



A comparative study on performance of ITC hotels and Taj hotels ltd from 2013- 2017 using leverage and trend

¹ Lakshmi G, ² Shirley Evarita, ³ S Smrithi, ⁴ G Sri Soundarya

¹ Assistant Professor, B.Com (Professional Accounting), PSGR Krishnammal College for Women Coimbatore, Tamil Nadu, India

²⁻⁴ III B.Com (PA) Studentspsgr Krishnammal College for women Coimbatore, Tamil Nadu, India

Abstract

A Comparative study on performance of ITC & TAJ Ltd has been chosen for the study because hotel industry is one of the fastest growing sectors of the economy. To analyse the performance leverage and trend are used. Leverage refers to the employment of assets or sources of fund bearing fixed payment to magnify EBIT or EPS respectively. So, it may be associated with investment activities or financing activities. Operating leverage is concerned with the investment activities of the firm. Financial leverage is mainly related to the mix of debt and equity in the capital structure of a firm. A degree of combined leverage (DCL) is a leverage ratio that summarizes the combined effect that the degree of operating leverage (DOL) and the degree of financial leverage have on earnings per share (EPS), given a particular change in sales. This ratio can be used to help determine the most optimal level of financial and operating leverage to use in any firm. The Comparative and Common Size statements suffer from a major limitation i.e., absence of a basic standard to indicate whether the proportion of an item is normal or abnormal. Trend analysis overcomes this limitation. This method is also an important and useful technique of financial statement analysis.

Keywords: debt and equity, optimal level of financial, capital structure, trend ratio

Introduction

One of the fastest growing sectors of the economy of our time is the hotel industry. The hotel industry alone is a multi-billion dollar and growing enterprise more and more IT professionals are moving into the Metro cities as the USD 23 billion software service sector pushing into the Indian economy. Indian hotel industry is set up to grow by 15% a year. In 2010 as the Delhi capital city of India hosted the commonwealth Games there were more than 50 international budget hotel chains moving into India. The Indian Hotel Industry Revenues grew by 5% -8% in 2014-2015. The growth was around 9%-11% in 2015-2016 driven by a modest increase in occupancy and small expects the revenue per Available Room to improve by 7%-8% driven by up to 5% pickup in occupancies and 2%-3% growth in average Room Rates (ARR).

The term leverage refers to the employment of assets or sources of fund bearing fixed payment to magnify EBIT or EPS respectively. So, it may be associated with investment activities or financing activities.

Financial Leverage

The financial leverage is used to magnify the shareholders earnings. It is based on the assumption that the fixed charges / cost funds can be obtained at a cost lower than the firm's rate of return on its assets. When the difference between the earnings from the assets financed by fixed cost funds and the cost of these funds are distributed to the equity stockholders, they will get additional earnings without increasing their own investment. The impact of financial leverage can be analysed while looking at earnings per share and return on equity capital.

Degree of financial leverage

$$= \% \text{change in EPS} / \% \text{change in EBIT}$$

Impact of leverage on loss: If firm suffers losses than the highly leveraged scheme will magnify the losses per share.

Operating Leverage

Operating leverage results from the presence of fixed cost that helps in magnifying net operating income fluctuations flowing from small variations in revenue. The fixed cost is treated as fulcrum of a leverage. The changes in sales are related to changes in revenue. The fixed costs do not change with the change in sales. Any increases in sales, fixed costs remaining the same, will magnify the operating revenue. The operating leverage occurs when a firm has fixed costs which must be recovered irrespective of sales volume. The fixed costs remaining same, the percentage change in operating revenue will be more than the percentage change in sales. The occurrence is known as operating leverage.

Degree of Operating leverage

$$= \% \text{change in EBIT} / \% \text{change in Sales}$$

$$\text{EBIT} = \text{Revenue} - \text{operating expenses}$$

Combined leverage

Both financial and operating leverage magnify the revenue of the firm. Operating leverage affects the income which is the result of production. On other hand, the financial leverage is the result of financial decisions. Combined leverage is also called as Composite leverage. The composite leverage focuses attention on the entire income of the concern.

$$DCL = DOL * DFL$$

Where, DCL= Degree of combined leverage
DOL= Degree of operating leverage
DFL= Degree of financial leverage

Trend Analysis

The Comparative and Common Size statements suffer from a major limitation i.e., absence of a basic standard to indicate whether the proportion of an item is normal or abnormal. Trend analysis overcomes this limitation. This method is also an important and useful technique of financial statement analysis. The calculation of trend ratio involves the ascertainment of arithmetical relationship which each item of several years to the same item of base year. Thus, one particular year out of many years is taken as base. The value of one particular item out of several items shown in the financial statement are converted into ratio or percentage taking of that items in base year as equal to 100.

Profile of the Company

The taj mahal palace hotel is a “Heritage Grand” class five star hotel in the Colaba region of Mumbai, next to the gateway of India. Historically it was known as the “Taj Mahal Hotel” or the “The Taj Palace Hotel”. The Former Chairman of Tata Groups- Ratan Naval Tata. The Indian Hotels Company Limited (IHCL), branded as Taj Hotels palaces Resorts Safaris is an international chain of hotels and resorts headquartered at Express Towers, Nariman Point in Mumbai. Incorporated by the founder of the Tata Group, Jamsetji Tata, in 1903 the company is a part of the Tata Group, one of the India’s largest business conglomerates.

ITC was incorporated on August 24, 1910 under the name Imperial Tobacco Company of India Limited. As the Company's ownership, progressively Indianised the name of the Company was changed from Imperial Tobacco Company of India Limited to India Tobacco Company Limited in 1970 and then to I.T.C. Limited in 1974. In recognition of the Company's multi-business portfolio encompassing a wide range of businesses -Fast Moving Consumer Goods comprising Foods, Personal Care, Cigarettes and Cigars, Branded Apparel, Education and Stationery Products, Incense Sticks and Safety Matches, Hotels, Paperboards & Specialty Papers, Packaging, Agri-Business and Information Technology - the full stops in the Company's name were removed effective September 18, 2001. The Company now stands rechristened 'ITC Limited,' where 'ITC' is today no longer an acronym or an initialised form.

Research methodology

A research design is purely and simply the basic frame work or plan for study that guides the collection and analysis of the data. In Financial Analysis, the researcher adopted the Comparative research design in the collection and analysis of the data. Methodology is a way to systematically solve the research problem. It explains various steps that are generally adopted by a researcher in studying the research problem.

Objectives

- To analyse the financial leverage, Operating leverage and Combined leverage of TAJ & ITC hotels limited.
- To compare the performance of TAJ & ITC from the year 2013 – 2017 using trend.

Source of data

The study is based on secondary data. It has been collected from various websites and journals and books.

Period of the study

A period of five years from 2013 to 2017 has been taken for the study.

Tools used for the study

The following tools have been applied in the study

- Leverage
- Trend Analysis

Limitations

The Data available for the study are subject to a few limitations which are as follows:

- The study is only for the periods from 2012-2017, the changes that took place before and after this period were not taken into consideration
- The reliability and correctness of the study depends on the information provided in the annual report of the company.

Review of Literature

Modigliani and Miller (1958) were the first one to landmark the topic of capital structure and they argued that capital structure was irrelevant in determining the firm’s value and its future performance. On the other hand, Lubatkin and Chatterjee (1994) as well as many other studies have proved that there exists a relationship between capital structure and firm’s value.

Modigliani and Miller (1963) showed that their model is no more effective if tax was taken into consideration since tax subsidies on debt interest payments will cause arise in firm value when equity is traded for debt. In more recent literatures, authors have showed that they are less interested on how capital structure affects the firm value.

Bhat (1980) made an attempt to analyse the determinants of financial leverage and to investigate the relationship between the leverage ratio and institutional characteristics viz. firm size, variation in income, growth, profitability, debt service and dividend pay out through correlation and regression analysis. The cross-section data for this study were collected for six years from 1973 to 1978 from only one industry i.e., Engineering Industry, so as to alleviate the effect of industry type on the financial leverage ratio. The study reveals that firm size, growth rate and the degree of operating leverage does not have any significant relationship with financial leverage whereas earnings rate, business risk, dividend pay out ratio and debt service ratio have been found to be negatively related. Only the relation of operating leverage with leverage has been found positive but insignificant

relationship. The study observed that the institutional leverage ratio. characteristics are important determinants of financial

Analysis and Interpretation

Leverage of the ITC hotels ltd and Taj Hotels Ltd.

Table 1: Showing EPS & EBIT

YEAR	ITC Limited		TAJ Limited	
	EPS	EBIT	EPS	EBIT
	(₹ Cr.)	(₹ Cr.)	(₹ Cr.)	(₹ Cr.)
2012	7.93	8,975.45	1.91	341.91
2013	9.39	10,790.09	-3.43	-70.46
2014	11.05	12,682.74	-7.31	-391.78
2015	11.99	14,075.97	-1.02	121.96
2016	11.59	14,506.00	0.85	395.67
2017	8.40	15,548.29	1.43	456.77

Source: Secondary data (www.ndtv.comwww.moneycontrol.com) The above table shows EPS and EBIT from the year 2012 – 2017

Table 2: Financial leverage of the ITC hotels Ltd and Taj hotels Ltd

Year	ITC Limited			TAJ Limited		
	% Change In EPS	% Change In EBIT	DFL	% Change In EPS	% Change In EBIT	DFL
2013	18.41	20.22	0.91	-279.58	-120.61	2.32
2014	17.68	17.54	1.01	113.12	456.03	0.25
2015	8.51	10.99	0.77	-86.05	-131.13	0.66
2016	-3.34	3.06	-1.09	-183.33	224.43	-0.82
2017	-27.52	7.19	-3.83	68.24	15.44	4.42

Source: Computed datawww.ndtv.com, www.moneycontrol.com)

When we analyse the degree of financial leverage of ITC, for the first three years studied it was positive. During the year 2016 and 2017, even though EBIT has increased EPS has declined due to increase in payment of fixed cost bearing securities. So the DFL shows negative figures. Analysis of TAJ shows that the degree of financial leverage shows a fluctuating trend. During the year 2015, the EBIT is positive but loss per share is 1.02 due to higher interest payment which is not healthy. During the last year the performance of TAJ has improved and shows an improved status.

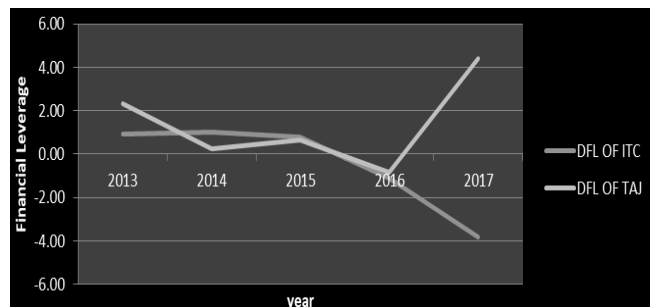


Fig 1: Chart showing financial leverage of itc hotels ltd and Taj hotels ltd

Table 3: Table Showing Sales & EBIT

YEAR	ITC Limited		TAJ Limited	
	Sales	EBIT	Sales	EBIT
2012	25,173.82	8,975.45	1,808.73	341.91
2013	29,901.27	10,790.09	1,875.86	-70.46
2014	33,238.60	12,682.74	1,929.51	-391.78
2015	36,507.40	14,075.97	2,024.38	121.96
2016	36,582.67	14,506.00	2,267.85	395.67
2017	40,088.68	15,548.29	2,391.25	456.77

Source: Secondary data (www.ndtv.com, www.moneycontrol.com)

The table (3) shows Sales and EBIT from the year 2012 – 2017

Table 4: operating leverage of the ITC hotels ltd and TAJ hotels ltd

Year	ITC Limited			TAJ Limited		
	% Change In EBIT	% Change In Sales	DOL	% Change In EBIT	% Change In Sales	DOL
2013	20.22	18.78	1.08	-120.61	3.71	-32.50
2014	17.54	11.16	1.57	456.03	2.86	159.45
2015	10.99	9.83	1.12	-131.13	4.92	-26.67
2016	3.06	0.21	14.82	224.43	12.03	18.66
2017	7.19	9.58	0.75	15.44	5.44	2.84

Source: Computed data (www.ndtv.com, www.moneycontrol.com)

The degree of operating leverage of ITC Ltd shows that percentage increase in sales results in higher percentage increase in EBIT. In the year 2014 an increase of 11% increase in sales, resulted in 17.5% increase in EBIT and so DOL is 1.57. During the year 2016 an increase of 0.21% increase in sales resulted in 3.06% increase in EBIT and so the DOL is 14.82 which is the highest during the studied period. When TAJ is analysed even though sales shows an increase in trend, the hotel has suffered losses during the first 2 years of study. During the year 2016, the performance of TAJ has improved showing profits with an increase in sales.

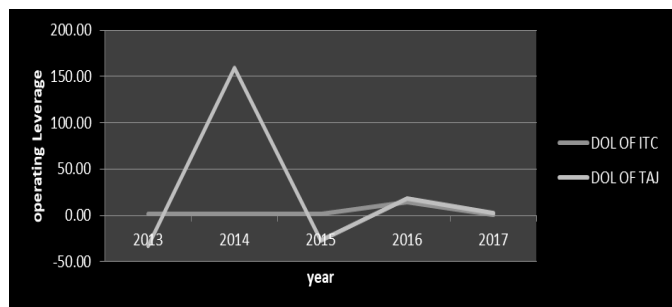


Fig 2: Chart Showing Operating Leverage of ITC Hotels Ltd And TAJ Hotels Ltd

Table: 5 combined Leverage of The ITC Hotels Ltd and TAJ Hotels Ltd

Year	DOC of ITC	DOC of TAJ
2013	0.98	-75.33
2014	1.58	39.55
2015	0.87	-17.50
2016	-16.18	-15.24
2017	-2.87	12.54

Source: Computed data (www.ndtv.com, www.moneycontrol.com)

Degree of Combined leverage shows how much percentage increase in sales results in increase in EPS. The position of TAJ is adverse while analysing the DOC due to higher payment of fixed cost bearing securities. The TAJ rely more upon debt financing. In ITC ltd, during the last two years, there is decline in EPS therefore DOC shows a negative trend.

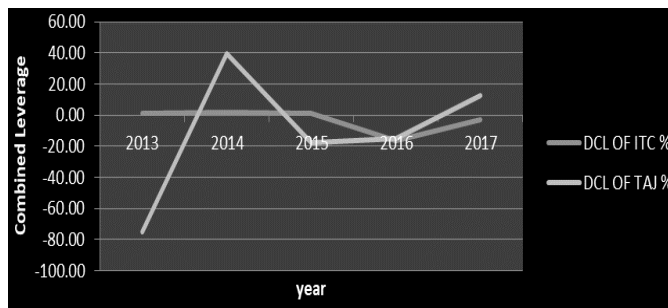


Fig 3: Chart showing Combined Leverage of ITC Hotels Ltd and TAJ Hotels Ltd

Trend Analysis of Taj Hotels Ltd and ITC Hotels Ltd

Table 6: Table showing Net Sales of ITC & TAJ LTD

Year	ITC Limited		TAJ Limited	
	Net Sales (₹ Cr.)	TREND	Net Sales (₹ Cr.)	TREND
2013	29,901.27	100.00	1,875.86	100.00
2014	33,238.60	111.16	1,929.51	102.86
2015	36,507.40	122.09	2,024.38	107.92
2016	36,582.67	122.34	2,267.85	120.90
2017	40,088.68	134.07	2,391.25	127.47

Note: 2013 is taken as a base year.

Source: Computed data (www.ndtv.com, www.moneycontrol.com)

There is a steady growth in sales. The increase in sales of ITC is higher than TAJ. The Sales of ITC ltd has increased to 34% and TAJ ltd has increased to 27%.

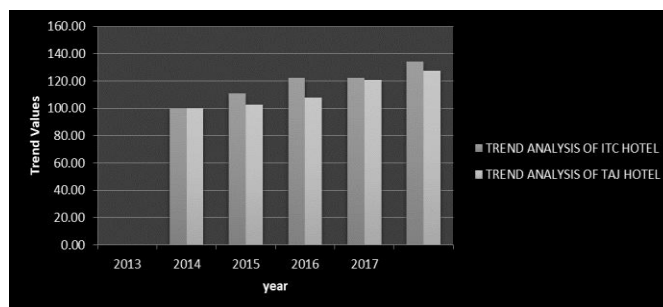


Fig 4: Chart showing Net Sales of ITC Hotels Ltd and TAJ Hotels Ltd

Table 7: Table showing Total Expenditure of ITC Hotels Ltd & TAJ Hotels Ltd

Year	ITC Limited		TAJ Limited	
	Expenses (₹ Cr.)	Trend	Expenses (₹ Cr.)	Trend
2013	19,282.72	100	1471.45	100
2014	20,763.08	107.68	1540.05	104.66
2015	23,083.14	119.71	1665.88	113.21
2016	22,904.14	118.78	1845.92	125.45
2017	25,504.55	132.27	1,871.17	127.17

Note: 2013 is taken as a base year.

Source: Computed data (www.ndtv.com, www.moneycontrol.com)

There is a steady increases in expenses during the study period. In comparison with TAJ, ITC’s expenditure is high showing an increase of 32% while comparing with base year.

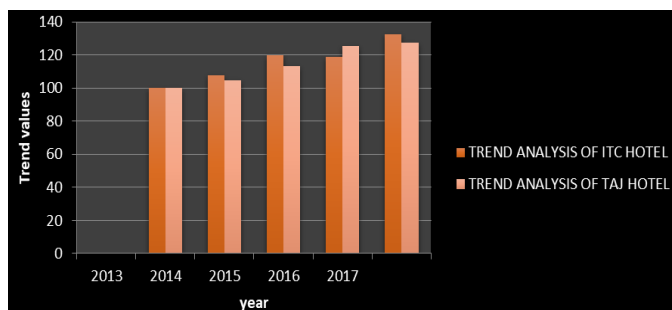


Fig 5: Chart showing Trend on expenses of ITC Hotels Ltd and TAJ Hotels Ltd

Table 8: Showing Net Profits of ITC Hotels Ltd & TAJ Hotels Ltd

YEAR	ITC Limited		TAJ Limited	
	NET PROFIT (₹ Cr.)	TREND	NET PROFIT (₹ Cr.)	TREND
2013	7,418.39	100	-276.61	-100
2014	8,785.21	118.42	-590.49	-213.47
2015	9,607.73	129.51	-82.02	-29.65
2016	9,328.37	125.75	84.15	30.42
2017	10,200.90	137.51	141.94	51.31

Note: 2013 is taken as a base year.

Source: Computed data (www.ndtv.comwww.moneycontrol.com)

The analysis shows a steady growth in the net profit of ITC ltd. The net profit has increased by 37% when compared with the base year. During the base year 2013, the net profit the TAJ shows a loss of 276.61 crore which has recovered and improved to show a profit of 141.94 crore.

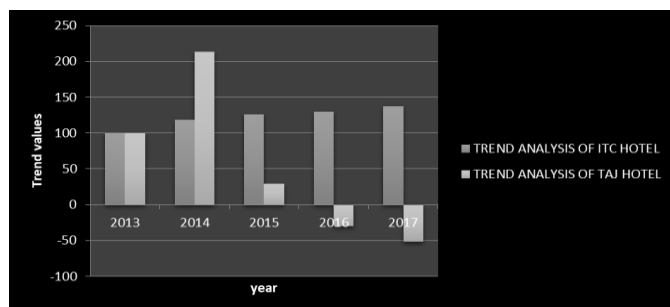


Fig 6: Chart showing Trend Analysis of ITC Hotels Ltd and Taj Hotels Ltd

Findings

- When we analyse the degree of financial leverage of ITC,

for the first three years studied it was positive. Analysis of TAJ shows that the degree of financial leverage shows a fluctuating trend. During the year 2015, the EBIT is positive but loss per share is 1.02 due to higher interest payment which is not healthy.

- The degree of operating leverage of ITC ltd shows that percentage increase in sales results in higher percentage increase in EBIT. When TAJ is analysed even though sales shows an increase in trend, the hotel has suffered losses during the first 2 years of study. During the year 2016, the performance of TAJ has improved showing profits with an increase in sales.
- The TAJ rely more upon debt financing. In ITC ltd, during the last two years, there is decline in EPS therefore DOC shows a negative trend.
- The Sales of ITC ltd has increased to 34% and TAJ ltd has increased to 27%.
- In comparison with TAJ, ITC’s expenditure is high showing an increase of 32% while comparing with base year.
- The analysis shows a steady growth in the net profit of ITC ltd than TAJ ltd.

Conclusion

A Taj hotel has a high operating leverage which has further increased with on-going renovations and product upgrades. It has been noticed that product gains, higher revenue with acceptances of its products in the market and improved revenue per room available. It gains financial leverage, by expansion through management contracts under new brands gateway and Vivanta by Taj. In trend analysis it’s clearly analysed that the ITC hotel is higher than TAJ hotel, 2013 is taken as base year. Government gains huge fiscal benefits from ITC hotels since it falls under higher tax slab rate than Taj.

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