

CAPITAL STRUCTURE PRACTICES OF PRIVATE CORPORATE SECTOR IN INDIA

by

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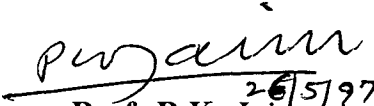
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CERTIFICATE

This is to certify that the thesis entitled **CAPITAL STRUCTURE PRACTICES OF PRIVATE CORPORATE SECTOR IN INDIA** being submitted by Mr. Suresh Babu T.K. to the Indian Institute of Technology, Delhi, India, for the award of the **DOCTOR OF PHILOSOPHY** is a record of bonafide research carried out by him under my guidance and supervision. He has fulfilled the requirements for the submission of the thesis which has attained the standard required for a Ph.D degree of the Institute. The results presented in this thesis has not been submitted in part or full to any other university or institution for award of degree or diploma.


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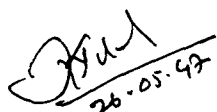
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ABSTRACT

The choice of debt and equity in financing the assets of corporate firms assumes vital significance in corporate financial management due to their influence both on return and risk of the shareholders. Corporate enterprises generally are inclined to use more debt in financing their assets. The major reasons are: (i) debt is a cheaper source of finance in view of tax advantage on interest payments, (ii) it does not lead to the problem of dilution of control from its existing owners and (iii) it magnifies the rate of return to its equity-holders. However, the corporate managers are to guard themselves against the excessive use of debt as it may endanger the very survival of the corporate firms.

The primary objective of the study is to enumerate the capital structure practices followed by the private corporate enterprises in India during 1980-94. Besides, the study also aims at comparing the capital structure practices of foreign controlled companies in India with the domestic companies. The study, *inter-alia*, examines the constituents of debt, risk characteristics of the corporate firms, the existence of pecking order hypothesis (firms follow a preferred hierarchy in raising funds, internal to external; if external, debt to equity) in India and some of the major design parameters of capital structure. The present endeavour also seeks corporate finance managers' opinion on factors affecting capital structure decisions and the changes, if any, in the wake of liberalisation in India.

The study is broadly divided in four parts, spread over nine chapters. The first part, the background, relates to the problem identification, main issues / hypotheses, scope of the research, literature survey and the research methodology used. The

second part of the study deals with the aggregative analysis of the Indian private corporate sector capital structure practices. Dis-aggregative analysis discussed in part three includes capital structure practices of foreign controlled companies in comparison with that of Indian companies and the industry-wise analysis. This part also covers the major design parameters of the private corporate sector capital structure. In the last part the main conclusions, implications and suggestions for further work have been discussed.

The empirical evidence indicates that the private corporate sector in India had shown marked preference for debt in designing their capital structure. The nineties witnesses a marginal decline in the use of debt; in other words, there is recuperation of equity in the capital structure of the private corporate sector firms in India. However, the ascendancy of debt in the capital structure continues. Another notable finding of the study is that, there is a shift towards preference for long-term debt to the short-term. The study also reveals that the ordinary shareholders of the private corporate firms in India are subject to a high degree of financial risk. The private corporate firms are exposed to very high degree of risk and financial distress in view of their alarmingly low debt service capacity.

The study brings to fore that the Indian private corporate sector enterprises follow multiple financial goals / objectives. Ensuring long-term survivability and maintaining good long-term relations with banks and institutions have been rated as the important financial planning principles affecting financing decisions. The survey reveals that there exists a pecking order hypothesis in India, i.e., corporate firms prefer internal to external financing, and external funds, *inter-se*, debt to equity.

Foreign controlled companies differ significantly from the Indian companies in that foreign controlled companies are essentially equity oriented whereas the domestic companies are more debt oriented. Another significant finding of the study is that it brings out strong industry influence in deciding the financing pattern of the corporate enterprises in India. Financial risk, operating risk, debt service capacity and size of the firm are the other important design parameters which affect the choice of debt and equity in the capital structure of the private corporate enterprises in India.

The economic reform process initiated in 1990-91 has not, by and large, caused any significant changes (worthnoting) in the capital structure practices of the private corporate sector firms in India. However, the financial risks and business risk of corporate enterprises have significantly increased during the early stages of the post-liberalised period. The study is likely to provide useful insight to various regulatory bodies like SEBI, commercial banks, investment agencies in their policy formulations, besides corporate firms themselves.

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