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An Analytical Study on the Impact of Profitability on Long-Term Solvency (Leverage) for Selected Non-Banking Financial Institutions (Shriram Transport Finance Company) in India.

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ABSTRACT

This analytical study explores the financial dynamics of a selected entity, focusing on the relationships between the Debt Equity Ratio (D/E) and key financial metrics, namely Net Profit (NP), Return on Equity (ROE), and Return on Capital Employed (ROCE). Utilizing a five-year dataset spanning from 2018-19 to 2022-23, the study reveals a consistent positive correlation between D/E and the other financial variables. The correlation matrix highlights strong positive relationships, with coefficients ranging from 0.9887 to 0.9985, indicating that as the Debt Equity Ratio increases, so do Net Profit, ROE, and ROCE. Notably, the Debt Equity Ratio demonstrates a decreasing trend over the study period, reflecting improved long-term solvency. While the study identifies positive correlations, caution is advised in interpreting causation, as correlation does not imply a direct cause-and-effect relationship. This study contributes valuable insights into the complex interplay between leverage and profitability, offering a foundation for strategic decision-making within the financial landscape of the examined entity.

KEY WORD : Debt equity. Net profit, long term solvency, ROCE, ROA

1. INTRODUCTION

Non Banking Finance Institutions is a constituent of the institutional structure of the organized financial system in India The term "Finance" is often understood as being equivalent to "money". However, finance exactly is not money; it is the source of providing funds for a particular activity. Providing or securing finance by itself is a distinct activity or function, which results in Financial Management, Financial Services and Financial Institutions. Finance therefore represents the resources by way funds are needed for a particular activity. We thus speak of 'finance' only in relation to a proposed activity. Finance goes with commerce, business, banking etc.

Finance is also referred to as "Funds" or "Capital", when referring to the financial needs of a corporate body. The Financial System of any country consists of financial markets, financial intermediation and financial instruments or financial products. All these items facilitate transfer of funds and are not always mutually exclusive.

2. DEFINITION OF NBFC

Section 45I of the Reserve Bank of India Act, 1934 defines ''non-banking financial company'' as–

Non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner; Such other non-banking institution or class of such institutions, as the Bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify.

PROFITBAILTY

Profitability refers to an organization company firm or enterprise ability to profit from all of its business activities. Profitability is the most critical factor in the survival and success of any business, and it is difficult to overstate its importance. It can be described as an investment ability to generate a profit from its use**. (Prakashan, 2013)**

LONG TERM SOLVENCY

The use of assets/funding sources for which the organization pays a fixed cost/fixed return is referred to as leverage. The examination included both operational and financial leverage. The amount of money borrowed to complete a transaction is referred to as "long term solvency" It denotes the link between a company earnings before interest and taxes, also known as operating profit, and earnings accessible to equity shareholders. Long-term debt bonds and debentures are included in these types of sources, where long-term loans or debentures include a set rate of interest, which is a larger risk for the corporation or share company. In general, financial leverage is produced by fixed financial costs, such as interest. Financial leverage is also considered as long term solvency.

2 REVIEWS OF LITERATURE

Fadzlan Sufian, and Roy faizal Razali Chong (2008) examined the determinants of profitability of Philippines banks during the period 1990–2005. Their empirical findings suggest that all the bank-specific variables have statistically significant impact on bank profitability. They also found that size, credit risk, and expenses, preference behavior are negatively related to banks' profitability, while non-interest income and capitalization have a positive impact. According to their analysis inflation has a negative impact on bank profitability, while the impact of economic growth, money supply, and stock market capitalization have not significantly explained the variations in the profitability of the

Philippines banks.

Shah-Noor Rahman and Tazrina Farah (2012), in their research paper "Non Bank Financial Institution‟s Profitability Indicators: Evidence from Bangladesh" examined the indicators of the profitability of firms in the Non Banking Financial Institution (NBFIs) industry of Bangladesh. The study established a relationship between independent variables like; Current Assets, operating expenses, Long term liability, Interest Income, and Operating revenue and dependent variable; Net Profit (NP). It was observed that firms‟ Liquidity and operational efficiency has significant impact on Profitability of Non Bank financial sector in Bangladesh.

James W. Scott and José Carlos Arias (2011) in their study" Banking profitability determinants" surveyed top five bank holding companies in the United states and concluded that determinants of profitability of the banking industry include positive relationship between the return of equity and capital to asset ratio as well as the annual percentage changes in the external per capita income. There was also a virtual consensus identified concerning the effect that the internal factor of size as measured by an organization‟s total assets had on its ability to compete more effectively, even in times of economic downturns.

Christos K. Staikouras & Geoffrey E. Wood (2011) examined the factors that that influence the profitability of financial institution in their research paper "The Determinants of European Bank Profitability". Their main finding was "the rate of return earned by a financial institution is affected by numerous factors. These factors include elements internal to each financial institution and several important external forces shaping earnings performance. The type of explanation would determine possible policy implications and ought to be taken seriously". Their paper quantifies how internal determinants ("within effects" changes) and external factors ("dynamic reallocation" effects) contribute to the performance of the EU banking industry as a whole in 1994-1998.

Adrian Morar (2009) Liquidity is necessary to the bank institutions for compensating the awaited or not awaited balance sheets fluctuations and for providing the necessary assets to development. The liquidity represents the capacity of a bank institution to cope efficiently with deposit withdrawals and other payable debts and covering the extra financing necessary, for credits and investment portfolio. A bank disposes of an adequate liquidity potential when it's able to obtain the necessary funds (by raising the debts, bonding, assets selling) immediately and at a reasonable price. The price of the liquidity depends on the market conditions and on the market perception of the risk level of the debtor institution.

RESEARCH GAP

To sum up, aforesaid reviews of literature confirm that no significant studies have been undertaken in the NBFIs in India However, variables considered have contextual reference to the study which is proposed to be considered for the study. Researcher found the gap that no more study on impact of profitability on long term solvency for selected Non -Banking financial institutions in India.

3. RESEARCH METHODOLOGY

3.1 RATIONAL OF THE STUDY

The financial sector of India has been facing liquidity crisis in the recent years. Not just the banking industry but also the NBFI industry is affected by it. Some of the players in the industry have been able to remain profitable even though their momentum slowed down. Other players, however, are struggling to stay profitable as the cost of fund has increased significantly because of the crisis. It is one of the biggest challenges towards the sustainability of individual NBFIs as well as the entire industry. This situation demands to investigate whether the profitability of the NBFIs can be enhanced in the following years. Furthermore, NBFIs not only involve themselves in deposit and lending activities but also a wide array of other profit seeking activities as well. Sometimes these activities may lead to very high exposure to risk. Therefore, it is important to find out the factors that contribute most to their profitability. Improving on these factors may lead them to a sustainable future in the long run. This study tries to address the determinants of profitability of non-bank financial institutions in India and also present the impact of long term solvency in India.

3.2 STATEMENT OF THE PROBLEM

Finance is regarded as a life blood of a business. Every firm measures its long term solvency (leverage) position. If organization maintain high leverage position it indicates the sound long term solvency position and to meet out long term obligation. And also its indicate firm's ability to meet the fixed interest and its costs and repayment schedules associated with its long term borrowings If the firm is not maintain proper long term solvency position or leverage position , they will consequence to meet out it long term finance obligation. Leverage or long-term fund indicates the proportion of owner's fund and non-owners funds. This study analysis the how long-term solvency (leverage) position affect the NBFI company profitability in India.

- **Is profitability being affect the long-term solvency on NBFI in India.?**
- **How impact of profitability on the long term solvency on NBFI in India.?**

3.3 OBJECTIVES OF THE STUDY

To examine the relationship between profitability and long-term solvency for selected non-banking financial institutions in India.

3.4 SCOPE OF THE STUDY

- The aim for this study examined profitability of selected NBFIs companies in India.
- The study will be helpful for conducting further research to the research scholars, research institutes, selected NBFCs as well as those who are directly or indirectly linked with the NBFIs industry.

3.5 RESEARCH DESIGN

A research design is considered as the framework or plan for a study that guides as well as helps the data collection and analysis of data. The study will be Purposive in nature.

3.6 SAMPLING DESIGN

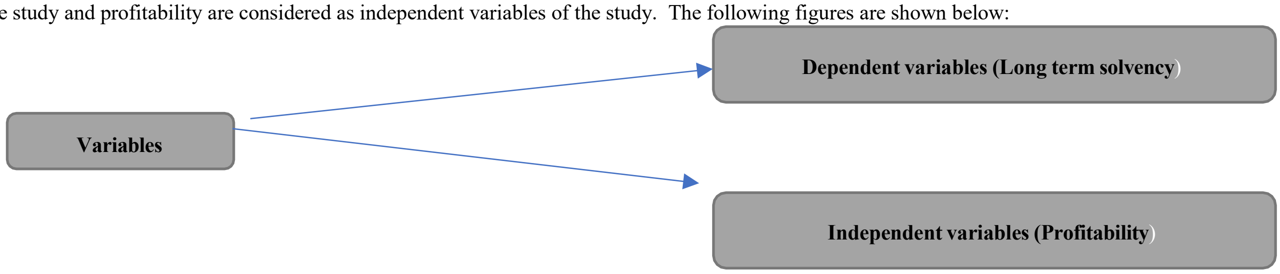
The researcher has decided to take convenient sample that are working in India and listed in the stock exchanges in India. Researcher has proposed to select Top 10 NBFIs companies as a sample for the study. But for this study paper only Shriram transport finance company limited has to proposed.

3.7 PERIOD OF THE STUDY

The present study will mainly be intended to examine the Analytical study and impact the profitability on long term solvency of selected NBFCs companies operating in India for **five years** from 2018-19 to 2022-2023

3.8 VARIABLES OF THE STUDY

The study variables are categories in two parts such as dependent and independents. While long term solvency is considered as dependent variables of the study and profitability are considered as independent variables of the study. The following figures are shown below:



3.9 MEASUREMENT OF VARIABLES

The measurement of the variables for the study is taken in the below table

TABLE NO 3 MEASUREMENT OF THE VARIABLES

Study variables	Sub variables	symbol	Method of components
Dependent variables (long term solvency)	Debt-to equity ratio	**D/E**	Debt / Equity

Independent variables	Net profit ratio	**NPR**	Net profit / Net revenue
(Profitability)	Return on capital employed	**ROCE**	Net profit before int and tax / capital employed
	Return on equity	**ROE**	Net profit / equity share holder

3.10 EMPIRICAL MODELS

In order to test our propositions, panel data regression analysis of cross sectional and time series data have been employed in the study. We have used regression analysis and multiple regression analysis for the study.

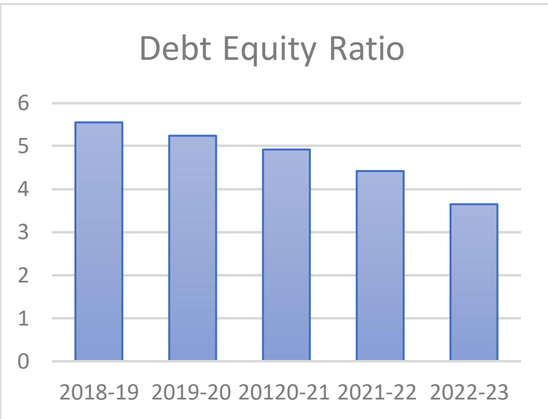
$$\mathbf{D/E_{it} = \beta_{1i} + \beta_2 NPR_{it} + \beta_3 ROA_{it} + \beta_4 ROE_{it} + \varepsilon_{it} \ldots}$$

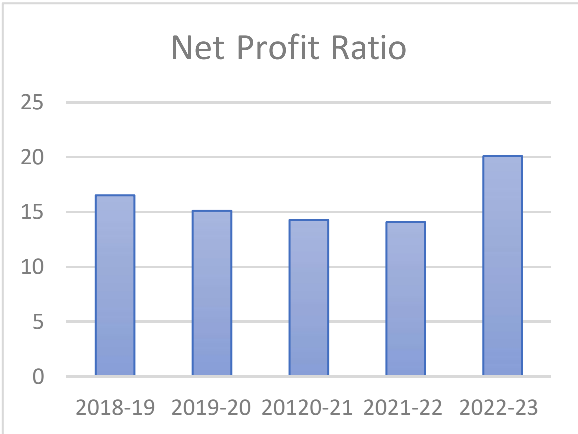
3.11 LIMITATIONS OF THE STUDY

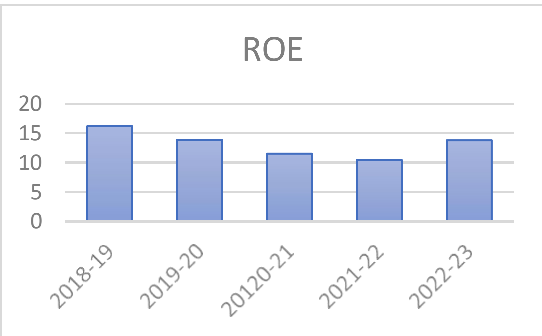
1. Financial information that will be collected for the present study will entirely secondary in nature. In such a scenario, the investigation takes into consideration all the drawbacks inbuilt with the secondary data and financial data.
2. The study is restricted to selected companies only for the period of ten years from 2018-19 to 2022-2023.

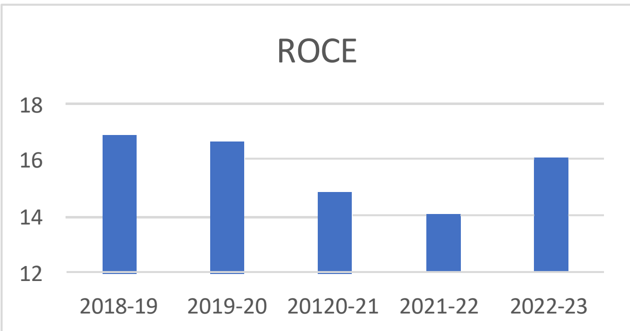
4 DATA ANALYSIS AND INTERPRETATION

YEAR	Debt equity ratio	Net profit ratio	ROE	ROCE
2018-19	5.55	16.51	16.19	16.88
2019-20	5.24	15.11	13.89	16.67
20120-21	4.92	14.27	11.53	14.88
2021-22	4.42	14.06	10.44	14.12
2022-23	3.65	20.08	13.80	16.17
Average	23.78	80.03	65.85	78.72









1. Debt Equity Ratio:

- Trend: The debt-equity ratio has been consistently decreasing over the years, indicating a decline in the proportion of debt relative to equity.
- Implication: The decreasing trend suggests an improvement in the financial risk profile and a lower reliance on external debt for financing.

2. Net Profit Ratio:

- Trend: The net profit ratio has shown volatility, with a notable increase in 2022-23.
- Implication: The increase in net profit ratio in 2022-23 may indicate improved operational efficiency or effective cost management.

3. Return on Equity (ROE):

- **Trend:** ROE has declined steadily over the years.
- **Implication:** The decreasing ROE may signal challenges in generating profits from shareholders' equity, warranting a closer examination of the company's operational efficiency and strategic decisions.

4. Return on Capital Employed (ROCE):

- **Trend:** Similar to ROE, ROCE has experienced a decline over the years.
- **Implication:** The declining ROCE suggests that the capital employed is becoming less efficient in generating returns. It's crucial to explore factors affecting capital utilization and operational effectiveness.

HYPOTHESITING

There is No relationship between debt equity (long term solvency) and Profitability (NP,ROE, and ROCE) for selected Shriram transport financial companies in India during last five year.

CORRELATION TEST

	D/E	*NP*	*ROE*	*ROCE*
DE	1			
NP	0.988701	1		
ROE	0.995213	0.996216	1	
ROCE	0.996746	0.997398	0.998482	1

The Debt Equity Ratio is positively correlated with Net Profit, Return on Equity, and Return on Capital Employed, indicating that an increase in these profitability metrics is associated with an increase in the Debt Equity Ratio.

FINDINGS OF THE STUDY

Positive Aspects: The decreasing debt-equity ratio is positive for long-term solvency, indicating a healthier capital structure The increase in net profit ratio in 2022-23 is a positive sign of improved profitability.

Concerns: Declining ROE and ROCE suggest challenges in utilizing equity and capital efficiently to generate returns. The significant decrease in the debt-equity ratio might have implications for the firm's growth or investment opportunities.

SUGGESTIONS OF THE STUDY

1. **Efficient Capital Utilization:** Evaluate the factors contributing to the declining ROE and ROCE. Focus on optimizing the utilization of equity and capital for improved returns.
2. **Strategic Debt Management:** While the decreasing debt-equity ratio is positive, ensure that it does not limit the company's ability to undertake profitable projects. Consider strategic debt for growth opportunities.
3. **Operational Efficiency:** Continue to focus on improving operational efficiency, as reflected in the increased net profit ratio. Identify and replicate successful strategies.
4. **Diversification and Growth:** Explore avenues for growth and diversification to enhance overall profitability and mitigate risks associated with a decline in certain ratios.

CONCLUSION:

While the company has shown positive trends in certain areas, it is essential to address declining efficiency ratios and ensure a balanced approach to financial management. Regular monitoring and strategic adjustments will contribute to long-term sustainability and success.

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