Chapter VII
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SUMMARY AND CONCLUSION

The objective of the present study is to make a detailed analysis of the financial performance, capital structure, cost of capital and growth of selected software companies in India. There are seven chapters in the present study.

The present study is based on secondary data collected from the Corporate Database (PROWESS) of the Centre for Monitoring Indian Economy (CMIE), Capital Line 2000 data base and www.moneycontrol.com for a continuous period of eleven years from 1996-97 to 2006-07. To carry out the study, a sample of forty six software companies belonging to Indian software industry was taken up. The companies selected for the study have been divided in to three categories: small, medium and large based on the average sales turnover. The following statistical tools were used to analyze the data collected.

a. Summary Statistics
b. Analysis of Variance and
c. Growth Rate

7.1 Results of Financial Performance Analysis

Analysis of financial performance of three categories of companies is presented using financial ratio analysis. Ratios are used primarily to identify the operating and financial problems faced by software companies. Hence the following ratios are used to analyze the financial performance of the sample companies.

1. Gross profit ratio
2. Net profit ratio
3. Return on Investment
4. Return on Net worth and
5. Current ratio
Gross Profit Ratio

A high ratio highlights higher margin of gross profit and on the other hand, low ratio indicates poor profitability. It is observed that the companies namely Pan India Corpn. Ltd from small category, Computech International Ltd, KPIT Cummins Infosystems Ltd from medium category and CMC Ltd from large category indicated poor performance. It may reflect higher cost of production due to inefficient utilization of resources. It is suggested that the companies which have low gross profit ratio to improve their performance in increasing the sales to raise the gross profit.

During the study period, the year wise analysis of gross profit ratio of small, medium and large category indicated better performance. It is an indication of good management and it implies relatively low cost of production. Hence profitability performance from the point of view of gross profit ratio is found to be satisfactory in all the three categories of companies. Analysis of Variance indicated that there exists no significant difference among the three categories of companies with respect to the gross profit ratio.

Net Profit Ratio

Net profit margin is the ratio of net profit to net sales. The ratio will be higher, if the operating as well as non-operating expenses tends to be lower with increasing sales. A progressive increase of this ratio year after year is a healthy sign. However in this study high fluctuation in the net profit ratio is noticed in few companies which can be attributed to the factors like market conditions and pricing policies.

It is observed that the net loss is reported by Pan India Corpn Ltd from small category and RS Software (India) Ltd from medium category which is due to decrease in sales. The large category companies show reasonable net profit for the entire study period. It is considered as good when compared to other two categories. The companies
namely Panoramic Universal Ltd in small category, SSI Ltd, Hinduja Ventures Ltd in medium category and Rolta India Ltd, I-Flex Solutions Ltd in large category revealed better performance. These companies indicate that the operating as well as non-operating expenses tend to be lower with increasing sales. Among the companies in three categories most of the companies in medium and large category indicate better performance in net profit ratio. Thus it can be noted that the operating efficiency of medium and large category companies is better than companies in small category.

It is found that none of the years show net loss in small, medium and large category for the entire study period. So it is considered good profitability position of the companies in all the three categories. Analysis of Variance indicated that there exists significant difference among the three categories of companies with respect to the net profit ratio.

**Return on Investment**

The profitability of a business enterprise is measured in relation to investment. It is the prime measure of the overall profitability of an enterprise. Return on investment measures the overall effective management in generating profits with its available assets. This ratio reveals how profitably the firm's assets have been utilized.

It is observed that Pan India Corpn Ltd from small category and RS Software (India) Ltd from medium category had negative returns. It indicates that the operating assets are not utilized effectively in these companies.

It is found that Panoramic Universal Ltd from small category, Aftek Ltd, Hinduja Ventures Ltd from medium category and I-Flex Solutions Ltd, Tech Mahindra Ltd, Infosys Technologies Ltd from large category have better return on investment when compared to other companies. These companies show the effective utilization of the total assets. Among the three categories most of the companies in medium and large category
performed better than companies in small category. It is found that the year 2001-02 from small category had negative returns. It indicates that the earnings are not available to investors in that particular year. The return on investment is found to be positive throughout the study period in medium and large category, which shows the effective utilization of the total assets when compared to small category. It is inferred that medium and large category companies performed better than small category companies in terms of return on investment. Analysis of Variance indicated that there exists significant difference among the three categories of companies with respect to return on investment.

**Return on Net worth**

This ratio is widely used by investors. The return on net worth ratio is an important measure of a company’s earnings performance. This ratio indicates how profitable a company is by comparing its net income to its average shareholders’ equity. The return on net worth ratio measures how much the shareholders earned for their investment in the company. The higher the ratio, the more efficient is the management in utilizing its equity base and the better return is to its investors.

It is found that Pan India Corpn Ltd and Onward Technologies Ltd from small category had negative returns. It shows that the equity earnings are not available to investors in those particular companies. LCC Infotech Ltd and Genesys International Corpn Ltd from small category recorded very low returns. It indicates very low earnings available to the investors in these companies i.e. it shows that there is inefficient management in utilizing its equity funds. It is suggested that these companies from small category try to avoid the negative returns by utilizing the equity funds in an effective manner to increase the returns to investors. The analysis of return on net worth ratio reveals that the companies in medium and large category utilized the owner’s equity profitably than the companies in small category.
It is observed that the year 2001-02 from small category had negative returns. It indicates that the equity earnings are not available to investors in that particular year. In the years 2002-03 and 2003-04 from small category recorded very low returns. It indicates very low earnings available to the investors in the above years i.e. it shows that there is inefficient management in utilizing its equity funds. Most of the years indicate higher return on equity in medium and large category. Companies in these two categories performed better than companies in small category. Analysis of Variance indicated that there exists significant difference among the three categories of companies with respect to return on net worth.

**Current Ratio**

The true liquidity position of a company is judged by its ability to meet the current liabilities within a short period of time. Excessive and insufficient liquidity are equally dangerous to an organization. Conventionally, a standard ratio of 2:1 is considered satisfactory.

The companies falling under small category have reported higher current ratio. The current ratio of the three categories is remained above the standard norm. Among the sample companies, six companies satisfied the standard norm and the ratio of only one company was below the standard norm. A good current ratio may mean a good cushion for creditors. But for the management it reflects bad financial planning or presence of idle assets or over capitalization. It is noted that the liquidity in terms of current ratio of large category is not impressive, but it is far better than that of small and medium categories.
It is found that companies in small category recorded high current ratio i.e. above the standard norm in all the years during the period of study. It indicated the presence of idle assets or over capitalization through out the study period it is not good for the company, it will decrease the profitability of the company. Among the three categories liquidity position of large category is satisfactory when compared to other categories. The companies in all the three categories indicated that the ability to meet immediate financial obligations. Analysis of Variance indicated that there exists significant difference among the three categories of companies with respect to current ratio.

7.2 Results of Capital Structure Analysis

Analysis of capital structure of all the sample companies is studied to identify the relative share of each component of capital. Category wise analysis of capital structure is also discussed. In addition to this, to study the long term solvency position of the companies in three categories debt equity ratio, liability to asset ratio and interest coverage ratio are computed and analyzed.

Estimation of capital requirements for current and future needs is important for a company. Equally important is determining the capital mix. Equity and debt are the two principal sources of finance for the company. Capital structure planning aims to maximize the profits and the wealth of the shareholders and ensures maximum value of the company. It is very important for the financial manager to determine the proper mix of debt and equity for the company. Debt is considered to be cheaper, but it is likely impose a high interest burden. On the other hand, equity could lead to lower earnings per share. A company's reasonable, proportional use of debt and equity to support its assets is a key indicator of balance sheet strength. A healthy capital structure is a very positive sign of investment quality.

The analysis of capital structure clearly reveals the insignificant role of preference share as a source of finance in the companies of all the three categories. Companies in all
the three categories indicated that there is a high dependence on internally generated funds. Equity and shareholders reserves contribute the major source of finance in most of the companies in all the three categories. The companies namely Logix Microsystems Ltd, Onward Technologies Ltd and Karuturi Networks Ltd in small category, RS Software (India) Ltd in medium category and 3i Infotech Ltd in large category seem to have high utilization of long-term debts in their capital structure. Analysis of Variance technique indicated that there exists significant difference among the three categories of companies with respect to the proportion of equity share capital and shareholders reserves. Regarding the proportion of preference share capital and long term debts there exists no significant difference among the three categories of companies.

**Debt equity ratio**

The relationship between borrowed funds and owners equity is a popular measure of the long-term financial strength of software companies. This relationship is reflected by the debt equity ratio. This ratio is employed as a principal tool for analyzing the composition of capital structure. This ratio is important for judging the financial policy followed by the concern. An ideal norm of the ratio is 2:1 that is, the long-term debt could be two times the owned funds in the business.

It is indicated that the lenders have contributed more funds than owners in the companies Karuturi Networks Ltd, Logix Microsystems Ltd, Trigyn Technologies Ltd and Onward Technologies Ltd from small category, Cranes Software Intl Ltd from medium category and 3i Infotech Ltd, GTL Ltd, CMC Ltd from large category. If a firm has excessive debt, it will experience difficulty in locating additional debt financing. The firm will be able to borrow only at high interest rates, if at all. It is suggested that the above companies try to reduce the excessive use of debt to pay interest on debt capital.

The debt equity ratio is very low in case of Genesys International Corpn Ltd, Pan India Corpn Ltd, Orient Information Technology Ltd, LCC Infotech Ltd from small
category, Nucleus Software Exports Ltd, Geometric Ltd from medium category and Polaris Software Lab Ltd, I-Flex Solutions Ltd, Tech Mahindra Ltd from large category. If the ratio is low it may indicate a failure to use relatively lower cost borrowed funds to raise the return earned on the common stock.

It is found from the year wise analysis of debt equity ratio that the lenders have contributed more funds than owners in the years 1996-97 and 2003-04 from small category 2002-03 from medium category and 1996-97, 1997-98 from large category. It is suggested that the companies must try to reduce the excessive use of debt to pay interest on debt capital.

The medium category companies have shown low debt equity ratio when compared to small and large categories. A low debt equity ratio implies a greater claim of owners than creditors. From the point of view of creditors, it represents a satisfactory capital structure of the business since a high proportion of equity provides a larger margin of safety for them. The low proportion of debt in capital structure is a welcome sign of long-term financial solvency. The financial position of medium category is considered as good when compared to small and large category. Analysis of Variance indicated that there exists significant difference among the three categories of companies with respect to debt equity ratio.

**Liability to Asset Ratio**

This ratio indicates the relationship between the total liabilities to outsiders to total assets of a firm. The liability to asset ratio is very low in four companies. Generally lower the ratio of total liabilities to total assets, more satisfactory or stable is the long-term solvency position of a firm.

It is understood that Karuturi Networks Ltd, Logix Microsystems Ltd, Trigyn Technologies Ltd, Onward Technologies Ltd, from small category,
Cranes Software Intl Ltd, RS Software (India) Ltd, Zensar Technologies Ltd from medium category and 3i Infotech Ltd, CMC Ltd from large category have registered higher liability to asset ratio. The long term solvency position is not favourable in these companies.

It is found that Pan India Corpn Ltd, LCC Infotech Ltd from small, Aftek Ltd from medium and Infosys Technologies Ltd from large category indicates lower liability to asset ratio. The long term solvency position of these companies is more satisfactory and stable. The other companies indicate moderate liability to asset ratio. Hence the long term solvency position of these companies is satisfactory.

It is revealed that the years 1996-97 and 2005-06 from small category, the year 1996-97 from medium category and the year 1997-98 from large category indicate higher liability to asset ratio. The long term solvency position is not favourable in the above stated years. The long term solvency position of other years is satisfactory. Hence it is inferred that the long term solvency position of companies in three categories is satisfactory. Analysis of Variance indicated that there exists no significant difference among the three categories of companies with respect to liability to asset ratio.

**Interest Coverage Ratio**

The interest coverage ratio indicates the extent to which earnings may fall without causing any embarrassment to the firm regarding the payment of the interest charges. A higher ratio is desirable i.e. more safe to the long-term creditors. But too high interest coverage ratio may not be good for the firm because it may imply that the firm is not using debt as a source of finance to increase the earnings per share.

It is observed that Panoramic Universal Ltd, Vakrangee Softwares Ltd from small category, Nucleus Software Exports Ltd, Geometric Ltd, Aftek Ltd, Hinduja Ventures Ltd, Infotech Enterprises Ltd, Mastek Ltd from medium category and Mphasis Ltd, Hexaware
Technologies Ltd, Polaris Software Lab Ltd, I-Flex Solutions Ltd, Satyam Computer Services Ltd, infosys Technologies Ltd, Wipro Ltd from large category have witnessed higher interest coverage ratio and these companies are very conservative in using the debt, and these firms are not using credit to the best advantage of share holders.

It is found that Logix Microsystems Ltd, Onward Technologies Ltd, Melstar Information Technologies Ltd from small category and R S Software (India) Ltd, Cranes Software Intl Ltd, Computech International Ltd from medium category indicate low interest coverage ratio due to excessive use of debt, or inefficient operations. These companies may make efforts to improve the operating efficiency, or to retire debt to have a comfortable coverage ratio. It is found that companies in large category have higher interest cover as compared to companies in the other two categories. It indicates that this category is very conservative in using debt, and that it is not using debt to the best advantage of shareholders. The interest coverage ratio of the companies in three categories indicated that these companies are able to meet their operational expenses.

From the year wise analysis of interest coverage ratio, it is evident that the years 2006-07 from small category, 2000-01, 2004-05, 2005-06 and 2006-07 from medium category indicate high interest coverage ratio and 2003-04 to 2006-07 from large category indicate higher interest coverage ratio. The above mentioned periods indicate that the companies are very conservative in using the debt, and that it is not using credit to the best advantage of share holders. Negative interest coverage ratio is indicated in the year 2005-06 from small category. It is due to excessive use of debt or inefficient operations. Analysis of Variance indicated that there exists significant difference among the three categories of companies with respect to interest coverage ratio.
7.3 Results of Cost of Capital Analysis

Analysis of cost of capital is made for all the three categories of companies. The cost of equity and cost of debt is calculated. The weighted average cost of capital is calculated for each company for all the eleven years. The company wise and year wise cost of equity, cost of debt and weighted average cost of capital is analyzed.

It is inferred that Pan India Corpn Ltd from small and Tech Mahindra Ltd from large category indicated low average cost of equity. This shows the companies ability to mobilize cheaper source of equity than the other companies. LCC Infotech Ltd from small category indicated negative cost of equity due to fluctuation in earnings per share.

It is observed that Karuturi Networks Ltd, Scintilla Software Technology Ltd, California Software Co. Ltd, KLG Systel Ltd, Goldstone Technologies Ltd, Trigyn Technologies Ltd from small category, Nucleus Software Exports Ltd, Geometric Ltd, Cranes Software Intl Ltd, Aftek Ltd and KPIT Cummins Infosystems Ltd from medium category and Satyam Computer Services Ltd, Infosys Technologies Ltd, Wipro Ltd, Mphasis Ltd from large category indicate high cost of equity due to large portion of funds obtained from equity source in the capital structure of these companies. It is suggested that the companies in three categories try to minimize the cost of equity.

It is observed that the year wise analysis of cost of equity revealed that the companies in small category show low cost of equity during the study period when compared to other two categories. Analysis of Variance indicates that there exists significant difference in cost of equity among the three categories of companies.

It is observed that the cost of debt is high in Logix Microsystems Ltd from small category, RS Software (India) Ltd from medium category and Rolta India Ltd, GTL Ltd from large category. The cost of debt of companies in all the three categories is considered satisfactory. It is observed from the year wise analysis that the companies in
large category indicated satisfactory cost of debt throughout the study period. The company wise and year wise analysis of cost of debt indicate fluctuating trend in all the three categories which is due to fluctuation in market conditions.

The analysis of weighted average cost of capital of the small, medium and large category companies reveals that there are six companies below the mean weighted average cost of capital of 4.86 percent in small category, ten companies below the mean weighted average cost of capital of 25.80 percent from medium and ten companies below the mean weighted average cost of capital of 18.26 percent from large category. It is found that Karuturi Networks Ltd, Logix Microsystems Ltd, Onward Technologies Ltd from small category, RS Software (India) Ltd from medium category and 3I Infotech Ltd large category indicate high proportion of long term debts in the capital structure.

Most of the companies from three categories mainly depend on internally generated funds and equity share capital. In case of Infosys Technologies Ltd, there was no debt capital. It means that the company has used only shareholders funds. It is suggested that the above companies try to use the maximum amount of debt to increase the return on equity through earnings per share. Financial decision is based on the overall weighted average cost of capital. Hence it may be concluded that the debt should be used to an extent because of its tax advantage. While determining the optimal capital structure every management has to keep in mind to maximize the value of the firm and to minimize the weighted average cost of capital.

It is found that most of the companies indicate low weighted average cost of capital in small category than companies in large and medium category. It is suggested that companies in large and medium category try to reduce weighted average cost of capital. Analysis of Variance indicates that there exists no significant difference in cost of debt among the three categories of companies.
7.4 Results of Growth Analysis

Growth is studied with reference to annual compound growth rate computed based on the compound interest rate formula adopted by the World Bank using the least square methods. The growth of three categories of software companies are measured in terms of net sales, net profit, net worth, and total asset.

In this chapter the sustainable growth rate is also discussed to ascertain the creditworthiness of the companies in the three categories. The sustainable growth rate is the year on year growth rate. The analysis of the sustainable growth rate identifies the maximum rate at which a company can grow without depleting its financial resources.

The internal performance of the companies is analyzed by using profitability ratio, asset utilization or efficiency ratio and leverage ratio. These ratios are combined to determine the rate of return for a company and its owners (ROE). Further combining ROE and profits retained, the rate at which the company can grow, the sustainable growth rate is determined.

Annual Compound Growth Rate

It is observed that Logix Microsystems Ltd, Goldstone Technologies Ltd, Orient Information Technology Ltd, Onward Technologies Ltd, Melstar Information Technologies Ltd from small category, Computech International Ltd, SSI Ltd, Sonata Software Ltd from medium and Hexaware Technologies Ltd, NIIT Ltd, GTL Ltd from large category recorded low growth rate in net sales which is due to decrease in sales in some of the years during the study period. It is suggested that these companies try to increase the sales.

It is observed that Scintilla Software Technology Ltd, Pan India Corpn. Ltd, Goldstone Technologies Ltd, Onward Technologies Ltd, Melstar Information Technologies Ltd, Kale Consultants Ltd from small category, Maars Software
International Ltd, Computech International Ltd from medium and Pentasoft Technologies Ltd, N I I T Ltd in large category indicated negative growth in net profit which is due to decrease in net profit and net loss incurred in few years during the study period. It is suggested that the above companies try to improve their operating efficiency to avoid loss and to improve their profitability position. The companies in medium and large category indicate better growth than the companies in the small category.

It is inferred that the growth rate of net worth in Goldstone Technologies Ltd, Trigyn Technologies Ltd, Melstar Information Technologies Ltd from small category, RS Software (India) Ltd from medium category indicate low growth rate in net worth. It is due to low reserves and surplus in few years during the period of study. The companies in all the three categories indicate better growth in networth.

It is inferred that the growth rate of total asset in Scintilla Software Technology Ltd, Pan India Corp. Ltd, Goldstone Technologies Ltd, Melstar Information Technologies Ltd from small category, RS Software (India) Ltd from medium category and Tata Elxsi Ltd, NIIT Ltd indicate low growth rate in total asset. Most of the companies in large category indicate better growth than the companies in the small and medium categories.

**Sustainable Growth Rate**

The analysis of sustainable growth rate reveals that five companies from small category (Panoramic Universal Ltd, Karuturi Networks Ltd, Vakrangee Softwares Ltd, Goldstone Technologies Ltd, Trigyn Technologies Ltd,), nine companies from medium category (ICSA (India) Ltd, Nucleus Software Exports Ltd, Geometric Ltd, Cranes Software Intl. Ltd, Aftek Ltd, K P I T Cummins Infosystems Ltd, Infotech Enterprises Ltd, Sonata Software Ltd, Mastek Ltd) and eight companies from large category (3I Infotech Ltd, Hexaware Technologies Ltd, NIIT Ltd, I-Flex Solutions Ltd, Tech Mahindra Ltd, Satyam Computer Services Ltd, Infosys Technologies Ltd, Wipro Ltd) indicates better performance in terms of sustainable growth rate than the other companies.
It is found that the sustainable growth rate is higher than the annual compound growth rate of sales in two companies (Goldstone Technologies Ltd and Orient Information Technology Ltd) from small category, six companies (Maars Software International Ltd, Geometric Ltd, Computech International Ltd, Zensar Technologies Ltd, SSI Ltd and Sonata Software Ltd) from medium category and nine companies (Tata Elxsi Ltd, Pentasoft Technologies Ltd, Rolta India Ltd, Hexaware Technologies Ltd, NIIT Ltd, GTL Ltd, CMC Ltd, Tech Mahindra Ltd and Wipro Ltd) from large category. Hence it is suggested that these companies try to utilize the financial resources fully to generate share holder value. Most of the companies in large category can continue to expand without new equity issuance. From the Analysis of Variance technique reveals that there exists significant difference among the three categories of companies with regard to the mean sustainable growth rate.

7.5 Conclusion

Based on the analysis, it may be concluded that the profitability in terms of gross profit ratio is better in all the three categories. The profitability of medium and large category is better than small category in net profit ratio. The medium and large category has performed better in terms of return on investment and return on equity than small category. The liquidity position of large category is not impressive, hence it is better than small and medium categories. The debt equity ratio of medium category is considered good when compared to small and large category. The long term solvency position of companies in three categories is satisfactory.

Analysis of capital structure reveals that there is insignificant role of preference share as a source of finance in all the three categories. All the three categories indicate high dependence on internally generated funds. Equity and shareholders reserves contribute the major source of finance in all the three categories. It is observed that companies in small category indicate low cost of equity. Companies in all the three
categories indicated satisfactory cost of debt. It is found that the companies in small category indicate low weighted average cost of capital. The annual compound growth rate and sustainable growth rate are also better for the medium and large category companies. Therefore it is suggested that the companies under small category try to use some strategies to improve their performance and sustain in the market. Thus it is concluded that the medium and large category companies have performed relatively better than companies in small category.