

CAPITAL - VIII

VARIATIONS IN TREND

VARIATIONS IN TREND

Introduction :

The trend of changes in the capital-structure of the jute industry, during the period from 1958-59 to 1967-68, was studied towards the end of Chapter-4. It was observed that, in respect of the 29 companies under study, the percentage of external capital moved from 71.1% to 77.9% and accordingly the internal capital from 28.9% to 22.1%. Thus the trend of rise in the proportion of external capital or fall in the proportion of internal capital of the previous period (pre-investigation period) was maintained though at a comparatively slow rate. Similarly, the proportion of creditorship capital (excluding preference share capital) increased from 31.5% to 54.8% and that of ownership capital came down from 68.5% to 45.2%. In the former case the rise was more rapid in comparison with the previous period. The fall in the latter case, was, however, equally rapid. As a result, creditorship surpassed ownership.

The above results in the change of capital-structure were occasioned by equity-share capital coming down from 27.3% to 16.9%, preference share capital from 12.3% to 6.2%, and retained profits from 28.9% to 22.1%. Borrowings, however, went up from 31.5% to 54.8%. As a result, the order of the previous period, that is borrowings occupying the highest percentage, and retained profits and equity-share capital coming next to it in succession did not change. The preference share capital in both the periods, invariably, occupied the lowest position.

In this connection certain inferences were made also at the end of the said chapter. The first inference that all these changes happened in the wake of an increase of the total capital was found subsequently to be true. So far as 29 companies are concerned, it increased from Rs. 41.65 crores to Rs. 78.77 crores. Though there was a fall in the percentage of equity-share

capital, it was found in Chapter-5 that, in absolute quantity, it increased from Rs. 11.37 crores to Rs. 13.34 crores. This increase was mainly due to bonus issues of Rs. 1.60 crores as against rights issues of 0.66 crores only. It was pointed out in the said chapter, how difficult it was for companies which were pretty old and whose shares were quoted in the market at a considerably high price to try for fresh issues. The rights issues, as a remedy, were not found to help the jute companies to a sizable extent. That is why, bonus issues were in greater use. Still, it was limited to the extent of retained profits available after payment of dividend as considered unavoidable under prevailing conditions. Evidently, the bonus issues did not appear to have any perceivable effect on bringing down market prices of shares (see Chapter-5) which could make fresh issues easier. It has to be mentioned, however, that the data for equity-share capital mentioned above are net amounts obtained after adjustment of reduction of equity share capital to the extent of Rs. 0.29 crores.

As against a fall in the percentage of preference share to total capital by about 50.0%, the fall in its absolute measure was not very high. It was from Rs. 5.11 crores to Rs. 4.68 crores. It was shown in Chapter-5 that calculated attempts were made against redemption by heavy amounts by raising the stipulated rates of dividend. The high rate recorded by fall in the percentage was, evidently, due to considerable rise in the absolute measure of total capital.

The retained profits, in spite of their fall in percentage to total capital from 28.9% to 22.1%, recorded a rise in absolute measure from Rs. 12.04 crores to Rs. 17.40 crores. The net figures were, however, obtained after addition of share premium on the one hand and deductions on the other by way of bonus shares and payment of dividends, in the face of insufficient current profit. It was observed in Chapter-7 that a greater retention, which could

have reduced procurement of capital from other sources, was not possible owing to the dividend policy adopted by the management.

It was found in Chapter-6 that the main source of the increase of total capital was borrowings. As against a rise of percentage from 31.5% to 54.6%, the actual borrowings went up from Rs. 13.13 crores to Rs. 43.16 crores. Out of these bank loans accounted for Rs. 9.78 crores in the beginning and Rs. 33.96 crores at the end. Thus of the total borrowed capital, bank loans went up from 74.5% to 78.7%. This shows the insignificance of the other sources of borrowings, particularly debentures, as pointed out in the said chapter, in comparison with bank loans. As borrowings were mainly responsible for the increase of total capital, so were bank loans for the increase of borrowed capital. The major portion of the borrowings, as also of bank loans and other sources, was, it has to be mentioned, secured.

Above is stated the bare trend, that is the mere change of conditions as at the end of the period of investigation from those at the beginning with regard to the change in the capital structure. It does not include the movement of the trend over time. The ups and downs or fluctuations in the trend have not been pointed out. The aim of this chapter is to study this movement of the trend over all the time units of the entire period of investigation from 1958-59 to 1967-68.

Shifts in trend of changes in the external and internal capital :

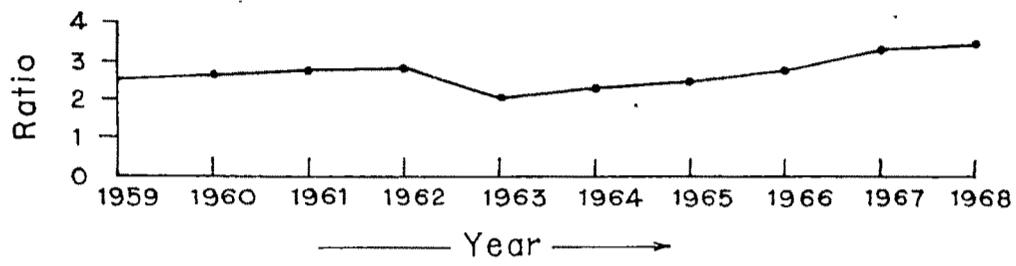
The trend of rise of the proportion of external capital, which was 71.1% in 1959, continued till 1962 when it reached 73.7%. But it suddenly sustained a fall to 68.0% in 1963 though again recorded a rise in 1964 for a continuous upward movement from 71.0% in that year to 77.9% in 1968.

Naturally, the internal capital which had shown a continuous trend for a fall of percentage to total from 1959 had a break in the same in opposite direction in 1963, but resumed its continuity right from the following year till the end. As a result, the ratio of external capital to internal capital recorded a continuous rise till 1962 when it stood at 2.8 but fell to 2.1 in 1963. It again registered a continuous rise since 1964, starting with 2.4, till the end of the period when the ratio was raised to 3.5. The graph 1 will show the position clearly.

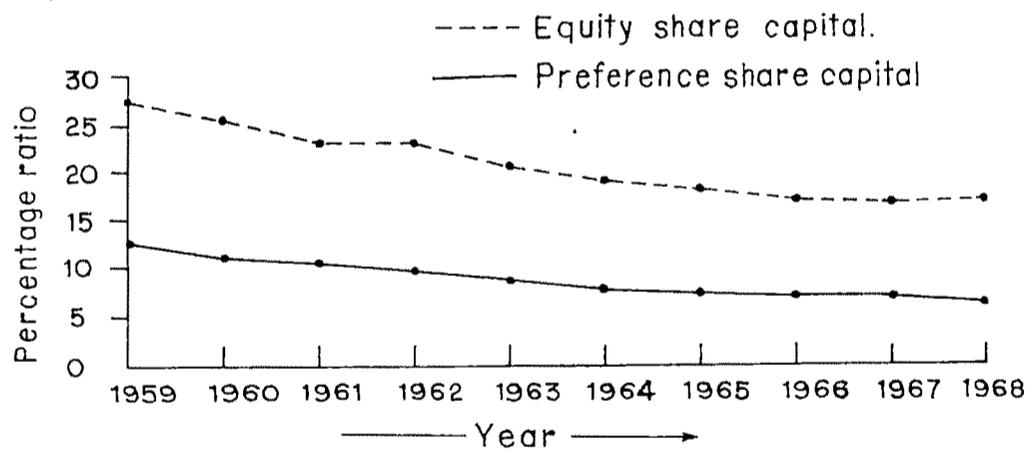
Shifts in case of components of external capital :

On review of the trend in the changes of the composition of external capital, it transpires that the proportions of equity share capital to total finance had a fall from 27.3% in 1959 to 23.3% in 1961 though it shot upto 23.5% in 1962. But the fall was resumed in 1963 when it came down to 20.4% and the percentage became lower every year till the period of investigation ended. On the other hand, preference share capital met with continuous fall all through. It may be observed that though the percentage of equity share capital had a variation from the trend in one of the years, the range involved was not very wide. As a result, both equity and preference share capital moved always downward more or less in unison with each other. It may be verified from the graph 2.

The ratio between the two was constant at 2.2 from 1959 to 1961. It had a slight rise to 2.3 in 1962 to 2.4 from 1963 to 1966 due evidently to the antitrendwise relative rise of equity share capital on the one hand and trendwise relative fall of preference share capital on the other. The rise of the ratio to 2.6 in 1967 and to 2.7 in 1968, were seemingly out of fall of preference share capital at a greater rate than equity share capital. Both the trend and fluctuations, therefore, were much more marked in case of borrowings. In its phenomenal and continuous rise of percentage from 31.5%



Graph-1. Ratio of External capital to Internal capital.



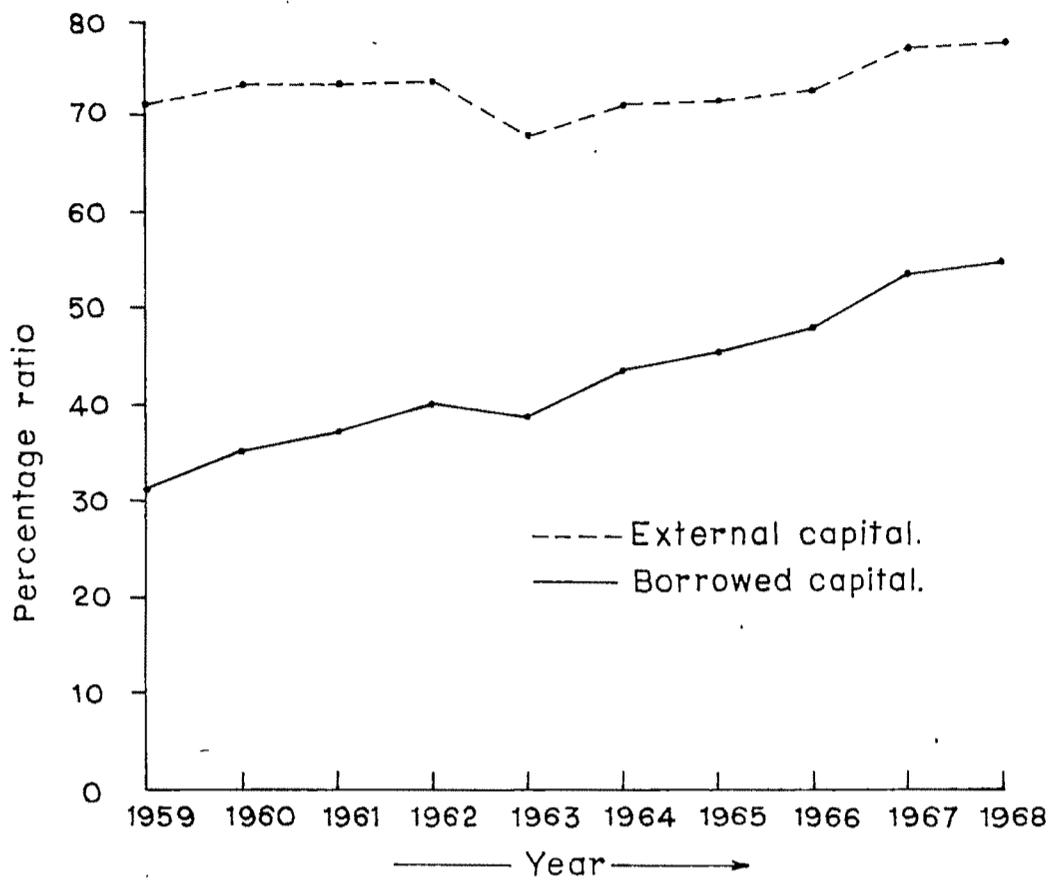
Graph-2. Percentage ratio of Equity share capital and Preference share capital.

to 54.8% there was a break in the year 1963. In that year the percentage came down to 39.0% from 40.2% of the immediately preceding year. It is evident that borrowed capital moved, and that also at a much higher rate, in the opposite direction all through the investigation period, the respective order being reversed only in the year 1963. It is curious to note that a unison of movement is observed between borrowed capital and external capital on the one hand and equity plus preference share capital and internal capital on the other. The proportion of borrowed capital, like that of external capital, increased upto the year 1962, fell in 1963, and then again increased till 1968. Similarly, the proportion of equity and preference share capital and that of internal capital had accordingly taken the opposite course simultaneously though internal capital only rose a bit in 1963. The findings may be illustrated by graph-3 in case of borrowings and external capital and graph 4 in case of equity plus preference share capital and internal capital.

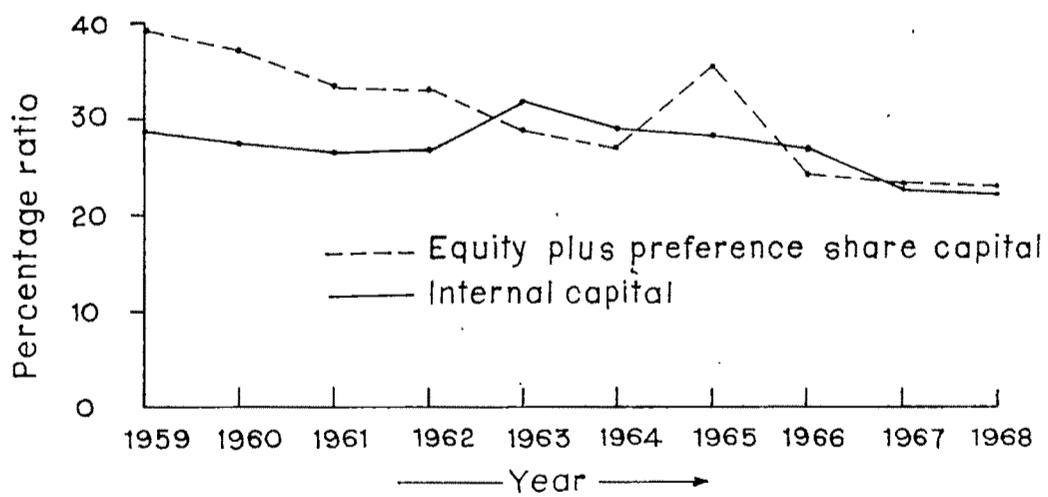
It has to be mentioned in this context that the ratio between borrowed and equity-share capital recorded a rising trend all through the period without any interruption. The same between borrowed and preference share capital, however, went up at a very rapid pace over the period.

Shifts in case of components of borrowed capital :

On review of the trends in the changes of the composition of the borrowed capital, it appears that secured loans contributed 29.9% of the total finance in 1959 which moved upwards to 50.5% of the same in 1968, while unsecured loans accounted for 1.6% of the total finance in 1959 and 4.3% of it in 1968. As percentage of borrowed capital itself, the picture was a bit different. The percentage of secured loans moved down from 94.9% to 92.1%, where as that of unsecured loans went up from 5.1% to 7.9%. Thus,



Graph-3. Percentage ratio of External capital and Borrowed capital.



Graph-4. Percentage ratio of Equity plus preference share capital and Internal capital

though secured loans came to absorb a much greater portion of total capital in comparison to what had been possible by unsecured loans, as between themselves the proportion of unsecured loans became a bit higher than what it had been in the past. The above position in 1968 was not, however, reached by movements of the percentage always in the same direction. As for instance, the percentage of secured loans to total borrowings went up to 95.2% in 1963 and having ups or downs every alternate year afterwards, finally reached 92.1% at the end of the period. The other percentage had naturally the corresponding changes till ending at 7.9% in 1968.

However, the percentage of debenture to total borrowed capital had recorded a continuous decline till it was 6.0% in 1964. After that, it suddenly jumped upto 11.4% and 11.7% respectively in 1965 and 1966, but sustained a fall again by coming down to 9.4% in 1967 and further downwards since then. The highest and the most important contributors of borrowed capital were, it was seen, banks. Their contribution fell to 70.8% of the borrowed capital in 1961. The same source again rose to 76.1% in 1962 and to 79.8% in 1964. It again came down to 74.1% in 1966, but moved up to 78.7% in 1967 and remained at that till the end. The remaining other sources of borrowed capital contributed 11.5% in 1959 and 12.3% in 1968 of the total borrowings with irregular fluctuations in the intervening period. If the contribution of the above sources of borrowed capital is considered in terms of percentage of total capital, the same in respect of debenture capital came down to 2.6% in 1964, jumped upto 5.6% in 1966 but again sustained a fall to 5.0% in 1967 and then again to what it was in 1968. The contribution of banks towards the total capital steadily went up to 35.0% in 1964, shifted downwards to 33.4% in 1965 and had a continuous rise till the end from 35.7% in 1966. The other sources contributed 3.6% in 1959 and 6.7% in 1968.

Shifts in case of components of internal capital :

On examination of the trend in the changes of the composition of the internal capital, it is revealed that the proportions of the general reserves and capital reserves respectively sustained a fall from 12.8% and 9.1% in 1959 to 7.5% and 3.5% in 1968. But these falls were not even in any case, as the former went up to 13.9% in 1960. A renewed downward trend was experienced when it fell down to 12.9% in 1961 and to 12.1% in 1962. This source once again rose to 13.8% in 1963 but fell down to 13.4% in 1964 after which it suffered a continuous fall till the end of the period. Similarly, the latter went down gradually till the end of the period with the exception that in the year 1962 it went up suddenly to 5.2%. The other source, which was the special reserves, recorded a sizable rise till 1963 when it was 13.6% and declined to 11.2% in 1964, and to 10.2% in 1967. But the said source actually registered a rising trend from 7.0% in 1959 to 11.1% in 1968. That is to say, among the components of internal capital this source was the highest contributor. As percentages of total internal capital, general reserves and capital reserves sustained a fall from 44.3% and 31.5% respectively as in 1959 to 34.0% and 16.0% as in 1968, while special reserves recorded a substantial growth from 24.2% as in 1959 to 50.0% as in 1968, though these falls and rises were not even in any case.

Thus the trend in the changes of the internal capital reveal that the said capital suddenly shot up in 1963 in the midst of continuous fall all through. This sudden rise was caused, it seems, by higher retention from higher profits earned during the year. However, the trends within the internal capital itself simply indicate that the percentage of capital reserves was almost halved over the period, while that of the special reserves was more than doubled and that of the general reserves fell by about 23% over themselves.

Thus the study of the trends in respect of external and internal components of the capital structure between 1959 and 1968 reveals that there was a rise in the proportion of external capital. It was contributed by borrowed capital alone, as the ratios between borrowed capital and equity-share capital, and those between borrowed and preference capital registered an upward shift, while ratios between equity and preference capital also did the same over the period.

Shifts in trend of changes in the ownership and creditorship capital :

So far as the other broad category of considering capital-structure from the stand point of ownership and creditorship interests is concerned, it may be said that ownership capital declined over the period. But it is a fact that, this fall in the ownership and rise in the creditorship capital were not smooth all through. The trend of fall of the proportion of ownership capital, which was 68.5% in 1959, continued till 1962 when it reached 59.8%. But it suddenly shot up to 61.0% in 1963, though again recorded a fall in 1964 for a continuous downward movement from 56.0% in that year to 45.2% in 1968. Naturally, the creditorship capital which had shown a continuous trend for a rise of its percentage to total from 1959 had a break in the same in opposite direction in 1963 but resumed its continuity right from the following year till the end. As a result, the ratio of ownership capital to creditorship capital recorded a continuous fall till 1962 when it stood at 1.5 but rose to 1.6 in 1963. It again registered a continuous fall since 1964, starting with 1.3, till the end of the period when the ratio stood at 0.8. Here preference share capital is a component of the ownership capital. If preference share capital is considered a part of the creditorship capital, the trend of fall of the proportion of ownership capital, which was 56.2% in 1959, continued till 1962 when it reached 49.8%. But it suddenly shot up to 52.4% in 1963, though again recorded a fall in

1964, for a continuous downward trend from 48.0% in that year to 39.0% in 1968. Obviously, the creditorship capital which recorded a continuous trend for a rise of its percentage to total from 1959 registered a break in the same in opposite direction in 1963 but resumed its continuity right from the following year till the end. As a result, the ratio of ownership capital to creditorship capital recorded a continuous fall till 1962 when it stood at 0.9 but rose to 1.1 in 1963. It again registered a continuous fall since 1964, starting with 0.9, till the end of the period when the ratio stood at 0.6. Therefore, a similar trend was visible in this case also. However, in both the cases, the creditorship exceeded the ownership capital over the period. In the first case, creditorship exceeded the ownership just from 1967, while, in the latter case, it started to exceed since 1961 with a set back to it in 1963.

The analysis of the trends in ownership and creditorship capital reveals that the fall in the percentage of the former was due to the simultaneous fall in that of all the three components of the same, if preference share capital was a component of the ownership capital. Of all the three components, the preference share capital sustained the highest fall. Equity share capital and retained profits experienced a fall next to it in succession. The ratio between retained profits and equity capital and that between equity and preference share capital will speak for it. The first ratio was 1.1 in 1959 and went up to 1.3 in 1968. The second ratio was 2.2 in the former year and 2.7 in the latter year.

In this context a comparison of the trends of capital-structure of the jute industry with those of cotton textile and tea industries would be worthwhile.

Trends in capital-structure of Cotton Textile Industry<sup>1</sup> :

On review of the trends in capital-structure of Cotton textile industry we find a trend of fall of the proportion of external capital, which was 74.7% in 1959, continued till 1962 when it reached 69.6%. But it suddenly shot up to 71.7% in 1963 for a continuous upward movement till it was 81.6% in 1968. Naturally the internal capital showed a continuous rise till 1962 when it stood at 30.4%, but resumed its continuity in opposite direction right from 1963, when it was 28.3%, till it reached 18.4% in 1968. As a result, the ratio of external capital to internal capital recorded a continuous fall from 2.9 in 1959 to 2.3 in 1962 and shot up in 1963 for a continuous rise from 2.5 to 4.4 in 1968.

A broad study of the trend in the changes of the composition of the external capital reveals that the proportion of equity share capital to total finance fell, though not uniformly, from 26.9% in 1959 to 19.4% in 1968. At the same time, preference share capital met with continuous fall all over the period from 5.2% in 1959 to 3.3% in 1968. It may be observed that equity and preference share capital moved always downward more or less in unison with each other. Borrowed capital, on the other hand, moved in opposite direction. It stood at 42.6% in 1959 to 58.9% in 1968. Therefore, the rise of the external capital was caused by borrowed capital alone.

A survey of the trend in ownership and creditorship capital reveals that, in this industry, the percentage of creditorship capital to total showed an increasing trend though not uniformly. This percentage went up from 42.6% in 1959 to 58.9% in 1968. Naturally, the ownership capital had

---

1. Figures relating to the above industry have been computed from the 'Financial Statistics of Joint Stock Companies in India', 1950-51-1962-63 published by Reserve Bank of India, Bombay, 1966, Reserve Bank of India Bulletin, December 1967, Finances of Medium and Large Public Limited Companies, 1970-71, September 1972. (See table - 1).

registered a declining trend from 57.4% to 41.1% over the period. Here preference share capital is a component of ownership capital. If preference share capital is considered a part of creditorship capital, the trend of rise of the proportion of creditorship capital, which was 47.8% in 1959, continued till 1968 when it was 62.2%, though this rise was not uniform all through. Similarly, the ownership capital recorded a fall from 52.2% in 1959 to 37.8% in 1968. As a result, the ratio of ownership capital to creditorship capital recorded a fall from 1.3 in 1959 to 0.7 in 1968, if preference shares were part of ownership capital. It would work up at 1.1 in 1959 to 0.6 in 1968, if preference shares were part of creditorship capital.

Thus from the analysis of the trend in respect of ownership and creditorship capital, it is evident that the former fall owing to the simultaneous fall in all the three components of it. But the greatest fall was observed in case of preference share capital as the ratio between equity capital and preference share capital was 5.0 in 1959 and went up to 6.0 in 1968, while that between retained profits and equity share capital was maintained at 0.9 in 1959 as well as in 1968.

Trends in capital-structure of Tea Industry<sup>2</sup> :

On review of the trends in capital-structure of tea industry, a different picture was observed. This industry had a highly equipped equity base. However, we find that the percentage of external capital to total showed an increasing trend though not uniformly. This percentage went up from 56.7% in 1959 to 68.2% in 1968. Naturally, the internal capital showed

---

2. Ibid. (See table - 2).

a declining trend from 43.3% in 1959 to 31.8% in 1968. As a result, the ratio of external capital to internal capital recorded a rise from 1.3 in 1959 to 2.1 in 1968.

On a broad study of the trend in the changes of the composition of the external capital, we find that the proportion of equity share capital to total finance fell, though not uniformly, from 40.5% in 1959 to 39.3% in 1968. At the same time, preference share capital met with a similar trend from 4.2% in 1959 to 2.4% in 1968. Borrowed capital, on the other hand, moved in opposite direction. This percentage went up from 12% in 1959 to 26.6% in 1968. Therefore, the rise in external capital was caused by borrowed capital alone.

From the study of the trend in ownership and creditorship capital, it is evident that, in this industry, the percentage of creditorship capital to total showed an increasing trend though not uniformly. This percentage went up from 12% in 1959 to 26.6% in 1968. Naturally, the ownership capital had registered a downward trend from 88% in 1959 to 73.4% in 1968. Here preference share capital was a part of ownership capital. If preference share capital is considered a component of creditorship capital, the trend of rise of the proportion of the creditorship capital, which was 16.2% in 1959, continued till 1968 when it was 29.0%, though this rise was not uniform all through. Similarly, the ownership capital recorded a fall from 83.8% in 1959 to 71.0% in 1968. As a result, the ratio of ownership capital to creditorship capital recorded a fall from 7.3 in 1959 to 2.8 in 1968, if preference shares were part of ownership. It would work up at 5.2 in 1959 to 2.4 in 1968, if preference shares were part of creditorship capital.

As a matter of fact, the trend in ownership and creditorship capital reveals that the ownership capital fell owing to the fall in all the three components of it. The highest fall was sustained by preference share capital. Retained profits were next to it. Equity share capital came last in this case. The ratio between retained profits and preference share capital and that between retained profits and equity share capital will justify the contention. The first ratio was 10.3 in 1959 and went up to 13.2 in 1968, while the second ratio was 1.0 in 1959 and fell to 0.8 in 1968.

Observations :

From the analysis of the variations in trend, the following facts have been found :

1. Rise in the percentage of external capital and fall in that of internal capital were observed in case of all the industries.
2. Fall in the proportion of ownership and rise in that of creditorship capital were found to have occurred in all the three industries.
3. The proportions of equity share capital, preference share capital and retained profits suffered a fall while that of borrowings had a rise in all the cases.

The following causes may be attributed towards the aforesaid change in trend :

1. This period of study, that is from 1958-59 to 1967-68, was marked with inflationary trends in the economy<sup>3</sup>. Expenditures on raw materials

---

3. Vijaya Saradhi S.P. - Op. cit. p. 5.

and wages and excise duty on products rose very high. The rate of growth in the Indian Economy became slower due to the continued stagnation in agricultural output and deceleration in industrial activities<sup>4</sup>. In the year 1963 there was a rising trend in production that enabled the industries to make larger profits.

2. Investment in fixed assets was low in comparison to that in current assets. Therefore, the capital structure decision hinged particularly around the financing of current assets. Corporate management resorted to bank finance inspite of increasing interest charges<sup>6</sup> to finance the said requirements.

3. The role of net-retentions as a major source of funds had been on the decline due to reduced profitability and increased tax provisions<sup>7</sup>.

4. The recession and the declining profitability, prevalent in the economy<sup>8</sup>, affected the market price of shares. Therefore, fresh issues were not favoured by the investors for 'uncertain prospects'. At the same time management of companies did not consider it economic to resort to new issues.

5. Rising taxes encouraged the management to obtain loans as interest was deductible from tax liability<sup>9</sup>. On the other hand, the recessionary trends in profits and the rising rates of interest encouraged the institutional investors in extending loans instead of buying equity and preference shares of companies.

---

4. Ibid.

5. The Calcutta Stock Exchange, 1908-68, Calcutta, 1968, pp. 91-92. Diamond Jubilee Publication, Edited by Sur A.K.

6. Vijaya Saradhi S.P. - Op. cit., p. 5.

7. Ibid.

8. Ghosh B. - The Changing Profile of India's Industrial Economy, Calcutta, 1974, pp. 238-45.

9. Williams C.M. and Williams H.A. - Incentive Financing - A new opportunity, Harvard Business Review, Vol. 38 (March-April, 1960), pp. 123-34.

Table - 1

Capital Structure of Cotton Textile Industry		1958-59	1959-60	1960-61	1961-62	1962-63	1963-64	1964-65	1965-66	1966-67	1967-68
Type of Capital											
Equity Share Capital	26.9	27.3	25.3	25.1	23.2	21.7	20.0	18.7	20.0	19.4	19.4
Internal Capital	25.3	26.6	27.8	30.4	28.3	28.1	27.0	23.5	21.8	18.4	18.4
Preference Share Capital	5.2	5.5	5.1	4.9	4.4	4.2	4.0	3.6	3.5	3.3	3.3
Borrowings	42.6	40.6	41.8	39.6	44.1	46.0	49.0	54.2	54.7	58.9	58.9

Table - 2

Capital Structure of Tea Industry		1958-59	1959-60	1960-61	1961-62	1962-63	1963-64	1964-65	1965-66	1966-67	1967-68
Type of Capital											
Equity of Capital	40.5	40.3	39.7	38.0	38.9	38.9	37.4	32.7	35.1	39.2	39.2
Internal Capital	43.3	45.2	45.2	43.8	40.7	41.5	41.8	41.1	38.7	31.8	31.8
Preference Share Capital	4.2	4.2	4.1	3.9	3.7	3.9	3.9	2.6	2.5	2.4	2.4
Borrowings	12.0	10.3	11.0	14.3	16.7	15.7	16.9	23.6	23.7	26.6	26.6