determine the impact of change in capital structure of the bank on its performance over the period of time. So it is very important to have a clear idea about these factors and cost of different sources in the banking industry. Therefore, the problem in the study is to determine & to find out effective determinant of capital structure. While choosing the source of finance a financial manager makes an attempt to ensure that risk as well as cost of capital is minimum. For this purpose he has to answer the following questions:
1. How much amount should be raised through issue of equity?
2. How much amount should be raised through issue of preference share capital?
3. How much amount should be raised through debentures and other long-term debts?

RESEARCH METHODOLOGY:
The secondary data is collected from various journals, reports and annual reports have been collected from various websites of PNB Bank & HDFC Bank.

Period of the study: The years selected for analysis are 2014-2015.

REVIEW OF LITERATURE
Noulas and Ketkar (1996) conducted a study to examine the technical and scale efficiency of banks.
Majid (2005) compared the productive efficiency of Islamic and conventional banks in Malaysia. They used stochastic frontier function approach to estimate the efficiency of banks to compare their relative performance. For the study, 34 banks were selected and data about these banks were obtained from the annual reports of the banks and the directory of the association of banks in Malaysia from 1993 to 2000. However, their study related inefficiency of the bank with its size in a non-linear way.
Roshan Budhoo (1996) propounded that there have always been controversies among finance scholars when it comes to the subject of capital structure. So far, researchers have not yet reached a consensus on the optimal capital structure of firms by simultaneously dealing with the agency problem. This paper provides a brief review of literature and evidence on the
relationship between capital structure and ownership structure. The paper also provides theoretical support to the factors (determinants) which affects the capital structure.

Minaxi Phor (2014) studied the different determinant of capital structure in the banking industry and analysed capital structure of SBI Bank & ICICI Bank during period 2006-2008. She concluded that the banks should have liquidity in their capital structure & Timely review of their capital structure is necessary in banking industry.

COMPANY PROFILE

Without a sound and effective banking system in India it cannot have a healthy economy. The banking system of India should not only be hassle free but it should be able to meet new challenges posed by the technology and any other external and internal factors. The banking sector mirrors the larger economy – its linkages to all sectors make it a proxy for what is happening in the economy as a whole. Efficient functioning of banking sector is required for the growth of overall economy. Banking plays a silent, yet crucial role in our day-to-day lives. The banks work as financial intermediaries, pooling savings and channelizing them into investment, helps in economic development of a country. A banking system also referred as a system provided by the bank which offers cash management services for customers, reporting the transactions of their accounts and portfolios, throughout the day. The banking system in India should not only be hassle free but it should be able to meet the new challenges posed by the technology and any other external factors. For the past three decades, India’s banking system has several outstanding achievements to its credit. The banks are the main participants of the financial system in India. The banking sector offers several facilities and opportunities to credit, and payments services, such as checking accounts, money orders, and cashier’s cheques. The banks also offer investment and insurance products. As a variety of models for cooperation and integration among finance industries have emerged, some of the traditional distinctions between banks, insurance companies, and securities firms have diminished. In spite of these changes, banks continue to maintain and perform their primary role - accepting deposits and lending funds from these deposits. The efficient working of banking system leads to survival of any country. The banking system of India is featured by a large network of bank branches, serving many kinds of financial needs of the people. The commercial Banking system provides a large portion of the medium of exchange of a given country, and is the primary instrument through which Monetary policy is conducted, through their deposit mobilization and lending operations. Commercial banks make the productive utilization of
ideal funds, thus assists the society to produce wealth. Commercial Banks are the institutions specifically designed to further the capital formation process through the attraction of deposits and extension of credit.

**OBJECTIVES OF THE STUDY**

2. To find out the cost of different financial sources of project financing.
3. To know the portion of debt and equity in capital structure.
4. To make company analysis & determine company having an effective capital mix.
5. To determine the effect of changes in capital structure over the period of time on the company’s performance.

**ANALYSIS OF STUDY**

**Punjab National Bank**

PNB was founded in the year 1894 at Lahore as an offshoot of the Swadeshi Movement. Among the inspired founders were Sardar Dayal Singh Majithia, Lala HarKishen Lal, Lala Lalchand, Shri Kali Prosanna Roy etc. The bank made steady progress right from its inception. It has shown resiliency to tide over many a crisis. It withstood the crisis in banking industry of 1913 and severe depression of the thirties. It survived the most critical period in its history. Nationalisation of the fourteen major banks on 19th July, 1969 was a major step for the banking industry. PNB was one amongst these. As a result, banking was given a new direction and thrust. PNB has always responded enthusiastically to the nation's needs. It has been earnestly engaged in the task of national development. In the process, the bank has emerged as a major nationalised bank. The bank has earned many laurels & accolades in different areas. To name a few, PNB was the only bank amongst public sector banks to receive “IBA Banking Technology Award” under “Best Risk Management Initiatives”. The bank was also awarded with “Agriculture Leadership Award” 2015 by Agriculture Today Group & “National Educational Excellence Award” NEEA, 2015 etc. During the long history of over 120 years of the banks, 7 banks have merged with PNB & it has become stronger & stronger with a network of 6635 branches & 8622 ATM'S as on 30th sept, 2015.

As per the comparative analysis it is clear that the bank has increased its share capital and also its reserves & surplus, which ultimately affects the profitability due to increase in the cost of capital and cash balance in the bank.

In case of borrowings, the bank has decreased the loan amount, which has decreased the financial risk for the business.

Moreover the liabilities of the bank are showing increase, & bank has made loss during 2015, which means bank is not properly utilising its resources and is totally debted.

**HDFC Bank**

*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 liberalisation 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 The bank has earned many laurels & accolades in different areas. To name a few, HDFC has received National Payments Excellence Awards 2015, FinanceAsia Awards, AIMA Managing India Awards 2015 etc.

HDFC Bank has its deposit programmes rated by two rating agencies - Credit Analysis & Research Limited. (CARE) and Fitch Ratings India Private Limited. The bank's Fixed Deposit programme has been rated 'CARE AAA (FD)' [Triple A] by CARE, which represents instruments considered to be "of the best quality, carrying negligible investment risk". HDFC

<table>
<thead>
<tr>
<th>Particulars</th>
<th>2014</th>
<th>2015</th>
<th>Absolute Increase / Decrease</th>
<th>% Increase / Decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td>SHARE CAPITAL</td>
<td>362.07</td>
<td>370.91</td>
<td>8.84</td>
<td>32.007</td>
</tr>
<tr>
<td>Reserves</td>
<td>34,125.07</td>
<td>37,321.06</td>
<td>3195.99</td>
<td>9.36</td>
</tr>
<tr>
<td>Borrowings</td>
<td>48,034.41</td>
<td>45,670.55</td>
<td>-2363.86</td>
<td>-4.92</td>
</tr>
<tr>
<td>Liabilities &amp; Provisions</td>
<td>15,093.44</td>
<td>17,204.89</td>
<td>2111.45</td>
<td>13.99</td>
</tr>
</tbody>
</table>

<table>
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<tr>
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<th>2015</th>
<th>Absolute Increase / Decrease</th>
<th>% Increase / Decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit</td>
<td>3,342.58</td>
<td>3,061.58</td>
<td>-281</td>
<td>-8.41</td>
</tr>
</tbody>
</table>
Bank also has its long term unsecured, subordinated (Tier II) Bonds of Rs.4 billion rated by CARE and Fitch Ratings India Private Limited. CARE has assigned the rating of "CARE AAA" for the Tier II Bonds while Fitch Ratings India Pvt. Ltd. has assigned the rating "AAA( ind )" with the outlook on the rating as "stable". In each of the cases referred to above, the ratings awarded were the highest assigned by the rating agency for those instruments.

**Comparative Financial Statements Analysis (2014-2015)**

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2015</th>
<th>Absolute Increase/ Decrease</th>
<th>% Increase / Decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>SHARE CAPITAL</strong></td>
<td>4,798,101</td>
<td>5,012,991</td>
<td>214890</td>
<td>4.48</td>
</tr>
<tr>
<td><strong>Reserves</strong></td>
<td>429,988,169</td>
<td>615,081,174</td>
<td>185093005</td>
<td>43.04</td>
</tr>
<tr>
<td><strong>Borrowings</strong></td>
<td>394,389,918</td>
<td>452,135,582</td>
<td>57745664</td>
<td>14.7</td>
</tr>
<tr>
<td><strong>Liabilities &amp; Provisions.</strong></td>
<td>413,444,042</td>
<td>324,844,559</td>
<td>-88599483</td>
<td>-21.4</td>
</tr>
<tr>
<td><strong>Profit</strong></td>
<td>196,105,607</td>
<td>248,700,721</td>
<td>52595114</td>
<td>26.8</td>
</tr>
</tbody>
</table>

As per the comparative analysis it is clear that the bank has increased its share capital by 4.48% and also its reserves & surplus by 43.04% (nearly 10 times), which ultimately effects the profitability due to increase in the cost of capital.

In case of borrowings, the bank has increased the loan amount, which has increased the financial risk for the business.

Moreover the liabilities of the bank are showing decrease, which depicts the company is utilising its resources optimally & bank has been earning profit during 2015.

**TO SUM UP**

As the overall analysis of the study, it is clear that PNB Bank has raised maximum capital as compared with HDFC Bank, but HDFC has created maximum balance of reserves & surplus by creating additional reserve of 43.04% as compared to 9.36 % by HDFC Bank. This depicts that HDFC Bank is risk averse as compared to the PNB Bank to secure its future & to meet uncertain financial crunch.
With regard to the borrowings, PNB Bank has decreased its borrowings by 4.96% as compared to HDFC Bank which has increased its borrowings by 14.7%. This depicts that PNB Bank has reduced the risk of financial burden as compared to HDFC Bank which has increased its financial risk.

**COMPARISON OF CAPITAL STRUCTURE OF PNB AND HDFC**

The capital structure which maximize the value of firm, minimize the cost of capital is called optimum capital structure.

<table>
<thead>
<tr>
<th>BANK</th>
<th>PNB</th>
<th>HDFC</th>
</tr>
</thead>
<tbody>
<tr>
<td>YEAR/SOURCE</td>
<td>Equity</td>
<td>Debt</td>
</tr>
<tr>
<td>2014</td>
<td>370.91</td>
<td>48,034.41</td>
</tr>
<tr>
<td>2015</td>
<td>362.07</td>
<td>45,670.55</td>
</tr>
</tbody>
</table>

**Interpretation**

It is clear from the study that equity used by HDFC is more than PNB. Debt used by PNB more than HDFC. Debt & Equity used by HDFC Bank at increasing rate, and Debt & Equity used by PNB bank at decreasing rate.

**COMPARISON OF EQUITY CAPITAL**

Equity capital is owner’s capital and most costly source of finance but least risky then the preference and debt source of finance.

**Interpretation**

It is clear from the study that equity used by HDFC Bank is more than PNB Bank. The equity is used by HDFC at increasing rate whereas used by PNB at decreasing rate. Equity capital is owners capital it means a good indicator for health of an organization.

**COMPARISON OF DEBT**

Debt are least costly source of finance because the rate of interest is lower than the rate of dividend and interest paid on debenture is deducted from the profit while calculating the taxes but these are most risky.

**Interpretation**

It is clear from the study that debt used by PNB is more than HDFC. The debt used by PNB at decreasing rate & by HDFC at increasing rate.
PNB
Debt-Equity Ratio = Debt ÷ Equity

<table>
<thead>
<tr>
<th>Year</th>
<th>Debt</th>
<th>Equity</th>
<th>Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>48034.41</td>
<td>370.91</td>
<td>129.5</td>
</tr>
<tr>
<td>2015</td>
<td>45670.55</td>
<td>362.07</td>
<td>126.13</td>
</tr>
</tbody>
</table>

HDFC
Debt-Equity Ratio = Debt ÷ Equity

<table>
<thead>
<tr>
<th>Year</th>
<th>Debt</th>
<th>Equity</th>
<th>Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>39438.99</td>
<td>479.81</td>
<td>82.19</td>
</tr>
<tr>
<td>2015</td>
<td>45213.56</td>
<td>501.30</td>
<td>90.19</td>
</tr>
</tbody>
</table>

Interpretation
It is clear from the graph that the debt equity ratio of PNB is more than HDFC. If the debt equity Ratio is more than it shows rather risky financial position from the long term point of view. As it indicate that more and more fund invested in the business provided by the long term lenders. The high debt equity ratio is a dangerous signal for the long term lenders.

Cost of Capital
Cost of capital is the minimum

\[
Ke = \frac{DPS \times MP}{100}
\]
\[
DPS = \text{Dividend per share}
\]
\[
MP = \text{Market Price}
\]

\[
Kd = \frac{I \times NP}{100}
\]
\[
I = \text{Interest}
\]
\[
NP = \text{Net Proceed}
\]

PNB Bank
2014 Ke = \(100 ÷ 362.07 \times 100 = 27.61\)
2015 Ke = \(165 ÷ 370.91 \times 100 = 44.48\)
2014 Kd = \(27077.28 ÷ 48034.41 \times 100 = 56.37\)
2015 Kd = \(29759.79 ÷ 45670.55 \times 100 = 65.16\)

HDFC Bank
2014 Ke = \(342.50 ÷ 479.81 \times 100 = 71.38\)
2015 Ke = 400÷501.3×100= 79.79
2014 Kd = 22652.9÷39438.99×100= 57.43
2015 Kd = 26074.24÷45213.56×100=57.66

<table>
<thead>
<tr>
<th>BANK</th>
<th>PNB</th>
<th>HDFC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year/Source</td>
<td>Cost of Equity</td>
<td>Cost of Debt</td>
</tr>
<tr>
<td>2014</td>
<td>22.61</td>
<td>56.37</td>
</tr>
<tr>
<td>2015</td>
<td>44.68</td>
<td>65.16</td>
</tr>
</tbody>
</table>

COMPARISON OF COST OF CAPITAL
Cost of capital is minimum rate of return that firm must earn on the equity financed position of an investment project in order to leave unchanged the market price of the share.

COST OF CAPITAL
Interpretation
It is clear from the study that Cost of equity of HDFC is more than PNB. On the basis of study it is clear that cost of debt of HDFC is more than PNB for the year 2014 whereas cost of debt of PNB is more than HDFC for the year 2015 and cost of debt is increasing and cost of equity is increasing more in PNB as compared to HDFC Bank.

FINDINGS AND CONCLUSIONS
On the basis of study conclude that HDFC is better than PNB because it continue to focus decreasing the cost of debt as compared to PNB
- HDFC have the better capital structure than PNB.
- Cost of debt of PNB is more than HDFC.
- Cost of equity of HDFC is more than PNB.
- Cost of equity of PNB & HDFC is increasing per year.
- Cost of debt of HDFC is increasing more as compared to PNB.

RECOMMENDATION
- Public bank should improve their capital structure.
- Private sector bank should try to reduce their overall cost of capital.
Determinant of capital structure should be considered while forming capital structure.

- Bank should have liquidity in their capital structure
- Timely review of their capital structure is necessary in banking industry
- Timely review of their cost of capital of different sources (debt, equity) is necessary in banking industry

REFERENCES

Websites

1. www.pnb.com
2. www.hdfc.com
3. www.moneycontrol.com