



## A STUDY ON CAPITAL RESTRUCTURE OF INFOSYS AND TCS (SOFTWARE INDUSTRIES)

### KEYWORDS

capital restructure,debt and equity proportion,rate of return,EPS

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### ABSTRACT

Indian IT industry has built up valuable brand equity for itself in the global markets. IT industry in India comprises of software industry and information technology enabled services (ITES), which also includes business process outsourcing (BPO) industry. Thus, the capital structure decision can affect the value of the firm either by changing the expected earnings of the firm, but it can affect the earnings of the shareholders for the development of new project,modernisation ,expansion ,tax benefits,profitability and efficiency of the IT companies.The purpose of this study is how to restructure the capital based on company benefits and also consider survival and retain the growth of INFOSYS and TCS. But both the companies can compete the global level ,they should modify the capital structure. So this study ,evaluate the capital structure based on some assumption for investment (debt,equity proportion)and rate of return with the help of EPS computation

### INTRODUCTION

Information Technology (IT) industry in India is one of the fastest growing industries. Indian IT industry has built up valuable brand equity for itself in the global markets. IT industry in India comprises of software industry and information technology enabled services (ITES), which also includes business process outsourcing (BPO) industry. India is considered as a pioneer in software developments and a favourite destination for IT-enabled services. The origin of IT industry in India can be traced to 1974, when the main-frame manufacturer, Burroughs, asked its India sales agent, Tata Consultancy Services (TCS), to export programmers for installing system software for a U.S. client. The IT industry originated under unfavorable conditions. Local markets were absent and government policy toward private enterprise was hostile. The industry was begun by Bombay-based conglomerates which entered the business by supplying programmers to global IT firms located overseas

### INFOSYS

Infosys Ltd (formerly Infosys Technologies) is an Indian [multinational corporation](#) that provides [business consulting,information technology, software engineering and outsourcing](#) service. It is headquartered in [Bangalore, Karnataka](#).Infosys is the [third-largest India-based IT services company](#) by 2014 revenues, and the fifth largest employer of [H-1B visa](#) professionals in the United States in FY 2013. On 31 March 2014, its [market capitalisation](#) was ₹ 188,510 crores (\$31.11 billion), making it India's fifth largest publicly traded company.

Infosys was co-founded in 1981 by Narayan Murthy, Nandan Nilekani, N. S. Raghavan, S. Gopalakrishnan, S. D. Shibulal, K. Dinesh and Ashok Arora after they resigned from Patni Computer Systems.The company was incorporated as "Infosys Consultants Pvt Ltd." with a capital of Rs. 10,000 (roughly \$250) in Model Colony, Pune as the registered office and signed its first client, Data Basics Corporation, in New York. In 1983, the company's corporate headquarters was relocated to Bangalore.

**Tata Consultancy Services Limited (TCS)** is an Indian [multinational](#) information technology (IT) service, consulting

and business solutions company headquartered in [Mumbai, Maharashtra](#). TCS operates in 46 countries. It is a subsidiary of the [Tata Group](#) and is listed on the [Bombay Stock Exchange](#) and the [National Stock Exchange of India](#). TCS is the largest Indian company by [market capitalization](#) and is the [largest India-based IT services company](#) by 2013 revenues. TCS is now placed among the 'Big 4' most valuable IT services brands worldwide. In 2013, TCS is ranked 40th overall in the *Forbes* World's Most Innovative Companies ranking, making it both the highest-ranked IT services company and the top Indian company. It is the world's 10th largest IT services provider, measured by the revenues

### STATEMENT OF THE PROBLEM.

The value of the firm depends upon its expected earnings stream and the rate used to discount this stream. The rate used to discount earnings stream it's the firm's required rate of return or the cost of capital. Thus, the capital structure decision can affect the value of the firm either by changing the expected earnings of the firm, but it can affect the earnings of the shareholders for the development of new project,modernisation of company,expansion ,tax benefits,profitability and efficiency of the companies.Most of the IT companies can utilised the revenues and resource for this purpose it will affect the capital structure of the company.The purpose of this study is how to restructure the capital based on company benefits and also consider survival and retain the growth of INFOSYS and TCS.

### OBJECTIVES OF THE STUDY

- The primary objective of the study is to redesign capital restructure for Infosys and TCS
- To analyse the existing capital structure of Infosys and TCS , the proportion of debt and equity and its implications so far.
- To analyse the various options for raising fresh capital for Infosys and TCS to keep it running, under the assumption that it would be able to generate certain revenue

### SCOPE AND LIMITATIONS OF THE STUDY

The scope of the study includes the balance sheet, income

statement and other financial statements of the Infosys and Tcs from financial year 2010 to 2014. In the financial statements, importance has been given to the capital structure of Infosys and Tcs and also the debt in the capital structure has been analysed. The cash flow of Infosys and Tcs and its surplus and shortage of funds is also a subject of analysis

## REVIEW OF LITERATURE

**Amarjit Gill, Nahum Biger, Neil Mathur** (2011) explained that the relationship between capital structure and profitability cannot be ignored because the improvement in the profitability is necessary for the long-term survivability of the firm. They seek to extend Abor's (2005) findings regarding the effect of capital structure on profitability by examining the effect of capital structure on profitability of the American service and manufacturing firms. A sample of 272 American firms listed on New York Stock Exchange for a period of 3 years from 2005 – 2007 was selected. The correlations and regression analyses were used to estimate the functions relating to profitability (measured by return on equity) with measures of capital structure. Empirical results show a positive relationship between i) short-term debt to total assets and profitability and ii) total debt to total assets and profitability in the service industry. Their findings show a positive relationship between i) short-term debt to total assets and profitability, ii) long-term debt to total assets and profitability, and iii) total debt to total assets and profitability in the manufacturing industry. This paper offers useful insights for the owners/operators, managers, and lending institutions based on empirical evidence.

**H. Bierman, K. Chopra, and J. Thomas** (1975) found out that at any point in time a firm must decide both the level of working capital consistent with its productive assets and how to finance these assets. Academic theorists in business administration have traditionally approached decision making of the firm on a segmented rather than on a global basis and have been satisfied with developing sub optimizing decision rules. Thus there has been concern about managing working capital and concern about choosing the optimum capital structure, but traditionally the two decisions have not been made jointly. And even if they were made jointly, decisions would still remain in the working capital area involving inventories, credit granting, and marketable securities. This paper is an attempt to interrelate working capital and capital structure decisions with working capital used not only as a buffer to avoid ruin but also to affect sales via changing inventory levels and credit policies. The possibility of ruin introduces a discontinuity that precludes perfect elimination of leverage effects via a market.

**Diamond, Douglas W**(1994) stated that traditional capital structure theory obtains strong results by framing the choice as a trade-off between tax savings and exogenous costs of bankruptcy. When there are no costs of bankruptcy, an all-debt firm is optimal; when there are bankruptcy costs but no tax savings, an all-equity firm is optimal. It can be shown that firms with more variable cash flows choose less debt. More recent control-based theories of capital structure have not been framed as representing a trade-off of tax savings against bankruptcy cost. The costs of bankruptcy can sometimes be negative; there are situations when bankruptcy is beneficial to prevent management from initiating a bad investment project. Relative to publicly issued debt, bank debt is more expensive because banks must cover many variable operating costs. Banks enjoy an offsetting cost advantage: they can restructure outside bankruptcy those firms that default but have access to

viable investment projects.

**Gilson, Stuart C**(1997) found that a study provides evidence that transactions costs discourage debt reductions by financially distressed firms when they restructure their debt out of court. As a result, these firms remain highly leveraged and 1-in-3 subsequently experience financial distress. Transactions costs are significantly smaller, hence leverage falls by more and there is less recurrence of financial distress, when firms recontract in Chapter 11. Chapter 11 therefore gives financially distressed firms more flexibility to choose optimal capital structures

## Research Methodology

### Data Collection Method

The method of data collection employed for the study is secondary data collection. The sources of secondary data are the annual reports of INFOSYS and TCS from financial year 2010 to 2014.

### Sources of Data

The sources of data include the balance sheet, profit & loss account, cashflow statement and financial ratios of INFOSYS and TCS which are available in the annual reports of INFOSYS and TCS from financial year 2010 to 2014. In order to obtain more recent data, articles in newspapers such as The Hindu, Business Line and online news portal such as Bloomberg and magazines were also referred. Various websites also provided for required information.

### Statistical Tools Used

The following statistical tools have been used for the study of INFOSYS and TCS capital restructure.

Where, Earnings available to equity share holders = Earnings before Interest and Tax – Interest – Tax – Preference Dividend

### Capital Structure Analysis

**Table .1 Calculation of EPS for expected ROI at 30% and investment of Rs.42000crores for INFOSYS**

	FINANCIAL PLAN				
Equity/Debt	100:0	75:25	50:50	25:75	0:100
EBIT	12000	12000	12000	12000	12000
INTEREST	0	1050	2100	3150	4200
PBT	12000	10950	9900	8850	7800
TAX	2760	2518.5	2277	2035.5	1794
PAT	9240	8431.5	7623	6814.5	6006
PD					
EAESH	9240	8431.5	7623	6814.5	6006
No of shareholders	448	430	400	425	435
EPS	20.63	19.61	19.06	16.03	13.81

Note: All the values are rupees in crores

Here the Earnings before Interest and Tax is taken as 30% of the capital. As capital structures with maximum equity have resulted in maximum Earnings per share, it may be interpreted that though interest acts as a tax shield, it is a more of a burden in the form of fixed financial charge rather than a boon in the form of tax shield. With government announcing that software industry can directly utilising the debt capital, taxes can be saved with the help of the tax

shield – interest. Even with a return of 30% on investment Infosys is in a position to make positive earnings per share. This shows that Infosys has to either raise more capital or make more returns from the available capital structure. (100:0)

**Table .2 Calculation of EPS for expected ROI at 50% and investment of Rs.44000crores for TCS**

	FINANCIAL PLAN				
	I	II	III	IV	V
Equity/Debt	100:0	75:25	50:50	25:75	0:100
EBIT	21000	21000	21000	21000	21000
INTEREST	0	1100	2200	3300	4400
PBT	21000	19900	18800	17700	16600
TAX	4830	4577	4324	4071	3818
PAT	16170	15323	14476	13629	12782
PD					
Earnings available to equity shareholders	16170	15323	14476	13629	12782
No of shareholders	584	580	450	550	540
EPS	27.69	26.42	32.17	24.78	23.67

Note: All the values are in rupees crores

Here the assumption is that Rs.44000crores need to be raised. The expected return on investment is 50%, which is shown in the form of earnings before interest and tax. The earnings per share in the above table is more positive than the previous table. This is because, in the above scenario, interest has raised along with the increase in earnings before interest and tax increases. The earnings per share is also proportional to the number of share holders. The more the number of share holders, the higher the earnings per share. This relation has been obtained because higher the number of share holders, equal the proportion of equity and debt in the capital structure (50:50)

### CONCLUSION

Both the software company like INFOSYS and TCS can continue the capital structure with in India. But both the companies can compete the global level ,they should modify the capital structure. They should restructure the capital for the purpose of modernisation,expansion,and also tax purposes INFOSYS can continue with its present capital structure which has a huge volume of equity because this company is based on human capital . Hence the equity has to be raised from venture capitalists, foreign direct investors or other investors. For TCS Similarly the debt portion of the restructured capital need to be raised through debentures .TCS is suitable for equal debt and equity capital structure.and INFOSYS is suitable for equity and non debt capital structure,It is also suitable for majority of equity and minority of debt.

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