CAPITAL STRUCTURE

ANALYSIS OF A SMALL ENTERPRISE - A CASE STUDY OF SRI RAMACHANDRA PAPER BOARDS LIMITED

Dr. Podile, Venkateswararao, Fr. Kataru Anil Kumar & Dr. Chinta. Hema Venkata Siva Sree

Abstract: Capital structure refers to the combination of debt and equity. The financial manager has to strike a balance between various sources of funds so as to maximise return of an Enterprise without affecting risk composition in the business. An optimal capital structure is very much essential to maximise the owner’s wealth of any Enterprise. In this paper, an attempt is made to analyse the capital structure in Sri Rama Chandra Paper Boards Limited. Sri Rama Chandra Paper Boards Limited is one of the leading companies in the paper making sector in the Godavari belt of Andhra Pradesh. It is located at Yeditha. It is involved in Manufacturing of paper and paper products. This Enterprise has an annual turnover of Rs. 5943.99 lakhs as per 2015-16 annual accounts. The total assets of the enterprise are 3062.9 lakhs. In this paper composition of capital structure in the enterprise for a period of ten years is analysed. Leverage analysis was also done. Debt- Equity ratio, Proprietary Ratio, Solvency Ratio, Fixed Assets to Net worth Ratio, Fixed Assets Ratio, Current Assets to Proprietary Ratio and Interest Coverage Ratio are calculated for the study period. Chi-square test is used for testing Hypotheses.

Index Terms - Capital structure, Degree of Combined leverage, Degree of Financial Leverage, Fixed Assets ratio, Interest coverage ratio, Solvency ratio.

I. INTRODUCTION

Finance decision is one of the important decisions of financial management in any Enterprise. It deals with capital structure or finance mix of an Enterprise. Capital structure refers to the combination of debt and equity. The financial manager has to strike a balance between various sources of funds so as to maximise return of an Enterprise without affecting risk composition in the business. An optimal capital structure is very much essential to maximise the owner’s wealth of any Enterprise. In this paper, an attempt is made to analyse the capital structure in Sri Rama Chandra Paper Boards Limited. Sri Rama Chandra Paper Boards Limited is one of the leading companies in the paper making sector in the Godavari belt of Andhra Pradesh. It is located at Yeditha. Sri Rama Chandra Paper Boards Limited was started in 1996. It is classified as Non-Govt Company and is registered at Registrar of Companies, Hyderabad. It is involved in Manufacturing of paper and paper products. It is a Manufacturer of writing paper, printing paper, news printing paper, offset printing paper. This Enterprise has an annual turnover of Rs. 5943.99 lakhs as per 2015-16 annual accounts. The total assets of the enterprise are 3062.9 lakhs.

II. REVIEW OF LITERATURE

The present study is mainly based on secondary data. The data is taken from the financial statements including balance sheet, trading account and profit and loss account of Sri Ramachandra Paper Boards Limited. The period of study is ten years covering the financial years from 2006-07 to 2015-16. The data gathered is analyzed through the technique of percentages and certain appropriate ratios relating to capital structure of the enterprise. Degree of Operating Leverage, Degree of Financial Leverage and Degree of Combined Leverage are calculated during study period for leverage analysis. The ratios covered include Debt – Equity Ratio, Proprietary Ratio, Solvency Ratio, Fixed Assets to Net worth Ratio, Fixed Assets Ratio, Current Assets to Proprietary Ratio and Interest Coverage Ratio. Chi-square test is used for testing the hypotheses formed.

VI. Composition of capital structure

The data in Table-1 represent the fact that Share capital as a percentage of total equity capital has varied between 34.5 during 2014 and 70.7 during 2007. It is also observed that reserves and surplus as a percentage of total equity capital had varied between 29.3 during 2007 and 65.5 during 2014. Total equity capital as a percentage of total capital has varied between 62.7 during 2008 and 74.2 during 2011. It is also observed that long term debt as a percentage of total debt had varied between 45.3 during 2015 and 99.4 during 2007. On the other hand, short term debt as a percentage of total debt has varied between 0.6 during 2007 and 54.7 during 2015. Total debt capital as a percentage of total capital has varied between 25.8 during 2011 and 37.3 during 2008.

The specific objectives include the following. 
1. To examine composition of capital structure in Sri Ramachandra Paper Boards Limited during the period of study.
2. To analyze the status of Degree of Operating Leverage, Degree of Financial Leverage and Degree of Combined Leverage in Sri Ramachandra Paper Boards Limited during the period of study.
3. To investigate long term solvency position of Sri Ramachandra Paper Boards Limited during the period of study.
4. To examine the coverage of financial expenses in the small enterprise during the period of study.
5. To offer suggestions for improvement of capital structure decisions, if required.

IV. HYPOTHESES

H₀₁: Degree of Operating Leverage in Sri Ramachandra Paper Boards Limited is uniform during the period of study.
H₀₂: Degree of Financial Leverage in Sri Ramachandra Paper Boards Limited is uniform during the period of study.
H₀₃: Degree of Combined Leverage in Sri Ramachandra Paper Boards Limited is uniform during the period of study.
H₀₄: Debt - Equity Ratio in Sri Ramachandra Paper Boards Limited is uniform during the period of study.
H₀₅: Proprietary Ratio in Sri Ramachandra Paper Boards Limited is uniform during the period of study.
H₀₆: Solvency Ratio in Sri Ramachandra Paper Boards Limited is uniform during the period of study.
H₀₇: Fixed Assets to Net worth Ratio in Sri Ramachandra Paper Boards Limited is uniform during the period of study.
H₀₈: Fixed Assets Ratio in Sri Ramachandra Paper Boards Limited is uniform during the period of study.
H₀₉: Current Assets to Proprietary funds Ratio in Sri Ramachandra Paper Boards Limited is uniform during the period of study.
H₀₁₀: Interest Coverage Ratio in Sri Ramachandra Paper Boards Limited is uniform during the period of study.

V. METHODOLOGY

The general objective of the study is to analyze the capital structure of Sri Ramachandra Paper Boards Limited. The specific objectives include the following.

To examine composition of capital structure in Sri Ramachandra Paper Boards Limited during the period of study.
To analyze the status of Degree of Operating Leverage, Degree of Financial Leverage and Degree of Combined Leverage in Sri Ramachandra Paper Boards Limited during the period of study.
To investigate long term solvency position of Sri Ramachandra Paper Boards Limited during the period of study.
To examine the coverage of financial expenses in the small enterprise during the period of study.
To offer suggestions for improvement of capital structure decisions, if required.

The data in Table-1 represent the fact that Share capital as a percentage of total equity capital has varied between 34.5 during 2014 and 70.7 during 2007. It is also observed that reserves and surplus as a percentage of total equity capital had varied between 29.3 during 2007 and 65.5 during 2014. Total equity capital as a percentage of total capital has varied between 62.7 during 2008 and 74.2 during 2011. It is also observed that long term debt as a percentage of total debt had varied between 45.3 during 2015 and 99.4 during 2007. On the other hand, short term debt as a percentage of total debt has varied between 0.6 during 2007 and 54.7 during 2015. Total debt capital as a percentage of total capital has varied between 25.8 during 2011 and 37.3 during 2008.
VII. LEVERAGE ANALYSIS

Leverage analysis is useful for understanding the ability of the enterprise to magnify the effect of changes in sales on operating profit, the effect of changes in operating profit on Net Income and the effect of changes in sales on Net Income.

Degree of Operating Leverage

The Degree of Operating Leverage has varied between -10.97 and 15.85 during the period of study. Operating leverage is favorable during 2008, 2009, 2014 and 2015 as DOL is greater than one. Operating leverage is unfavorable during other six years as DOL is less than one. It is found in the significance test that Degree of Operating Leverage is not uniform during the period of study.

Table-2: Degree of Operating Leverage

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<tbody>
<tr>
<td>EBIT</td>
<td>-6.8</td>
<td>42.8</td>
<td>90.5</td>
<td>-10.0</td>
<td>-0.4</td>
<td>-58.0</td>
<td>13.5</td>
<td>156.9</td>
<td>-21.0</td>
<td>2.3</td>
</tr>
<tr>
<td>Sales</td>
<td>6.0</td>
<td>2.7</td>
<td>32.3</td>
<td>-20.0</td>
<td>34.5</td>
<td>11.7</td>
<td>-27.5</td>
<td>73.2</td>
<td>-2.9</td>
<td>-9.1</td>
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<tr>
<td>DOL</td>
<td>-10.97</td>
<td>15.85</td>
<td>2.80</td>
<td>0.50</td>
<td>-0.01</td>
<td>-4.96</td>
<td>-0.49</td>
<td>2.14</td>
<td>7.24</td>
<td>-0.25</td>
</tr>
</tbody>
</table>

Source: Annual Reports of Sri Ramachandra Paper Boards Limited from 2006-07 to 2015-16

Calculated value of $\chi^2$ for Degree of Operating Leverage = 377.6. The Critical value of $\chi^2$ at 9 degrees of freedom at 5% level of Significance is 16.919. Calculated value is greater than Critical Value i.e., 377.6>16.919, Hence, H₀ is Rejected.

Degree of Financial Leverage

The Degree of Financial Leverage has varied between -32.35 and 19.25. Financial leverage is favorable during 2009, 2011, 2013, 2014 and 2015 as DFL is greater than one. Financial leverage is neither favorable nor un-favorable during 2007. Financial leverage is unfavorable during other four years as DFL is less than one. It is found in the significance test that Degree of Financial Leverage is not uniform during the period of study.

Table-3: Degree of Financial Leverage

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<tbody>
<tr>
<td>Profit</td>
<td>-66.1</td>
<td>7.0</td>
<td>100.6</td>
<td>-8.1</td>
<td>-7.7</td>
<td>-56.8</td>
<td>25.3</td>
<td>166.8</td>
<td>-77.9</td>
<td>-74.4</td>
</tr>
<tr>
<td>EBIT</td>
<td>-65.8</td>
<td>42.8</td>
<td>90.5</td>
<td>-10.0</td>
<td>-0.4</td>
<td>-58.0</td>
<td>13.5</td>
<td>156.9</td>
<td>-21.0</td>
<td>2.3</td>
</tr>
<tr>
<td>DFL</td>
<td>1.00</td>
<td>0.16</td>
<td>1.11</td>
<td>0.81</td>
<td>19.25</td>
<td>0.98</td>
<td>1.87</td>
<td>1.06</td>
<td>3.71</td>
<td>-32.35</td>
</tr>
</tbody>
</table>

Source: Annual Reports of Sri Ramachandra Paper Boards Limited from 2006-07 to 2015-16

Calculated value of $\chi^2$ for Degree of Financial Leverage = 5994.9. The Critical value of $\chi^2$ at 9 degrees of freedom at 5% level of Significance is 16.919. Calculated value is greater than Critical Value i.e., 5994.9>16.919, Hence, H₀ is Rejected.

Degree of Combined Leverage

The Degree of Combined Leverage has varied between -11.0 and 26.9. Combined leverage is favorable during 2008, 2009, 2014, 2015 and 2016 as DCL is greater than one. Combined leverage is unfavorable during other five years as DCL is less than one. It is found in the significance test that Degree of Combined Leverage is not uniform during the period of study.
Table-4: Degree of Combined Leverage
(Figures in Lakhs)

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<tbody>
<tr>
<td>DCL</td>
<td>-66.1</td>
<td>7.0</td>
<td>100.6</td>
<td>-8.1</td>
<td>-7.7</td>
<td>-56.8</td>
<td>25.3</td>
<td>166.8</td>
<td>-77.9</td>
<td>-74.4</td>
</tr>
</tbody>
</table>
| Source: Annual Reports of Sri Ramachandra Paper Boards Limited from 2006-07 to 2015-2016. Calculated value of $\chi^2$ for Degree of Combined Leverage = 335.2. The Critical value of $\chi^2$ at 9 degrees of freedom at 5% level of Significance is 16.919. Calculated value is greater than Critical Value i.e., 335.2>16.919, Hence, $H_0$ is rejected.

VIII. CAPITAL STRUCTURE RATIOS

Capital structure ratios are useful for understanding long term solvency of the Enterprise. Long term solvency means ability of the enterprise to meet long term obligations.

Debt-Equity Ratio

The Debt-Equity ratio of the Enterprise varied between 0.35 during 2011 and 0.59 during 2008. It is found in the significance test that Debt-Equity ratio is uniform during the period of study. Debt- Equity ratio is less than one during all the years of study indicating high margin of safety to lenders.

Table-5: Debt-Equity Ratio
(Figures in Lakhs)

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<tbody>
<tr>
<td>Outside funds</td>
<td>457.8</td>
<td>666.5</td>
<td>577.7</td>
<td>579.7</td>
<td>593.5</td>
<td>817.9</td>
<td>845.9</td>
<td>853.5</td>
<td>953.4</td>
<td>1106.9</td>
</tr>
<tr>
<td>Share Holders funds</td>
<td>1018</td>
<td>1121.4</td>
<td>1328.8</td>
<td>1519.5</td>
<td>1706.5</td>
<td>1782.4</td>
<td>1877.6</td>
<td>2119.9</td>
<td>1957.4</td>
<td>1956</td>
</tr>
<tr>
<td>Debt-Equity Ratio</td>
<td>0.45</td>
<td>0.59</td>
<td>0.43</td>
<td>0.38</td>
<td>0.35</td>
<td>0.46</td>
<td>0.45</td>
<td>0.40</td>
<td>0.49</td>
<td>0.57</td>
</tr>
</tbody>
</table>
| Source: Annual Reports of Sri Ramachandra Paper Boards Limited from 2006-07 to 2015-2016. Calculated value of $\chi^2$ for Debt-Equity Ratio = 0.12. The Critical value of $\chi^2$ at 9 degrees of freedom at 5% level of Significance is 16.919. Calculated value is less than Critical Value i.e., 0.12<16.919, Hence, $H_0$ is accepted.

Proprietary Ratio

The Proprietary ratio of the Enterprise varied between 0.63 during 2008 and 0.74 during 2011. It is found in the significance test that Proprietary ratio is uniform during the period of study. Proprietary ratio is relatively high during all the years of the study indicating good long term solvency.

Table-6: Proprietary Ratio
(Figures in Lakhs)

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<tbody>
<tr>
<td>Share Holders funds</td>
<td>1018</td>
<td>1121.4</td>
<td>1328.8</td>
<td>1519.5</td>
<td>1706.5</td>
<td>1782.4</td>
<td>1877.6</td>
<td>2119.9</td>
<td>1957.4</td>
<td>1956</td>
</tr>
<tr>
<td>Total Assets</td>
<td>1475.8</td>
<td>1787.9</td>
<td>1906.5</td>
<td>2099.2</td>
<td>2300</td>
<td>2600.3</td>
<td>2732.5</td>
<td>2973.4</td>
<td>2910.8</td>
<td>3062.9</td>
</tr>
<tr>
<td>Proprietary Ratio</td>
<td>0.69</td>
<td>0.63</td>
<td>0.70</td>
<td>0.72</td>
<td>0.74</td>
<td>0.69</td>
<td>0.69</td>
<td>0.71</td>
<td>0.67</td>
<td>0.64</td>
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</table>
| Source: Annual Reports of Sri Ramachandra Paper Boards Limited from 2006-07 to 2015-2016. Calculated value of $\chi^2$ for Proprietary ratio = 0.02. The Critical value of $\chi^2$ at 9 degrees of freedom at 5% level of Significance is 16.919. Calculated value is less than Critical Value i.e., 0.02<16.919, Hence, $H_0$ is accepted.

Solvency Ratio

The Solvency ratio of the Enterprise varied between 0.26 during 2011 and 0.37 during 2008. It is found in the significance test that Solvency ratio is uniform during the period of study. Solvency ratio is comparatively low during all the years of the study indicating high long term solvency.

Table-7: Solvency Ratio
(Figures in Lakhs)

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<tbody>
<tr>
<td>Total Liabilities to outsiders</td>
<td>457.8</td>
<td>666.5</td>
<td>577.7</td>
<td>579.7</td>
<td>593.5</td>
<td>817.9</td>
<td>845.9</td>
<td>853.5</td>
<td>953.4</td>
<td>1106.9</td>
</tr>
<tr>
<td>Total Assets</td>
<td>1475.8</td>
<td>1787.9</td>
<td>1906.5</td>
<td>2099.2</td>
<td>2300</td>
<td>2600.3</td>
<td>2732.5</td>
<td>2973.4</td>
<td>2910.8</td>
<td>3062.9</td>
</tr>
<tr>
<td>Solvency Ratio</td>
<td>0.31</td>
<td>0.37</td>
<td>0.30</td>
<td>0.28</td>
<td>0.26</td>
<td>0.31</td>
<td>0.31</td>
<td>0.29</td>
<td>0.33</td>
<td>0.36</td>
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</table>
| Source: Annual Reports of Sri Ramachandra Paper Boards Limited from 2006-07 to 2015-2016. Calculated value of $\chi^2$ for Solvency ratio = 0.03. The Critical value of $\chi^2$ at 9 degrees of freedom at 5% level of Significance is 16.919. Calculated value is less than Critical Value i.e., 0.03<16.919, Hence, $H_0$ is accepted.

Fixed Assets to Net worth Ratio

The Fixed Assets to Net worth ratio of the Enterprise varied between 0.54 during 2011 and 0.96 during 2007. It is found in the significance test that Fixed Assets to Net worth ratio is uniform during the period of study. Fixed Assets to Net-worth ratio is less than one during all years of the study, indicating that owner funds are more than fixed assets in the enterprise. This is good for the enterprise.
Fixed Assets Ratio
The Fixed Assets ratio of the Enterprise varied between 0.43 during 2011 and 0.67 during 2007. It is found in the significance test that Fixed Assets ratio is uniform during the period of study. Fixed Assets ratio is always less than one indicating that part of long term funds are also available for financing working capital requirements. This is good for the enterprise.

Table-9: Fixed Assets Ratio

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<tbody>
<tr>
<td>Fixed Assets</td>
<td>982.1</td>
<td>975.3</td>
<td>1002.5</td>
<td>965.7</td>
<td>915.5</td>
<td>1178.5</td>
<td>1162.8</td>
<td>1288.9</td>
<td>1143.4</td>
<td>1115.3</td>
</tr>
<tr>
<td>Total Long Term funds</td>
<td>1473.1</td>
<td>1627.2</td>
<td>1743.8</td>
<td>1934.7</td>
<td>2136.6</td>
<td>2211.6</td>
<td>2307.2</td>
<td>2549.8</td>
<td>2389.1</td>
<td>2544</td>
</tr>
<tr>
<td>Fixed Assets Ratio</td>
<td>0.67</td>
<td>0.60</td>
<td>0.57</td>
<td>0.50</td>
<td>0.43</td>
<td>0.53</td>
<td>0.50</td>
<td>0.51</td>
<td>0.48</td>
<td>0.44</td>
</tr>
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</table>

Calculated value of χ² for Fixed Assets ratio = 0.09. The Critical value of χ² at 9 degrees of freedom at 5% level of Significance is 16.919. Calculated value is less than Critical Value i.e., 0.09<16.919, Hence, H₀₉ is accepted.

Current Assets to Proprietary Funds Ratio
The Current Assets to Proprietary Funds ratio of the Enterprise varied between 0.67 during 2014 and 0.90 during 2009 and 2016. It is found in the significance test that Current Assets to Proprietary Funds ratio is uniform during the period of study. Current assets to proprietary ratio is always less than one during all the years of the study.

Table-10: Current Assets to Proprietary Funds Ratio

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<tbody>
<tr>
<td>Current Assets</td>
<td>775.9</td>
<td>1001.6</td>
<td>1200.9</td>
<td>1358.8</td>
<td>1494.0</td>
<td>1267.6</td>
<td>1362.6</td>
<td>1421.4</td>
<td>1520.3</td>
<td>1758.6</td>
</tr>
<tr>
<td>Share Holders funds</td>
<td>1018</td>
<td>1121.4</td>
<td>1328.8</td>
<td>1519.5</td>
<td>1706.5</td>
<td>1782.4</td>
<td>1877.6</td>
<td>2119.9</td>
<td>1957.4</td>
<td>1956</td>
</tr>
<tr>
<td>Ratio</td>
<td>0.76</td>
<td>0.89</td>
<td>0.90</td>
<td>0.89</td>
<td>0.88</td>
<td>0.71</td>
<td>0.73</td>
<td>0.67</td>
<td>0.78</td>
<td>0.90</td>
</tr>
</tbody>
</table>

Calculated value of χ² for Current Assets to proprietary funds ratio = 0.09. The Critical value of χ² at 9 degrees of freedom at 5% level of Significance is 16.919. Calculated value is less than Critical Value i.e., 0.09<16.919, Hence, H₀₉ is accepted.

Interest Coverage Ratio
The Interest Coverage ratio of the Enterprise varied between 6.4 during 2007 and 405.9 during 2015. It is found in the significance test that Interest Coverage ratio is not uniform during the period of study. High interest coverage ratio is good for long term creditors. Very high ratio indicates very high margin of safety for lenders.

Table-11: Interest Coverage Ratio

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</thead>
<tbody>
<tr>
<td>EBIT</td>
<td>120.3</td>
<td>171.8</td>
<td>327.3</td>
<td>294.7</td>
<td>293.5</td>
<td>123.3</td>
<td>140</td>
<td>359.7</td>
<td>284.1</td>
<td>290.5</td>
</tr>
<tr>
<td>Interest</td>
<td>18.7</td>
<td>18.1</td>
<td>7.1</td>
<td>1.8</td>
<td>2.7</td>
<td>1.7</td>
<td>2.0</td>
<td>0.9</td>
<td>0.7</td>
<td>0.7</td>
</tr>
<tr>
<td>Interest Coverage Ratio</td>
<td>6.4</td>
<td>9.5</td>
<td>46.1</td>
<td>163.7</td>
<td>108.7</td>
<td>72.5</td>
<td>70.0</td>
<td>399.7</td>
<td>405.9</td>
<td>415.0</td>
</tr>
</tbody>
</table>

Calculated value of χ² for Interest coverage ratio = 1529.4. The Critical value of χ² at 9 degrees of freedom at 5% level of Significance is 16.919. Calculated value is less than Critical Value i.e., 1529.4>16.919, Hence, H₁₀ is Rejected.

IX. CONCLUSION
Operating leverage is favorable for four years, financial leverage is favorable for five years and combined leverage is favorable for five years during the period of study. Degree of Operating Leverage, Degree of Financial Leverage and Degree of Combined Leverage are not uniform during the period of the study. All capital structure ratios except interest coverage ratio are uniform during the period of study. Low Debt- Equity ratio, high proprietary ratio and low solvency ratio in the enterprise indicate good long term solvency and high margin of safety. Fixed Assets to Net-worth ratio is less than one during all years of the study, indicating that owner funds are more than fixed assets in the enterprise. Fixed Assets ratio is always less than one indicating that part of long term funds are also available for financing working capital requirements. Interest coverage ratio is very high during the period of study. High interest coverage ratio is good for long term creditors. Very high ratio indicates very high margin of safety for lenders. To conclude, capital structure in the enterprise is good. There is some scope for improvement in capital structure.
REFERENCES


