VOLUME - 11, ISSUE - 01, JANUARY - 2022 • PRINT ISSN No. 2277 - 8160 • DOI : 10.36106/gjra

Original Research Paper

Management

A STUDY ON ANALYSIS OF I-REITs AND THEIR CAPITAL STRUCTURE

Kiranmayi Patel Assistant Professor, Data Sciences Department Siva Sivani Institute of Management

P Pranavi Student, Siva Sivani Institute of Management

ABSTRACT In this study the factors related to capital structure in Indian Real Estate Investment Trusts (I-REITs) have been analyzed. An empirical investigation had been made by using predictors such as Return on equity (ROE), Return on assets (ROA), Return on Capital Employed (ROCE) and Net Profit Margin (NPM). The capital structure (debt to equity ratio) has been used as dependent variable. Secondary data has been gathered from financial statements of the company. The literature needed for this study has been taken from academic journals, books and internet. The major finding is that a low Debt to Equity suggests I-REITs are less risky. We can understand that there is no significant relationship exists between capital structure and performance of the companies.

KEYWORDS : Capital structure, Debt to Equity, Real Estate Sector, Indian REITs.

INTRODUCTION

The relationship between the company's capital structure and financial performance is an important unresolved problem in the field of finance and has been thoroughly studied both theoretically and empirically. The important lies in the fact that different source of capital have different risk return characteristics. Capital structure in business organizations in affected by various factors such as company size, liquidity, net profit, return on equity, board size and tax rate. The external environment such as economic, political, banking sector and stock markets have influence on capital structure. REITs are businesses which provide platform for individual investors, institutional and non-institutional investors to participate in real estate sector.

Capital structure refers to the specific mix of debt and equity used to finance a company's assets and operations. From a corporate perspective, equity represents a more expensive, permanent source of capital with greater financial flexibility. Debt, on the other hand, represents a cheaper, finite-to-maturity capital source that legally obligates the company to fixed, promised cash outflows with the need to refinance at some future date at an unknown cost (CFA Institute, 2021). REITs are catching up big way in the Indian economy and the real estate sector. Regulated by SEBI, REITs are companies that own, operate, or finance income-producing commercial real estate (from the Indian perspective). Pooling together the capital of multiple investors, REITs make it possible for them to earn dividends from office property investments (Financial Express, 2021).

Need For The Study

Real estate had become preferred choice for investors in the present world. The pandemic had changed the preferences of customers with regard to selection of sectors for investment. Investors have developed intention towards investment because it can be performed through reliable platforms like REITs where they need not own the physical asset. Hence it is necessary at the movement to conduct some empirical investigation for providing suggestions to financial managers, fund managers and investors about this new REITS regime in India.

Scope Of The Study

The three Indian REITs are: Embassy REIT (started in 2017), Brookfield REIT (commenced in 2019), and Mindspace REIT (began in 2020). All three of them are listed and traded on both the BSE and the NSE. The information related to these three companies had been procured from NSE and respective company websites and Annual reports.

Objectives Of The Study

- To analyze the capital structure of selected REITs.
- To compare the capital structure of selected REITs.
- To check the effect of capital structure on financial performance of REITs.

Literature Review

REITs have the highest book debt ratio in countries where they must pay out most of their operating income. It implies that REITs prefer debt financing to equity financing (Dogan et al, 2019). Pandey and Sahu (2017) had found negative effect of capital structure on accounting performance of our sampled firms. Kumar et al (2017) had mentioned dominance of pecking order theory in explaining capital structure of firms theoretically as well as statistically. Pandey and Singh (2015) had used sector level and economic level for determining the factors related to capital structure. Factors related to capital structure can be size, liquidity, profitability, and tangibility (Tripathy and Asija, 2017). The relationship between profitability liquidity can be described by using capital structure as mediating variable (Putra and Sedana, 2019). Pecking order theory is more relevant to describe the rationale behind capital structure in organizations (Choudhry and Sundaram, 2013). According to Nejad and Wasiuzzaman (2015) had used variables such as risk, tangibility, age, tax, industry concentration, board size and firm asset liquidity to evaluate capital structure. Capital structure is composition or made up of its capitalization and it includes all long-term capital resources like loans, reserves, shares and bonds (Jacob and Ajina, 2021).

Capital structure decision, in turn, affects overall cost of capital of a company. This overall cost of capital is generally used as discount rate while evaluating capital projects under capital budgeting decision. There are three issues in capital structure decision of a company (1) What should be the mix of debt and equity? (2) Does capital structure affect value of a firm? Or is there any relationship between capital structure and firm's value? (3) Is there any optimal capital structure? (Taxmann, 2021).

REITs, or REITs, are companies that own or finance income-producing real estate across a range of property sectors. These real estate companies have to meet a number of requirements to qualify as REITs. Most REITs trade on major stock exchanges, and they offer a number of benefits to investors (REIT, 2021). REITs historically have delivered competitive total returns, based on high, steady dividend income and long-term capital appreciation. Their comparatively low correlation with other assets also makes them an excellent portfolio diversifier that can help reduce overall portfolio risk and increase returns. These are the characteristics of REIT-based real estate investment (REIT, 2021).

REITs structured on the lines of mutual funds were first introduced in the United States of America in the 1960s, through the Cigar Excise Tax Extension Act to boost real estate development by way of existing investments, from investors interested in holding a stake in the real estate sector. The upsurge in real estate presented the opportunity of reaping huge dividends on the investments made, thereby bringing to effect, the real estate development projects and rewarding the investors financially. REITs were first introduced in India by the Securities and Exchange Board of India (SEBI) in 2007, almost 50 years after they were first incorporated as an investment vehicle (Cleartax, 2021).

RESEARCH METHODOLOGY

Three REITs Companies have been chosen since they are only currently available in India. The three companies are Brookfield India, Embassy Office Parks, Mindspace Business Parks. The historical data related to capital structure and financial parameters have been collected for the years 2020 and 2021. The sources of secondary data for this study are Annual reports, Academic Journals, Textbooks and Financial data from respective company websites. The variables used in the study are Debt to Equity ratio (D/E), Return on equity (ROE), Return on assets (ROA), Return on Capital Employed (ROCE) and Net Profit Margin (NPM). The statistical tools used in this research during data analysis are correlation, descriptive statistics, pie charts and bar charts

Research Conceptualization

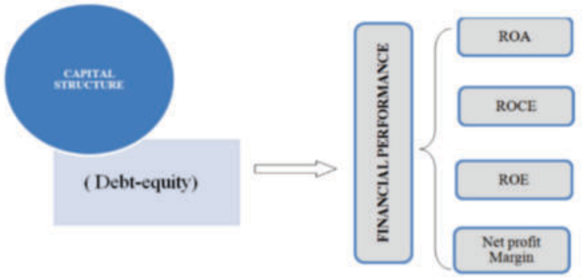

Figure 1: Research Conceptualization

Data Analysis

- **Capital Structure Components**

The mix of capital for the three Companies shows that the share capital has more contribution than borrowings. This means that the company is using more equity than debt to finance its operations. In debt, short term borrowings are negligible and consist of only long-term borrowings. The D/E ratio suggests that the company have low leverage and therefore less risky in the Investment Trusts space.

- **Comparison of capital structures**

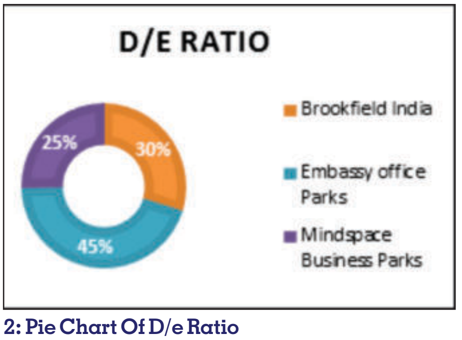

Figure 2: Pie Chart Of D/e Ratio

The three companies show similar Capital Structure. All of them have low leverage and depend majorly on equity financing. Equity financing in this industry can be useful especially during periods of low or slow growth. Investors can be interested in investing in such an industry and can include REITs in a portion of their portfolio.

- **Correlation Analysis**

The following four propositions (P) have been framed for the present study:

Table 1: Test Results Of Propositions

	Propositions	Correlation
P_1	There exists a relationship between Debt/Equity and Return on Equity	0.562
P_2	There exists a relationship between Debt/Equity and Return on Assets	0.397
P_3	There exists a relationship between Debt/Equity and Return on Capital Employed	0.252
P_4	There exists a relationship between Debt/Equity and Net Profit Margin	-0.205

The D/E ratio does not have any significant relationship with the other financial ratios. The relationship between D/E and Roe, ROA and ROCE has positive correlation and the relationship between D/E and NPM has negative correlation. This implies that the capital structure of REITs will not have a relationship with the performance.

Findings

- Indian REITs are following similar kind of capital structure.
- REITs have low gearing owing to their high operational risk.
- A low Debt to Equity suggests I-REITs are less risky.
- The REIT Regulations require to adhere to certain leverage conditions, which may limit the ability to acquire and/or dispose of assets.
- We can understand that there is no significant relationship exists between capital structure and performance of the company

CONCLUSION

REITs have given opportunity for individual investors to participate in most important sector. Embassy Office had been first bird with regard to experiencing profits in this segment. The real estate organizations are having bright future in India. Even though real estate companies operate in uncertain environments, the scarcity of land is the biggest issue. Hence there could be more demand for land in the future as population is increasing.

Capital structure has direct association with profits in the business world. The pressure on REITs increases when they procure more funds from banks or gather funds through debt instruments. At the same time equity market is another risk because the investors may also expect profits in short term. When the market booms, the investors also expect huge profits, again such situations cause pressure on the companies. However financial managers need to consider many things when developing capital structure or financial leverage strategy.

REFERENCES

1. Choudhry, S., & Sundaram, D. M. (2013). Testing the pecking order theory of capital structure–focus on Indian growth firms 1991–2009. *International Journal of Indian Culture and Business Management*, 6(3), 330-350.
2. CFA Institute. (2021). *Capital Structure, Level I*. https://www.cfainstitute.org/en/membership/professional-development/refresher-readings/capital-structure
3. Cleartax. (2021). *REITs (REITs) Funds: Eligibility, Advantages, Types*. https://cleartax.in/s/reit-funds
4. Dogan, Y. Y., Ghosh, C., & Petrova, M. (2019). On the determinants of REIT capital structure: evidence from around the world. *The Journal of Real Estate Finance and Economics*, 59(2), 295-328.
5. Financial Express. (2021). *Real Estate Investment Trust: How REITs have performed in India in 2021*. https://www.financialexpress.com/money/real-

estate-investment-trust-how-reits-have-performed-in-india-in-2021/2370271/

6. Jacob, T., & Ajina, V. S. (2021). Capital structure and financial performance of pharmaceutical companies in Indian stock exchange. *Asian Journal of Management and Commerce*, *2*(1), 10-16.
7. Kumar, S., Colombage, S., & Rao, P. (2017). Research on capital structure determinants: a review and future directions. *International Journal of Managerial Finance*.*13*(2), 106-132.
8. Nejad, N. R., & Wasiuzzaman, S. (2015). Multilevel determinants of capital structure: Evidence from Malaysia. *Global Business Review*, *16*(2), 199-212.
9. Pandey, A., & Singh, M. (2015). Capital Structure determinants: a literature review. *African Journal of Accounting, Auditing and Finance*, *4*(2), 163-176.
10. Pandey, K. D., & Sahu, T. N. (2017). An empirical analysis on capital structure, ownership structure and firm performance: Evidence from India. *Indian Journal of Commerce and Management Studies*, *8*(2), 63.
11. Putra, I. G. W. R., & Sedana, I. B. P. (2019). Capital structure as a mediation variable: Profitability and liquidity on company value in real estate companies in Indonesia stock exchange. *International Research Journal of Management, IT and Social Sciences*, 6(4), 62-72.
12. REIT. (2021). *What is a REIT (Real Estate Investment Trust)? | REIT.com*. https://www.reit.com/what-reit
13. Taxmann. (2021). *Financial Management - Financial & Capital Structure*. https://www.taxmann.com/post/blog/financial-management-financial-capital-structure/
14. Tripathy, N., & Asija, A. (2017). The impact of financial crisis on the determinants of capital structure of listed firms in India. *Journal of International Business and Economy*, *18*(1), 101-121.