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INDIAN CORPORATE AND ITS CAPITAL STRUCTURE: CHANGING TRENDS

Dr.Vikas Joshi

CSJM University, Kanpur

ABSTRACT

Background: Since the liberalization of Indian economy, there has been an upsurge in research on company finance, particularly aimed at understanding how companies finance their activities and why they finance their activities in these specific ways. In practice, it is observed that finance managers use different combinations of debt and equity. The present study is aimed at to find out the trend and pattern of financing by the Indian companies before and after the liberalization. The sheer size and diversity of the Indian capital market are, on their own, more than sufficient reasons for investigating Indian company financing in depth. In addition, the liberalization of the market offers a unique laboratory for evaluating the development of companies as liberalization proceeds. In this study, we attempt to compare and contrast the capital structure of Indian corporate before and after liberalization. Going beyond this, we examine the impact of liberalization and changes if any noticed due to liberalization, on the capital structure of Indian companies. Effort is also made to analyze the capital structure decisions of Indian companies in the recent past.

Objectives: The present study is aimed at to examine the changing trend of the capital structure financing pattern of Indian companies during pre and post liberalized era as well as in the recent past.

Methodology: We propose to analyze the financing pattern of 300 Indian private sector companies, comprising of 20 different sectors for the period 1999-2000 to 2007-2008, duly grouping them on the basis of their region, size, age, and nature etc.

Findings/Results**:** In this study, we try to find out the ways in which different companies at different times and in different institutional environments have financed their operations; and to identify possible implications of these financing patterns. The central issue we address is to examine the trend of changes in the capital structure of Indian companies and impact of liberalization on the capital structure decisions of Indian companies. We also try to find out the factors that determine the financing pattern of capital structure of Indian companies, particularly in the private sector.

Keywords: Capital Structure, Liberalization, Leverage, Indian Corporate, Private sector

1. Introduction

Capital structure is the combination of debt and equity that funds an organization's strategic plan. The "right" capital structure supports strategic-financial goals, while optimizing flexibility and minimizing cost. Capital structure management can be approached by answering the question, what is the appropriate amount, mix, structure, and cost of debt and equity to support the organization's strategic-financial goals? The proper and strategic management of capital structure ensures access to the capital needed to fund future growth and enhance financial performance. The key benefits of effective capital structure management are increased capital access, added flexibility, and lower overall cost of capital. "Organized properly in an organization of any size, a capital structure can be easily adjusted to meet changes in interest rates and the changing shape of interest rate yield curves," notes Kenneth Kaufman, managing partner of Kaufman Hall.

Unfortunately, there is no magic proportion of debt that a company can take on. The debt-equity relationship varies according to industries involved, a company's line of business and its stage of development. However, because investors are better off putting their money into companies with strong balance sheets, common sense tells us that these companies should have, generally speaking, lower debt and higher equity levels.

A company considered too highly leveraged (too much debt versus equity) may find its freedom of action restricted by its creditors and/or may have its profitability hurt as a result of paying high interest costs. Of course, the worst-case scenario would be having trouble meeting operating and debt liabilities during periods of adverse economic conditions. Lastly, a company in a highly competitive business, if hobbled by high debt, may find its competitors taking advantage of its problems to grab more market share.

Theoretically, the financial manager should plan an optimum capital structure for his company. The optimum capital structure is obtained when the market value per share is maximum. There is significant variation among industries and, among individual companies within an industry in terms of capital structure. Since a number of factors influence the capital structure decision of a company, the judgment of the person making the, capital structure decision plays a crucial part. Two similar companies can have different capital structures if the decision makers differ in their judgment of the significance of various factors. A totally theoretical model perhaps cannot adequately handle all those factors, which affect the capital structure decision. These factors are highly psychological, complex and qualitative and do not always follow accepted theory, since capital markets are not perfect and the decision has to be taken under in perfect knowledge and risk.

1.1 Liberalization of Economy

The Government of India started the economic liberalization policy in 1991. Even though the power at the center has changed hands, the pace of the reforms has never slackened till date. Before 1991, changes within the industrial sector in the country were modest to say the least. The sector accounted for just one-fifth of the total economic activity within the country. The sectoral structure of the industry has changed, albeit gradually. Most of the industrial sector was dominated by a select band of family-based conglomerates that had been dominant historically. Post 1991, a major restructuring has taken place with the emergence of more technologically advanced segments among industrial companies. Nowadays, more small and medium scale enterprises contribute significantly to the economy.

By the mid-90s, the private capital had surpassed the public capital. The management system had shifted from the traditional family based system to a system of qualified and professional managers. One of the most significant effects of the liberalization era has been the emergence of a strong, affluent and buoyant middle class with significant purchasing powers and this has been the engine that has driven the economy since. Another major benefit of the liberalization era has been the shift in the pattern of exports from traditional items like clothes, tea and spices to automobiles, steel, IT etc. The 'made in India' brand, which did not evoke any sort of loyalty has now become a brand name by itself and is now known all over the world for its quality.

1.2 Capital Structure of Indian Corporate Before Liberalization

Studies on capital structure of Indian Industries are inconclusive and often conflicting. A study by Sharma and Rao (1968) on 30 Engineering firms for 3 years concludes that debt due to its tax-deductibility is a prominent determinant of the cost of capital. A study by I. M. Pandey (1981) on cotton textiles, chemicals, engineering and electricity generations lends support to the traditional approach. Bhatt (1980) in his paper concludes that the leverage ratio is very much influenced by business risks measured in term of variability in earnings, profitability, debt service capacity, and dividend-payout ratio. I. M. Pandey (1984) in another study found that during 1973-81 about 80% of the assets of the companies sampled were financed by external debt and current liabilities. Large sized companies were more levered though a large number of small firms also courted more debt capital. Leverage did not exhibit a definite relationship with growth and profitability, although all the three variables moved in the same direction. He also found that a majority of the profitability and growth oriented companies were within the narrow bands of leverage. S. K. Chakraborty (1977) in his study found that age, retained earnings, and profitability were negatively correlated with the debit equity ratio, while total assets and capital intensity were directly related to it. He felt that a high cost of capital for all the consumer industries was due to their low debt component. His indirect attempt to test the MM hypothesis for 22 firms showed that cost of capital was almost invariant to the debt equity ratios.

Before 1980s Indian financial managers courted debt due to its low cost, tax advantages and the complicated procedures to be observed in garnering equity capital. The substitutability of short term debt for long term loan was another attraction. However, with the waves of liberalization, privatization and globalization sweeping the capital market in recent years, the corporate world has started wooing equity capital in a big way. The arrival of a matrix of new financial instruments such as commercial papers, asset securitization, factoring and forfeiting services, and the market related interest rate structure and their stringent conditions for lending, force modern enterprises to court equity finance.

In the study conducted by Chhabi Majumdar in 1992 for his Doctoral Thesis titled, "Borrowing as a Source of Financing Working Capital in The Corporate Sector in India: An Empirical Analysis" on Working Capital Financing Sources of Indian Corporate before liberalization, for the period 1981 to 1990, he analyzed the balance sheets of 20 companies, 10 from private sector and 10 from public sector. In addition, he has processed the relevant figures of a good number (ranging from 534 to 641 units) of public limited companies whose results have been published in the RBI (Reserve Bank of India) Bulletins during the period under study. While processing the figures so obtained, he has taken help of some accounting as well as statistical tools e. g. current ratio, debt-equity ratio, standard deviation, co-efficient of variation and test of significance.

In the process of the study he has seen that the working capital of each firm is constituted by several types of sources like bank borrowings, public deposits, trade credit, long-term borrowings and equity capital. At the outset, he has tried to find out the reasons behind utilizing several sources instead of relying upon one or two best-suited sources. What appears there from is that, since working capital needs are partly fixed and partly fluctuating, the companies cannot but resort to sources of different types and terms. Moreover, whereas short-term borrowings offer the benefit of reduced cost due to reduction of idle capital, the use of long-term borrowings has also the necessity on many grounds. Long- term borrowings are less risky than short-term borrowings and the firms would not have to meet the cash obligations off and on. Not only the long -term borrowings, but the equity capital has also its role to play in the financing of working capital in Indian corporate sector. At the initial stage of a firm, fixed assets as well as current assets have to be financed by this equity capital, since other sources may not be easily available at that time. Subsequently, when the firms get momentum, several lenders may stretch their hands for advancing loan, but the importance of equity capital does not end altogether. On the ground of stability and security, each firm is to maintain “equity-cushion” throughout its life time. In view of this, it has been deduced in his study that there is need for financing working capital from various sources.

Of different sources, bank credit has been working since long as a major source of working capital in India and abroad. In 1970s the use of bank credit in Indian corporate sector became so excessive that the desired correlation between bank credit and the holding of inventory and book debt was hampered in most cases. Hence, attempt was initiated to bring in a ‘check’ on the use of bank credit and several study groups (Dehejia Study Group, Tandon Study Group, Chore Study Group, Marathe Committee, Chakraborty Committee etc.) were set to find out a way in this regard. All the study Groups gave recommendations in favour of providing a ‘restraint’ on the use of bank credit, and the Tandon Study Group prescribed some definite norms to that effect. Suggesting a limit on the holding of inventory and book debt, the Tandon Study Group prescribed three methods (methods I,II &III) to be implemented one after another, with a view to reducing the share of bank credit in the working capital. Applying the prescribed (prescribed by Tandon Study Group) norms for holding inventory and bank credit he has seen in his study that there has been a positive impact of the Tandon Study Group recommendations on the use of bank credit by Indian companies. That means the desired correlation between bank credit and the holding of inventory and receivables has now been mostly established. Notwithstanding, the share of bank borrowings to total borrowings in public limited companies is 20% in average during the period 1981-90, and that to current assets is 22-25%. The yearly scores during the decade of eighty are also in agreement with the average results, and hence the standard deviations calculated thereon have been very low. In government companies, the combined scores in relation to total borrowings as well as to current assets are only 5-6% no doubt, but in six out of ten government companies the individual scores range from 17% to 31%. In view of this, it may be said that the role of bank borrowings in working capital financing in Indian corporate sector is still immense. Then, he has analyzed the role of public deposit as a source of working capital in Indian corporate sector. This source emerged in India in 1930s. In 1950s, there became a downfall in the use of it. In 1970s it again came into prominence. Use of public deposit may frustrate the Government's policy of canalizing the flow of funds to industrial sector according to planned priorities. Moreover, it is said that the unwary depositors may come into the trap of unscrupulous depositee companies, by lending their hard-earned money as public deposit. But from the standpoint of depositee companies, public deposit can be said to be a viable source of finance in many respects. The most important argument in favor of its use is that it is cheaper than bank borrowings and many other sources of finances. Now, government has imposed some regulation and as a result the interest of innocent investors has been protected to an extent and the flow of public deposit has also been restrained in the interest of planned economy. It is thus expected that the investors will now accept the offer for public deposit more freely and the firms, due to its cost advantage, will utilize this source up to at least the permissible limit. But what he has observed is that the share of public deposit to total borrowings is, on an average, only 6% in public limited companies, and this is as meager as0.08% in government companies. Share of public deposit to current assets is also only 7% in public limited companies and 0.08% in government companies. The individual results as to the use of public deposit are, however, widely scattered, and this is substantiated by the high co-efficient of variation (108%) of the scores. Nevertheless, it is evident from the combined results that the role of public deposit as a source of working capital is not significant in the decade of eighty, though in 1970s its role had been better to some extent.

Long-term borrowings like debenture, institutional loan and government loan have also a contribution to working capital financing, since, a part of current assets is usually covered by long-term funds. The corporate practices as to these of different types of long-term sources reveal that the position of debenture in corporate finance is almost equal to that of institutional loan. In RBI sample, both hold individually 14% of total borrowings. In case of ten selected public limited companies their individual scores are 7% and in case of government companies their scores are only 0.1% - 0.3%. Government loan, on the other hand, occupies as much as 66% share of total borrowings in government companies, though its position in public limited companies is really insignificant.

Sometimes long-term borrowings may occupy important role in total borrowings, but that does not mean that contribution of long-term borrowings to working capital will also be significant. If current liabilities cover the current assets in full, the long-term sources, whatever may be their position to total borrowings, will have to be presumed to be used for financing the fixed assets only. From this view point, he has computed the extent of gap between current assets and current liabilities of the selected companies, and has presumed that the gap has been financed by long-term sources as a whole. Multiplying the gap with the ratio of each long-term source to total long-term funds, he has estimated the share of different companies of long-term borrowings, viz, debenture, institutional loan and government loan, in the context of working capital. The results so obtained reveal that the individual share of institutional loan and debentures towards financing working capital is 2%-5% in case of public limited companies and 0.05% - 0.16% in case of government companies. Thus, it appears that the role of debenture and institutional loan in working capital finance is almost an exercise of paper only. Position of government loan is also disappointing in public limited companies. But in government companies its contribution is remarkable. This is quite expected as government companies have developed a practice of banking upon 'easily-available' government loans. However, the position of government loan as a source of finance is gradually decreasing even in government companies. On the other hand the position of debenture is gradually improving both in private as well as in public sector. Institutional loan exhibits a fluctuating trend during the decade of eighty, although ultimately its position has improved to an extent.

Another viable source of working capital is trade credit, which is considered to be a formality-free, security-free and interest-free source of finance. Due to the above advantages, trade credit has been practically a common source of working capital to almost all enterprises; notwithstanding the fact that there is some implicit cost associated with trade credit and the explicit cost is also originated when cash discount offered is foregone. During 1980s, 30% of current assets and 25% of total borrowings of public limited companies have come from trade credit and in case of government companies the scores have respectively been 8.3% and 8.8%. As such, it may be stated that the role of trade credit is equally important during the period under study. However, its contribution in public limited companies is higher in comparison with that in government companies.

One of the important factors determining the feasibility or otherwise of a particular source of finance is stated to be the cost. Hence, he has attempted to see thereafter how far the cost actually plays the decisive role in the selection of sources.

With an attempt to estimate the effect of cost on their selection, he has computed the specific costs of some sources. Trade credit has been taken to be less costly source of finance, although there are some implicit costs of trade credit over and above the cost of foregoing cash discount. Bank borrowings, on the other hand, appear to be costliest of the three sources. Thus, on cost consideration, it is natural that share of bank borrowing in working capital finance will be much lower than that of trade credit. But the corporate practices reveal that ratio of bank borrowings, to trade credit is, on an average, 88%, that is, bank borrowings do not lag as much behind the trade credit as it should be from the view point of cost of finance. Then, coming to the comparative position of bank borrowings and public deposit he found that, throughout the decade of eighty, the cost of public deposit had always been lower than that of bank borrowings. But during the period, the use of bank borrowings was approximately four times of public deposit. Moreover, it has been revealed that the cost of public deposit, contrary to general expectation, has gradually come down. Had the cost been a factor for the use of public deposit, its share to current assets would have been higher over time due to gradual reduction in cost. Reversely, he has observed a decreasing trend in the use of this source. In view of all these, he concluded that effect of cost on the selection of sources of working capital is not at all significant.

2. Impact of Liberalization on Capital Structure of Indian Corporate

Until the early nineties, corporate financial management in India was a relatively drab and placid activity. There were not many important financial decisions to be made for the simple reason that firms were given very little freedom in the choice of key financial policies. The government regulated the price at which firms could issue equity, the rate of interest which they could offer on their bonds, and the debt equity ratio that was permissible in different industries. Moreover, most of the debt and a significant part of the equity were provided by public sector institutions. At the beginning of the reform process, the Indian corporate sector found it significantly over-levered. This was because of several reasons:

- Subsidized institutional finance was so attractive that it made sense for companies to avail of as much of it as they could get away with. This usually meant the maximum debt-equity ratios laid down by the government for various industries.
- In a protected economy, operating (business) risks were lower and companies could therefore afford to take more risks on the financing side.
- Most of the debt was institutional and could usually be rescheduled at little cost.

The liberalization changed all of this. The corporate sector was exposed to international competition and subsidized finance gave way to a regime of high real interest rates. One of the first tasks for the Indian companies was substantial deleveraging. Fortunately, a booming equity market and the appetite of foreign institutional investors for Indian paper helped companies to accomplish this to a great extent in 1993 and 1994. The downturn in the stock market that has followed since then has stopped this process from going any further and has probably left many companies still excessively levered. According to the figures compiled by the Centre for Monitoring the Indian Economy, the average debt-equity ratio of private sector manufacturing companies in India fell from 1.72 in 1990-91 to 1.05 in 1996-97, and more than half of this reduction took place in one single year - 1994-95. And consequently, the post-liberalized era has started observing the following changes in the sources of Industrial finance:

2.1 Domestic Capital Formation

The planners, in the fifties, had recognized that the material shortage of capital in relation to labor was the principal constraint to the industrial growth. It was envisioned that increased capital formation would contribute for more industrial output & a 'virtuous circle' of growth. Gross Capital Formation (GCF) is estimated across three types of assets, viz., construction, machinery and equipment. The GCF, adjusted for errors and omissions, is termed as aggregate investment or Gross Domestic Capital Formation (GDCF). A positive association is hypothesized between the capital formation and the industrial production.

2.2 Foreign Direct Investment

Foreign investment can be classified as foreign direct investment (FDI) and foreign portfolio investment. International investment in financial assets such as shares, debentures and bonds, is called portfolio investment. Foreign investment in real assets is called foreign direct investment (FDI). Multinational corporations (MNC s) are the chief source of foreign direct investment in real assets. Real assets consist of physical things such as factories, land, capital goods, infrastructure and inventories. Multinational may collaborate in joint ventures with host country enterprises or may have fully owned subsidiaries in host countries. Such investments are called foreign direct investments.

A few decades ago, many countries considered FDI as the source of economic imperialism. But things are quite different now. The argument is that FDI contribute to the growth of host economies in many ways. e.g. physical capital formation, technology transfer, human formation stimulation of productivity, augmentation of output, promotion of foreign trade and improvement of competitiveness of indigenous entrepreneurs. After weighing the prospects and consequences, government of India seems keen to attract ever-increasing amount of FDI, which can be evidenced by its efforts aimed at deregulation, transparency and globalization. In brief, It can be regarded as a source of industrial growth. As part of the economic reforms introduced in 1991, in the wake of a sharp external payments crisis, policies relating to foreign investment and foreign technology agreements were radically changed. Foreign Investment Promotion Board (FIPB) was specifically created to invite and negotiate for substantially large investment by international companies.

2.3 Primary Issues in the Capital Market

Capital market constitutes primary (new issues market) and secondary (stock) market. The primary market helps the public and private sector companies in raising finance mainly for their new projects, expansion, modernization, acquisition etc. The secondary market provides liquidity for the financial instruments (equity, preference shares and debentures/bonds) through adequate marketability and price continuity. The array of financial institutions also have played crucial role in meeting long-term credit needs of the industrial sector.

With the liberalization of the Indian economy since 1991, the Government has provided a number of additional fiscal and other incentives to foster capital market development. The result has been an explosive growth of the market. The magnitude of the growth has been rapid and vivid in terms of fund mobilized, the amount of market capitalization and the expansion of investor population. The Indian market was opened up for investment by the foreign institutional investors (FIIs) in Sept.1992 and the Indian companies were allowed to raise resources abroad through Global Depository Receipts (GDR) and Foreign Currency Convertible Bonds (FCCB). Both the primary and secondary segments of the capital market displayed rapid expansion and growth accompanied by greater institutionalization and larger participation of individual investors during the post-reform period.

Despite the structural transformation of the Indian capital market, there are many problems which often come on the way of its efficiency. These relate to investor protection, consolidation (after massive expansion), integration with other market segments, product innovation and technology, etc. which are critical and need to be addressed. Reserve Bank of India has expressed concern over continued sluggishness in the primary capital market for the last two years (1996-97 and 1997-98), as long term prospects for industrial development are critically dependent on the revival of primary market.

2.4 Bank Credit

Banks are the dominant financial intermediaries in developing countries including India. Bank credit is considered as an important source of industrial finance. The dependence on bank for finance could vary according to the size of the companies. The small-scale industrial units have increased their dependence on banks for loans because they have virtually no access to the capital

The Reserve Bank of India's attempt at reforming the financial sector was visible from the recommendations of the Committee to Review the Working of the Monetary system (1985) (referred to as Chakraborthy Committee Report).The Committee advocated the necessity of moving away from quantitative controls which, it felt, led to distortions in the credit market and resulted in curbing the growth of the economy. But the impetus to reforms in the financial sector was given by the Report of the Committee on the financial system (Narasimham Committee). The financial sector reforms, based on this report were mainly aimed to provide credit to the industrial sector by reducing the Cash Reserve Ratio and Statutory Liquidity Ratio. The liberalization policy also called for increased efficiency of commercial banks by encouraging them to compete in the market. The public sector banks were given autonomy to frame their policies including interest rate fixation. It may be noted that the bank credit to the industrial sector has not increased during the post-reform period in spite of the various attempts.

3. Capital Structure of Indian Corporate After Liberalization

Capital Structure management has been impacted by a number of the developments discussed above - operational reforms in the area of credit assessment and delivery, interest rate deregulation, changes in the competitive structure of the banking and credit systems, and the emergence of money and debt markets. Some of the important implications of these changes for short term financial management in the Indian corporate sector are:

1. ***Creditworthiness:*** The abolition of the notion of maximum permissible bank finance has given banks greater freedom and responsibility for assessing credit needs and creditworthiness. Similarly commercial paper and other disintermediated forms of short term finance are very sensitive to the company's credit rating and perceived creditworthiness. Companies are suddenly finding that their creditworthiness is under greater scrutiny than ever before. Over a period of time, companies will have to strengthen their balance sheets significantly to ensure a smooth flow of credit. In the meantime, many borrowers' especially small and medium businesses have seen their source of credit dry up.

2. ***Choice:*** Top notch corporate borrowers are seeing a plethora of choices. The disintegration of the consortium system, the entry of term lending institutions into working capital finance, and the emergence of money market borrowing options gives them the opportunity to shop around for the best possible deal. Some borrowers indeed appear to have moved to a highly transaction oriented approach to their bankers. Over time, however, we would probably see the re-emergence of relationship banking in a very different form.

3. ***Maturity Profile****:* The greater concern for interest rate risk makes choice of debt maturity more important than before. Short term borrowings expose borrowers to roll-over risk and interest rate risk.

4. ***Cash Management****:* Cash management has become an important task with the phasing out of the cash credit system. Companies now have to decide on the optimal amount of cash or near-cash that they need to hold, and also on how to deploy the cash. Deployment in turn involves decisions about maturity, credit risk and liquidity. In the mid-nineties, many corporate found that they had got these decisions wrong. During the tight money

policy of this period, some companies were left with too little liquid cash, while others found that their "cash" was locked up in unrealizable or illiquid assets of uncertain value.

In quantitative terms, the growth of the Indian capital markets since the advent of reforms has been very impressive. The market capitalization of the Bombay Stock Exchange (which represents about 90% of the total market capitalization of the country) has quadrupled from Rs. 1.1 trillion at the end of 1990-91 to Rs. 4.3 trillion at the end of 1996-97. As a percentage of GDP, market capitalization has been more erratic, but on the whole this ratio has also been rising. Total trading volume at the Bombay Stock Exchange and the National Stock Exchange (which together account for well over half of the total stock market trading in the country) has risen more than ten-fold from Rs 0.4 trillion in 1990-91 to Rs. 4.1 trillion in 1996-97. The stock market index has shown a significant increase during the period despite several ups and downs, but the increase is much less impressive in dollar terms because of the substantial depreciation of the Indian rupee. It may also be seen from the chart that after reached its peak in 1994-95, the stock market index has been languishing at lower levels apart from a brief burst of euphoria that followed an investor friendly budget in 1997. For the primary equity market too, 1994-95 was the best year with total equity issues (public, rights and private placement) of Rs. 355 billion. Thereafter, the primary market collapsed rapidly. Equity issues in 1996-97 fell to one-third of 1994-95 levels and the decline appears to be continuing in 1997-98 as well. More importantly, most of the equity issues in recent months have been by the public sector and by banks. Equity issues by private manufacturing companies are very few.

A study conducted by Justin Paul, A. Ramanathan, reveals that bank credit constitutes two-third of the total credit to the industrial sector and still continues as the important source of finance for small-scale industries. More attention has to be paid for providing as much as bank credit for the industrial sector. Reserve Bank of India's efforts to reduce the Cash reserve Ratio and withdrawal of adhoc treasury bills (abolition of automatic monetization of fiscal deficit) will be helpful to pump more credit to the banking sector. But commercial banks are required to take steps for providing more credit to the industrial sector, rather than investing in government securities. Priority should be given for small-scale units and new entrepreneurs. Bank Rate has to brought down in order to reduce the cost of funds (interest rate) in India. Similarly, certain measures have to be adopted immediately in the financial sector to recover the buoyancy in the stock market.

3.1 Capital Structure of Indian Companies In Recent Past

In order to know the financing pattern of Indian companies in recent past, we have analyzed the financing pattern of 300 Indian private sector companies, comprising of 20 different sectors for the period 1999-2000 to 2007-2008, duly grouping them on the basis of their region, size, age, and nature etc. At first we conducted the analysis of the total sample of all the 300 companies on an aggregate basis. Later on we examined the capital structure of the companies after classifying them into different sizes, ages, regions and sectors. The different sources from where the corporate sector has raised the funds and the ways and means by which the so raised funds have been utilized have been analyzed in detail. The analysis of the study is based on the historical funds flow statements of each company. For the total sample, the aggregate of (300 companies) individual sources of funds and their investment in acquiring different assets has also been made. The key findings are as follows:

• Indian corporate employ substantial amount of debt in their capital structure in terms of the debt-equity ratio as well as total debt to total assets ratio. Nonetheless, the foreign controlled companies in India use less debt than the domestic companies. The dependence of the Indian corporate sector on debt as a source of finance has over the years declined particularly since the mid-nineties.

• The corporate enterprises in India seem to prefer long-term borrowings over short-term borrowings. Over the years, they seem to have substituted short-term debt for long-term debt. The foreign controlled companies use more long-term loans relatively to the domestic companies.

• As a result of debt-dominated capital structure, the Indian corporate are exposed to a very high degree of total risk as reflected in high degree of operating leverage and financial leverage and, consequently, are subject to a high cost of financial distress which includes a broad spectrum of problems ranging from relatively minor liquidity shortages to extreme cases of bankruptcy. The foreign controlled companies, however, are exposed to lower overall risk as well as financial risk.

• The debt service capacity of a sizeable segment of the corporate borrower as measured by Interest Coverage Ratio and Debt Service Coverage Ratio is inadequate and unsatisfactory.

• Retained earnings are the most favored source of finance. There is significant difference in the use of internally generated funds by the highly profitable corporate relative to the low profitable firms. The low profitable firms use different forms of debt funds more than the highly profitable firms.

• Loan from financial institutions and private placement of debt are the next most widely used source of finance. The large firms are more likely to issue bonds in the market than small corporate.

• The hybrid securities are the least popular source of finance amongst corporate India. They are more likely to be used by low growth firms. Preference shares are used more by public sector units and low growth corporate.

• Equity capital as a source of fund is not preferred across the board.

• Indian companies prioritize their sources of financing (from internal financing to equity) according to the law of least effort, or of least resistance, preferring to raise equity as a financing means "of last resort". Hence internal funds are used first, and when that is depleted debt is issued, and when it is not sensible to issue any more debt, equity is issued.

• Study revealed that an average of 60.54% of the total funds was raised from internal sources whereas external sources contribute only 39.46% of the total funds of Indian companies. It indicated that Indian companies prefer more to raise funds from internal sources as compared to external sources.

• It has been found that, issue of share capital had never been a major source of long-term finance for the corporate sector. The dependence on debt capital i.e. secured and unsecured loan is more as compared to equity.

• Small sized companies relies more on debt capital as compared to large sized companies. The average debt-equity ratio of small sized companies were found to be more than 3:1 whereas in case of large sized companies it is 1:1. This shows that the large sized companies followed a strict conservative policy while deciding the debt equity mix.

- The average debt-equity ratios of manufacturing companies were more than double of the average debt-equity ratio of service sector companies. It indicates that service sector companies relies more on the equity and less on the debt, and vice-versa in case of manufacturing companies.
- The common observation for the companies of all the four regions was that they have raised more funds through debt capital as compared to equity, may be due to the reason of easy availability of cheap debt capital.

- Although the size of the firm, its age, the region to which it belongs and industry-classification contribute to the existing variation in capital structure across industry classes but nature of the industry seems to dominate.

- The study revealed that in terms of total average inflow of funds, western region stood highest as this region is the most industrially advanced region of our country and covers 135 companies out of the total sample size of 300 companies. In terms of mean average southern region has the highest inflow of funds as compared to other regions because most of the large sized companies are situated in this region, which are capable of generating more funds as compared to the companies of other region.
- More specifically, it is the differences in external fund requirement based on technology differences that play a leading role in determining the inter-industry variation in capital structure. This signals that there exists a linkage between product market and capital market. This proves that the capital structure and the determinants of capital structure vary from industries to industries and the nature of the industry acts as a key determinant of the capital structure.

- To sum up, nature of the industry to which the firm belongs to, its size, age and location plays a major role in the determination of the capital structure of the private sector firms of Indian corporate.

4. Appendices

Table 1: Classification of companies according to their age

Year of Incorporation	Age Group	No. of Companies	*% to Total Sample*
Prior to 1947	Very Old	44	14.67
1947 - 1980	Old	95	31.67
After 1980	New	161	53.66
Total		**300**	**100**

Table 2: Classification of companies according to their region

Region/Group	Eastern	Western	Southern	Northern	*Total*
No. of Companies	34	135	85	46	300
% of Total Sample	11.33	45	28.33	15.34	100

Table 3: Classification of companies according to their size

Size of the Company	Total Assets as on 31st March 2008 (Rs. in Crores)	No. of Companies	*% to Total Sample*
SMALL	Below Rs. 100 Crores	75	25
MEDIUM	Rs.100 Crores to Rs.500 Crores	98	32.67
LARGE	Above Rs.500 Crores	127	42.33
TOTAL		300	100

Table 4: Classification of companies according to their sector/industry

INDUSTRIAL GROUP	NAME OF THE INDUSTRY/SECTOR	NO. OF COMPANIES	PERCENTAGE TO TOTAL SAMPLE
Agro Based Manufacturing Industries	Textiles Manmade, Food Processing, Edible Oil, Cotton Textiles, Paper, Sugar,	90	30
Mineral Based Manufacturing Industries	Chemicals, Cement, Fertilizer, Construction & Housing, Mining, Fabricated Metal, Electric Equipment, Pharmaceuticals, Plastic,	135	45
Service Industries	Computer Software, Hotel, Transport	45	15
Plantation Industries	Rubber, Tea & Coffee,	30	10
Total		300	100

5. Conclusion

So far as India is concerned, much remains to be done for industrialization. There exists the need to develop a synergic relation between the government and the private sector. State will have to keep constant dialogue with the entrepreneurs and their representatives to revive their confidence. To overcome the severe demand contraction in the economy, India has to rely on higher government spending and tax cuts. The government has to play a dominant role for allocating the limited resources and for more public investments. In sum, the study leads to the conclusion that India has to concentrate on domestic capital formation. In order to achieve this goal, we have to promote the private corporate investment from Indians nationals as well as non-resident Indians. Despite the relaxations in some regulatory acts, India continues to repel investors with interminable delays. Indians abroad, have demonstrated to the world that its entrepreneurial and professional skills are as good as best. Corporate sector has entered into a world where only the fittest can survive. To be able to do so, Indian industry must become more quality conscious, invest in human capital and encourage professional management.

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