

# A Study On Impact Of Capital Structure And Dividend Policy Towards Steel Industries In India

**Dr.K.Latha\* , Sreeja Kumar \*\***

*\*Associate Professor, SCMS School of Technology and Management , Cochin.*

*\*\* Sreeja kumar, Assistant Professor, Rajagiri college of management and Applied science, Kakkanad.*

## **Abstract:**

*The Indian construction industry has been playing an elixir role in the overall economic development of the country. The success of construction and its associated industries depend up on their efficient financial and business management. In a business enterprise, financial management is a very important aspect that ensures its survival, progress and smooth functioning. The proper allocation and usage of capital funds improves the efficiency of management and enhances the profitability of business. An appropriate proportion of various sources of funds used in a business is termed as financial structure and capitalization refers to the total amount of securities issued by a firm. Capital structure decision is critical for any firm for maximizing return to the various stake holders and also to enhance firms' ability to operate in a competitive environment (A.M.Goyal 2013).Therefore, this study aim to analyze the impact of capital structure and dividend policy towards steel industries in India.*

## **Keywords:**

*Capital Structure, Business Enterprises, Economic development, Dividend policy.*

## **1.1 Introduction:**

Capital structure decisions are important decisions for firms as the firms constantly make investment decisions for their sustenance and growth (Sakshi Khanna et al., 2014). Capital is the fund that every organization needs to undertake its business activities. Capital Structure refers to the way the firm's assets are financed out of long-term sources of finance (Rajni Kant et al., 2013). The long term sources of funds consists of debt and equity capital. Debt consists of debentures, bonds, long-term notes payable whereas equity comprises of common stock, preferred stock and reserves. The long term sources of funds are used for financing a firm's assets and overall operations. The optimum capital structure can be defined as the capital structure or the combination of debt and equity that leads to the maximum value of the firm. Optimum capital structure provides for the maximization of value of the firm, wealth for its owners and minimizes the company's cost of capital. The companies distribute a portion of its earnings to the equity Share holders, as dividend. Dividend policy refers to a company's policy which determines the amount of dividend payments and the amount of retained earnings for reinvesting in new projects (Mohammad et al., 2012). The preference shareholders are paid a fixed rate of dividend. The retained earnings are considered as easily accessible source for investment requirements. Therefore, the companies should ensure both fair payment of dividend to the investors and prompt retention of earnings. The relationship between capital structure and dividend decisions is complex. The increased dividend payment could increase or decrease the value of the firm, or make the source of finance to be quiet expensive. Thus, the dividend decisions has an impact on both the long term financing and the wealth of shareholders. The changes in capital structure significantly impacts the dividend decisions of many companies, but in some others there may exist little, or no impact of capital structure on its dividend decisions.

### 1.2 Review of Literature:

**Maryam Masnoon and Abiha Saeed (2014)** have conducted a research study entitled “**Capital Structure Determinants of KSE Listed Automobile Companies**”. The main objective of the study was to explore the various factors that determine the choice of financing sources for public limited companies in the automobile sector of Pakistan. A sample of 10 automobile companies listed in Karachi Stock Exchange were analyzed for a period of 2008 to 2012. They revealed that the companies finance first from internal equity and then they go for debt. In the event of higher profits, firms fulfill their funding requirements by retaining the earnings. It was also found that profitability and liquidity had significant negative impact whereas size and tangibility had insignificant negative effect on capital structure and Earning variability had insignificant positive association with capital structure.

**Nishi Sharma and Gurmail Singh (2014)** have done a research study entitled “**Capital structure and Firm’s Characteristics: Evidence from Indian Automobile Industry**”. The objective of the study was to investigate the relationship of capital structure with characteristics of Indian automobile firms that faced major oscillations in recent years. A sample of 46 Indian automobile Companies were analyzed for a period of 10 years from 2003-2012. It was revealed that growth, size and tangibility had positive impact on leverage. Liquidity and effective tax rate had negative impact upon total leverage. The Indian automobile companies favored Pecking order theory like other Asian companies. They concluded that companies having more tangible assets, bigger in size and enjoying growth in net sales were expected to have more debt ratio, as they were in a better position to shield their investors and provide collateral to the debt.

**Obaid Ur Rehman (2016)** has done a research study entitled “**Impact of capital structure and dividend policy on firm value**”. The objective of the study was to propose a new integrated theory of capital structure and dividend policy decision that would empirically predict their effect on value of the firm. The sample comprises of 111 non-financial listed companies listed in Karachi stock exchange during the period 2006-2013 were analyzed. He concluded that selected Pakistani firms using more debt can create more worth but up to a fixed limit. Hence it was suggested to find cheaper sources of debt unlike fixed interest bearing debts. It also revealed that fixed asset turnover ratio has no impact on the firm value and an increase in the earnings per share has resulted in the increase of firm value.

**Divya Aggarwal and Purna Chandra Padhan (2017)** have done a research study entitled “**Impact of Capital Structure on Firm Value: Evidence from Indian Hospitality Industry**”. The objective of the study was to examine the effect of capital structure and firm quality on firm value 22 Indian hotel companies which are listed on the BSE for a period of 15 years from 2001 to 15. It was revealed that quality, size, leverage and liquidity had a significant influence on the enterprise value. Firm size and cost of financial distress were measured through a firm quality score that showed a significant influence on the firm value. The results also implied that hospitality firms preferred debt funds for expansion and an increase in GDP had a significant positive impact on firm value of the hospitality firms.

### 1.3 Objectives of the Study:

The objectives of the research study, “Impact of capital structure on dividend decisions with specific reference to select Construction associated Industries in India” are

1. To identify the factors influencing the capital structure and dividend decisions of the select industries.
2. To examine the impact of capital structure on the value of the select industries.

#### **1.4 Research Methodology:**

The present study is concerned with analyzing the impact of capital structure on dividend decisions of selected steel Industries in India. The multi-stage sampling method was used to select sample companies for the study. For the research purpose, the steel Industries are classified as Basic Industries and Ancillary Industries.

#### **Sample selection criteria**

The criteria for sample selection are,

- (i) The companies should be listed in Bombay Stock Exchange during the period of study.
- (ii) The companies should have declared dividend for ten continuous years from financial year 2013- to 2023.

#### **1.5 Factors Determining Capital Structure**

##### **1. Trading on Equity**

Trading on equity or financial leverage denotes taking advantage of the usage of long term fixed interest bearing debt and preference share capital along with equity share capital on reasonable basis. It refers to additional profits that equity shareholders earn by issuance of debentures and preference shares. It is based on the assumption that, if the rate of dividend on preference capital and the rate of interest on borrowed capital is lower than the general rate of company's earnings, equity shareholders are at advantage. It means a company should go for a judicious blend of preference shares, equity shares as well as debentures. Trading on equity becomes more vital as variations in combination of securities may adversely affect the wealth and value of the firm.

##### **2. Degree of control**

In a company, the directors who are the elected representatives of equity shareholders have got maximum voting rights and control in a concern as compared to the preference shareholders and debenture holders. Preference shareholders have reasonably less voting rights while debenture holders have no voting rights. Hence while raising additional funds, the company's management policies are such that they want to protect their voting rights and control over the firm. In such case, issue of debt securities are ideal but the risk of payment of fixed interest and possibility of liquidation of the company should be considered.

##### **3. Choice of investors**

The company's policy generally is to have different categories of investors for its securities. Therefore, a capital structure should give enough choice to all kind of investors according to their taste and preference to invest. Bold and adventurous investors generally prefer to invest in equity shares. Loans and debentures are generally raised from over cautious investors for safety of investment and stability in returns. The less cautious investors prefer preference shares for stable returns.

##### **4. Capital market conditions**

The capital market condition has got an important influence in the price of a company's shares. During depression period, the companies generally issue debentures and loans. While in the period of booms and inflation, the companies prefer issuing of equity shares. The appropriate timely issue of shares reduces the cost of raising funds.

##### **5. Period of financing**

If a company requires finance for a short period, it can prefer issue of debentures, redeemable preference shares and avail loans from banks and other institutions. In the case of permanent and long term financial need, the companies can prefer issuance of equity shares.

##### **6. Cost of financing**

The capital structure of a company has to focus on minimizing the cost of capital, when the funds are raised. The debentures at the time of profit earning are a cheaper source of finance, as compared to equity shares since the equity shareholders demand an extra share in profits. The debenture possess the advantages of fixed per centage of interest and tax deduction on the interest paid.

##### **7. Stability of sales**

The capital structure of a company is highly influenced by the amount of sales turnover. Therefore, if sales are high, the profits are high and then the company can meet its fixed commitments like interest on debentures, dividends on preference shares and repayment of debts. In case of fluctuating sales or declining sales, the company is not able to meet fixed obligations and so equity capital proves to be the safer source of finance.

### **8. Size of a company**

The amount and proportion of capitalization depends upon the nature and size of the company. The capital structure of small size and private companies generally comprises of owners' funds, loans from banks and retained profits. Whereas, public companies possessing goodwill, efficiency and a consistent profitability can procure funds by issuance of shares and debentures as well as loans and borrowings from financial institutions.

### **9. Strategy of maneuverability**

Maneuverability refers to the ability of altering source of funds in accordance with the change in need for funds. Therefore, in order to make the capital structure flexible and raise additional funds at the time of need, the company should prefer issue of convertible securities. Such flexibility should provide for not only, in obtaining funds but also for repaying them. The securities such as callable preference shares and long-term debt with options for advance payment provides for maneuverability.

## **1.6 STEEL INDUSTRY IN INDIA:**

The steel retains its global market with growing demand across national boundaries, as it forms the base for various construction purposes. India is the third largest producer of crude steel in the world, with a production of 89.3 million tonnes per annum during the FY 2016. The country enjoys the benefits of domestic availability of raw material and cheap labour. It leads to the cost advantage of domestic steel industry. The construction sector occupies 35 per cent of total steel production in India. Steel forms the leading construction material, as it has its advantages of quality, durability, economical and can be reused or recycled endlessly. Steel is ideal for modernization, reconfiguring, extending or adapting with minimal disruption, and without costly, harmful redevelopment. The versatility of steel offers many advantages to the architects, the freedom to achieve their most ambitious innovative visions. Since steel is considered as one of the most sustainable construction materials, building owners naturally value the flexibility of steel buildings, and the value benefits they provide.

### **1.6.1 STEEL COMPANIES**

The profiles of the selected Steel Companies are as follows.

#### **1. Hisar Metal Industries Limited:**

Hisar Metal Industries Limited was established at Hisar, Haryana in 1991. They manufacture variety of Stainless Steel products of various grades and sizes for usage of small scale, medium and heavy industries. The company is popular for production of high precision, ultra-thin stainless steel strips and so Hisar is called as "Stainless steel city of India". It has attained ISO 9001 certification for the Quality standard of stainless steel products.

#### **2. JSW Steel Limited:**

JSW Steel Limited one of the leading producer of primary integrated steel, was started in 1982. The company manufactures various steel products that includes flat products – Hot rolled, Cold rolled, Color coated products, Galvanised steel, Galvalume steel and long products – TMT bars, Wire rods, special alloy steel. With over 40,000 employees, it plays a significant role as the largest exporter of coated products operating in over 100 countries. It is known as "Strategic first mover" in steel industry.

#### **3. Kirloskar Ferrous Industries Limited:**

Kirloskar Ferrous Industries Limited is a unit of Kirloskar group and was Incorporated in 1991. Its manufacturing plants are located at Karnataka and Maharashtra. The core products manufactured are Pig Iron, Grey iron castings and S.G iron castings. It has attained an annual turnover of ~1134

crores for the year 2016-17 in the manufacturing of Pig iron and castings. The company has achieved various awards and recognitions for its quality management systems such as ‘3 Star’ rating for EHS practices, CII Exim Bank Award for Business Excellence 2016, Best supplier Award from TAFE 2016, OHSAS 18001:2007, ISO-TS 16949:2009 certifications and so on.

#### **14 Sarda Energy & Minerals Limited**

Sarda Energy & Minerals Limited was incorporated in 2000. The company has merged with Chhattisgarh Electricity Company Limited (CECL) in 2007 and became a leading energy and minerals company. Its annual direct reduction process, for steelmaking capacity is 360,000 MT and crude steel manufacturing capacity is 240,000 Million Tonnes Per Annum (MTPA). They are also one of the leading exporters of ferro alloys from India with an annual production capacity of 75,000 MT. It has attained ISO 9001:2008 certification for its digital control system and manufacturing facilities.

#### **6. Tata Sponge Iron Limited**

Tata Sponge was established in 1991 as Ipitata Sponge Iron Limited and the name was later changed as Tata Sponge Iron Limited in 1996. It has the annual production capacity of 390,000 tonnes of sponge iron. It has attained various accreditations such as ISO 9002 and 14000 certifications. The company has achieved several awards for its superior quality standards and environmental endeavours such as Golden peacock National quality Award, Jn Tata highest delta Award, Earth care and Environment excellence Awards etc.

#### **Tata Steel Limited**

Tata Steel Limited was established in India in 1907 and it is operating in 26 countries with 80,000 employees. It has a production capacity of 9.7 MTPA, operating as Asia’s first integrated private sector steel company. It manufactures various Flat products such as hot rolled, cold rolled, metallic coated, direct rolled, tubes, pre-finished steels, packaging steels, electro plated steels, electrical steels and narrow strip, construction products includes structural steel, floors, walls, roofs, modular and building components, agricultural implements, bearings and processes.

### **1.8 Data Analysis and Interpretation:**

The descriptive statistics for the average of dependent and independent variables for one industries consisting of one companies for a period of 10 years from 2013 to 2023 were computed. The results are presented in tables, that includes the number of observation, mean, standard deviation and coefficient of variance for the selected variables belonging to the industries individually.

#### **1.8.1 STEEL INDUSTRY**

The descriptive statistical analysis for seven companies belonging to steel industry in India are computed for ten years from 2013 to 2023. The results are shown in the following Table 1.1

Table 1.1 Descriptive Statistics of Steel Industry

<b>Variables</b>	<b>Mean</b>	<b>S.D</b>	<b>Variance</b>
Long term debt Ratio	0.099	0.116	0.013
Short term debt Ratio	0.106	0.095	0.009
Total debt Ratio	0.319	0.279	0.078
Return on Asset	0.088	0.074	0.005
Return on Equity	0.122	0.079	0.006
Growth	2.879	43.60	1900

Risk	15.66	23.66	559.7
Asset Tangibility	0.426	0.243	0.059
Non-debt tax shields	0.040	0.019	0.000
Liquidity ratio	2.410	1.946	3.785
Dividend payout ratio	0.028	0.093	0.009
Leverage	0.319	0.279	0.078
Cash holdings	0.181	0.134	0.018
Solvency ratio	0.201	0.182	0.033
Dividend yield ratio	0.033	0.030	0.001

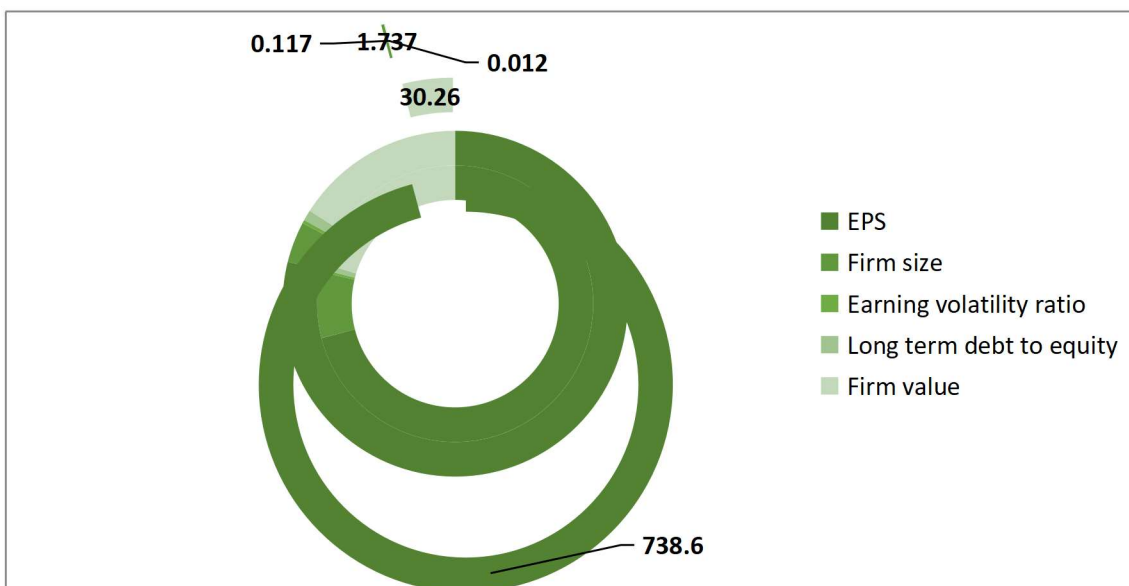
**Source: Computed Data**

Table 1.2 Descriptive Statistics of Steel Industry

Variables	Mean	S.D	Variance
EPS	27.23	27.18	738.6
Firm size	2.954	1.318	1.737
Earning volatility ratio	0.121	0.110	0.012
Long term debt to equity	0.263	0.342	0.117
Firm value	7.782	5.501	30.26

**Source: Computed Data**

Figure 1.1



It is revealed from Table 1.1, that the Long term debt ratio has a mean of 0.099 with a standard deviation of 0.116. It shows that the long term debt was highly fluctuating. The return on asset has a mean of 0.088, variance 0.005 and the return on equity has a mean of 0.122. It indicates consistency in earnings. Growth implied a mean of 2.879 with standard deviation 43.6. It indicates higher deviation in market capitalization and net asset value. The dividend payout ratio 0.028 and dividend yield ratio 0.03 showed less deviation implying consistency in distribution of dividends. Risk showed a mean of 15.66 and variance 559.7. It indicates higher fluctuation in market price per share and a low dividend payout. Earnings per share has a mean 27.23 and standard deviation 27.18 depicts consistency in earnings. The solvency ratio has a mean of 0.201 and a variance of 0.033. As the solvency ratio is more than 20%, the companies can be considered to be financially healthy. Earnings volatility mean is 0.121 with a standard deviation of 0.110 indicates less variation and a consistency in earnings during the study period. Long term debt to equity showed a variance of 0.117 signifying fluctuation and higher degree of business risk to meet the company's principal and interest obligations. Firm value had mean 7.782 with standard deviation 5.501 infers consistency and an enriched company value of steel companies. The remaining variables indicated consistency during the study period.

### 1.9 Suggestions:

- [1] The steel industry should increase the dividend payout and reduce retention of earnings in order to raise the market price of shares. Kirloskar, JSW and Sardha steel companies can increase their debt capital, so as to an increase their firm value. The Tata steel company can reduce its debt capital and issue new equity shares with a view to increase the firm value.
- [2] Majority of the construction associated industries have concentrated on retaining major portion of their earnings. Shareholders prefer current dividends to future capital gains and a high dividend will increase the market value of shares and in turn will increase the value of the firm. Therefore the selected companies can execute their capital structure decisions after comparing their impact on the dividends of their firm.

### 1.10 Conclusion:

In this study, the factors that determine the capital structure and dividend decisions of construction associated industries and their association are studied. The results reveal that return on asset, return on equity, firm size and liquidity ratio significantly influence the dividend decisions of steel industry. The factors such as return on assets return on equity, risk, firm size, non-debt tax shields and liquidity ratio significantly impacts the dividend decisions of cement industry. The factors namely return on asset, return on equity, asset tangibility, firm size, non-debt tax shields and liquidity ratio significantly influence the dividend decisions of paint industry. The factors such as return on assets return on equity, asset tangibility, firm size, earning volatility and non-debt tax shields significantly impacts the dividend decisions of granite industry. The factors namely return on asset, return on equity, risk, asset tangibility, firm size, earning volatility, non-debt tax shields and liquidity ratio significantly influence the dividend decisions of ceramic tiles industry. The development of an economy depends upon the sophisticated infrastructure and economic contentment of its people. An affordable construction and its associated activities forms base for the economic fulfillment of individual and the nation. The successful construction associated industries in India will tackle foreign competitors, utilize necessary funds, adopt new technologies, manufactures efficiently, increases its productivity, shares the profits to its investors promptly and expands itself with environmental and societal consciousness. It will boost steel industries provides opportunity for the development of other industries like brick, plastic, automobile and energy for their growth and thereby gradually improves the incredible Indian economy.

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