CHAPTER I

Introduction

India is emerging as a global manufacturing hub and it has all the requisite skills in product, process and capital engineering due to its long manufacturing history and technical education system. India’s cheap yet skilled man power is attracting number of companies, spanning of diverse industries, making India with its vast design skills has attracted a lot of outsourcing technological orders. Manufacturing industries are the chief wealth producing sectors of an economy and they employ a huge share of labour force and produce materials required by sectors of strategic importance such as national infrastructure and defense. These industries use various technologies and methods widely known as manufacturing process management. Manufacturing industries are broadly classified into engineering industries, construction industries, electronics industries, chemical industries, energy industries, food and beverage industries, textile industries, metal working industries, plastic industries and transport and tele-communication industries. Paper industry comes under the category of energy industries. As per United Nations Industrial Development Organization (UNIDO) analysis mentioned in the International year book of Industrial Statistics 2009, India ranks top among the twelve major producers of Manufacturing Value Added (MVA) products. In textiles, the country ranks fourth after China, USA and Italy, while in electrical machinery and apparatus, it ranks fifth. It holds sixth position in the basic metals category; seventh in chemicals and chemical products; tenth in leather products, refined petroleum products and nuclear fuel, twelfth in machinery and equipment and motor vehicles, fifteenth in paper and paper products.

In 1970, Indian economic policies have been marked by deregulation and decontrol and progressive liberalization and it assesses the impact of policy reforms on total productivity, growth in India’s energy intensive sectors such as aluminum, cement, fertilizer, iron and steel, glass and paper. The new millennium is going to be the millennium of knowledge. Hence, demand for paper would go on increasing in times to come. In view of paper industry’s strategic role for the
society and also for the overall industrial growth it is necessary that the paper industry performs well. After globalization the government has completely delicensed paper industry, to enhance the productivity. The entrepreneurs now required to file an Industrial Entrepreneur Memorandum with the secretariat for industrial assistance for setting up a new paper mill or substantial expansion of the existing mill in permissible locations. The paper industry is a priority sector for foreign collaboration and foreign equity participation. Several fiscal incentives have also been provided to the paper industry, particularly to those which are based on non-conventional raw material. There are about 1000 paper mills in India but most of them are of small capacities. In India a paper mill of 50,000 tonnes per annum or higher capacity is called a large mill. There are 21 large scale paper companies in India which have the capacity of more than 50,000 tonnes per annum. The large scale paper mills account around 60 per cent of the total production of paper¹.

Financial management of any corporate sector revolves around three major decisions, viz., financial decisions, investment decisions and dividend decisions. Financial decisions are concerned with the sources of finance, i.e. from where finances should be raised. There are basically two sources of finance i.e. short-term and long-term. Short-term sources of finance generally include short-term loan, bills payable, bank overdraft, cash credit and advances, creditors, etc. The long-term sources of finance of the company are also called permanent sources of finance. The capital structure of a company is determined by the long-term sources of finance. The capital structure (2005, p.5)² stated that the term capital structure is used to represent the proportionate relationship between debt and equity. A business enterprise generally procures its permanent capital in the form of long-term debt, preference shares, ordinary shares and reserves and surpluses. These are individual components, which when taken together, would constitute a company’s capital structure. Thus the aim of capital structure management is the profit maximization or wealth maximization ensuring minimum cost of capital and maximum rate of return to the common shareholders. Chakraborty (1981, p.111)³ stated that a judicious mix of debt and equity securities would maximize the value of equity. The financial manager of corporate has to plan an optimum capital
structure for the company in such a way that it gives the maximum benefits and thus maximizes the wealth of shareholders.

Thus, the ever increasing importance and role of corporate sector in the economic growth of a country, particularly, in the developing country like India, have attracted several academicians, professional institutions, researchers and administrators to conduct diversified studies in this area. There is a need to study the industries internal efficiency which ultimately shall determine the overall industrial development in future. The present study is a small endeavour to update the knowledge in this aspect.

**Corporate capital structure**

Capital structure is the composition of debt and equity securities that are used to finance company’s assets. Both debt and equity securities are used by most of the companies to raise funds. Having determined its investment policy, a company should plan the sources of finance and their mix. Companies which do not formally plan their capital structures are likely to have uneconomical and imbalanced capital structures and could face unforgivable difficulties in raising capital on favourable terms in the long-run. Also inappropriate mix of sources of finance can render the operations of the companies inflexible.

Financial experts and authorities differ as to the composition of funds in capital structure. Some believe that the capital structure and the financial structure are the same and hence, the capital structure represents both long-term and short-term sources of finance. According to Osborn\(^4\), the term ‘capital structure’ is used to mean the financial plan according to which all assets of a corporation are furnished. This capital is supplied by long and short-term borrowings, the sale of preferred and common stock and the reinvestment of earnings”. He further stated that “in analyzing the capital structure of an enterprise, short-term debt is often excluded from consideration”. Many others include only long-term sources of finance under the capital structure. Guthmann and Dougall\(^5\) stated that capital structure may be used to cover total combined investment of bond holders including any long-term debts such as mortgages and long-term loans as well as
total stockholders’ investment including retained earnings as well as original investment. Both the concepts of capital structure are more popular and widely accepted. Broadly speaking, the capital structure comprises owned funds and borrowed funds. The owned funds include the share capital and free reserves and surplus and the borrowed funds represent debentures, long-term and medium-term loans provided by various financial institutions.

The composition of capital structure is governed by a number of factors and no uniform standard can be prescribed for all the enterprises. Sectors of industry or trade to which a particular enterprise belongs can, however, provide a broad pattern of composition. For instance, a public utility concern, such as an electricity supply company can absorb a greater proportion of borrowed funds than an enterprise in a more competitive sector of industry due to more stability in earnings in the case of former than the latter. Within these broad parameters, each enterprise will have to plan its own capital structure keeping in view both its short-term requirements and long-term expansion programmes.

**Optimum Capital Structure**

An optimum or sound capital structure can properly be defined as that combination of debt and equity which achieves the goal of maximizing the company’s market value. The optimum capital structure is also defined as that combination of debt and equity which minimizes the company’s cost of capital. Hence, the optimum capital structure is concerned with two important factors at one time; the maximization of shareholder’s wealth as well as minimization of cost of capital.

In the wake of given objectives of maximization of shareholder’s wealth, the requirement for an optimal capital structure cannot, therefore, be over-emphasized in the financial decision-making process, every company should try to design its own capital structure. But determination of an optimum capital structure is not an easy task. It should be clearly understood that determining the precise proportion of debt that will maximize price per share is almost impractical. It is possible, however, to ascertain the approximate share of debt to be used in the
capital structure in tune with the objective of maximization of shareholder’s wealth. It may be mentioned that there are certain common and conflicting considerations involved in deciding the methods of financing assets. Different companies falling under a particular industry may have much in common regarding their financial plan. But they still may exhibit different earning trends, accounting methods and practice, general future conditions and predictions about the economy and the capital market. Moreover, the management’s capability to adjust the mix of debt and equity in conformity with these conditions is restricted by the availability of the various types of funds that are sought. Hence, these factors largely govern which pattern of capital structure is deemed desirable and which form of financing is chosen in a given situation. The existence of optimum capital structure is not accepted by all. A great deal of controversy has developed over this issue makes the researcher to study the pattern of capital structure.

**Capitalization, Financial Structure and Capital Structure**

In the area of financial management, two related expressions, ‘capitalization’ and ‘capital structure’ are more often than not erroneously used interchangeably. The capital structure decisions are not taken much frequently by a company. The following are the circumstances under which such a decision is taken:

a) Establishment of a new business

b) Expansion and development of the business

c) Rehabilitation of the business

d) Reconstruction of the financial structure

In these situations two fundamental issues have to be settled. First, what should be the total amount of securities to be issued? Secondly, what particular types of securities should be issued to raise the funds? The first issue forms the subject-matter of capitalization and the second issue lies in the purview of capital structure. In other words, ‘Capitalization’ embraces the owned capital and borrowed capital of an enterprise in so far as it represent its long-term
indebtedness, while ‘capital structure’ comprises the kind and proportion of each security that makes up the capitalization. The financial structure is the mixture of owners’ equity and creditors’ equity. It describes the proportion in which different sources of finance have been used to finance the assets of the company. It consists of equity capital, preference capital, reserves and surplus, debentures, long-term and medium-term loans and the short-term liabilities. In other words, it refers to the liability side of the balance sheet.

Capital structure is a part of the financial structure. It includes owners’ equity and creditors’ equity other than the short-term liabilities. It is a combination of long-term funds raised to finance all the fixed assets and permanent portion of working capital requirement. Hence, it is the blending of equity capital, preference capital, reserves and surplus, debentures, long-term and medium-term borrowing from banks, financial institutions and other sources. Among these three concepts, capitalization and capital structure was taken into account because it is the very important decision of capital intensive industries like paper industry

**Trading on equity**

In the financial circles, the term ‘leverage’ and ‘trading on equity’ are used synonymously. However, the term ‘leverage’ incorporates both operating and financial leverages. In fact, trading on equity refers to financial leverage only. Trading on equity is the process of using debt in the capital structure to magnify the return for the equity shareholders. This is known as trading on equity mainly due to the fact that the creditors are willing to advance funds on the strength of the equity supplied by the owners. Trading feature is simply taking advantage of the permanent investment in equity share capital to borrow funds on reasonable cost.

From the viewpoint of equity shareholders, debt capital is preferable to other sources due to various reasons. First, there is no dilution of control because the existing equity shareholders enjoy the same voting rights as before and control over the enterprise. Secondly, funds are obtained at a lesser cost than otherwise. If these funds can be invested to earn a return more than the cost of providing the funds, return on equity would increase more than it would have been if all the
capital was provided by equity. This phenomenon of using the fixed interest bearing sources of funds in the capitalization of a company is known as ‘Trading on Equity’.

**Cardinal principles governing capital structure**

A simple capital structure is composed of single security base i.e. equity share capital. A compound capital structure consists of a combination of two securities, such as, the equity and preference share capital. A complex capital structure is made up of a multi-security base, consisting of equity and preference share capital and a series of debentures and loans. Suitability of the capital structure of a company should be decided in view of the fundamental principles laid down in this regard. These principles may be conflicting with each other. A prudent financial executive strikes an appropriate balance among them. Managerial freedom to adjust debt equity mix is primarily conditioned by the availability of different types of sources of finance in desired quantum. In view of this, wisdom of financial manager is seen in a satisfactory adjustment between requirement and supply of funds. Therefore, while designing the capital structure of an enterprise, certain basic principles has to be complied with otherwise the desired objective may not be attained in full.

Under cost principle, securities should be issued in such a manner as to entail the least cost of financing to maximize earnings per share. The cost of capital is subject to interest rate at which payment has to be made to the supplier of funds as well as the tax status of such payments. Generally, the cost is the lowest in case of issue of debentures and highest in case of equity share. Rate of interest on debt capital is usually much less than the expected dividend rate. Debenture holders do not participate in the profits after interest and taxes. Secondly, interest on debt is deductible for income tax purposes, whereas, no deduction is allowed for dividends. Consequently effective interest rate which the company has eventually to bear would be less than the nominal rate of interest. Thus, the issue of debt is greatly helpful in raising the income of the company.
While designing capital structure of the company, the financial manager should also keep in mind that the control of the residual owners remains undisturbed. The use of preference shares and debentures offers an opportunity of raising funds without diluting control. The management desiring to retain control must fulfill its financial requirement through debt funds. Since, equity shares vary in voting rights, issues of new equity shares will dilute the control of existing shareholders. But this does not mean that the company should be indebted highly because that would certainly enhance the possibility of the company’s bankruptcy and the company might bear with the consequences of reorganization and liquidation. Instead of pouring more funds through debt, it would be better to issue equity shares and share some control with new equity shareholders.

The risk principle suggests that such a pattern of debt equity mix should be designed as would not create the risk of bankruptcy for the company. Since, debt reflects a commitment for a long-period, it involves risk. If the expectations on which the debt was issued are not met, debt may prove fatal to the survival of the company. As per flexibility principle, a finance executive should try to achieve such pattern of capital structure that enables the management to manoeuvre sources of funds at the time of expanding or contracting the requirement of funds. It should be possible for a company to adjust its capital structure with a minimum cost and delay, if required, by a changed situation. Therefore, the management should, as far as possible, avoid procuring cheaper debt on very restrictive terms and conditions. A company attempting to obtain debt funds on easy terms may have to pay higher rate of interest. Hence, the company should evaluate the desired degree of flexibility in terms of cost and benefits and balance them properly.

Time factor is an important element in financing, especially in a growing concern. The important point that is to be considered is to make the public offering of such securities is greatly in demand. Depending on various business cycles, investors’ attraction fluctuates with regard to different types of securities. In times of boom, when there is all-round business expansion and economic prosperity with investor’s strong desire to invest, it is not difficult to raise required funds through the issue of equity shares. Contrary to this, in periods of depression, funds should
be raised through debt because investors are afraid of risking their investment in shares which are, by and large, speculative. Therefore, timing may favour debt at one time and equity share capital at the other.

Therefore, the choice of a particular capital structure is an issue which cannot be resolved easily. One has to take into account the pros and cons for each possible alternatives. The ultimate choice has to be left to the individual judgment in each particular case. But at the same time, if the proper analysis of all these principles is carried out in an objective manner, the resultant capital structure is likely, within limits, to fit into a general pattern suited to the character of the industry in which the company operates.

Theories of Capital Structure

There are three major capital structure theories namely Trade-off Theory [Kraus, Litzenberger, R., (1973)]\(^6\), Pecking-Order Theory [Myers (1984)]\(^7\) Myers and Majluf (1984)\(^8\) and Agency Cost Theory [Jensen and Meckling (1976)]\(^9\). Considerable amount of work on the theory of capital structure since Modigliani and Miller’s\(^10\) provocative irrelevance propositions has resulted in what Myers (1984)\(^11\) has called the ‘static trade off’ theory of capital structure. According to this theory, a firm’s optimal debt ratio is viewed as determined by a trade off of the costs and benefits of borrowing, holding the firm’s assets and investment plans constant. The various costs considered in the literature are bankruptcy costs (Scott, 1977)\(^12\), agency costs (Jensen and Meckling, 1977)\(^13\) and loss of non-debt tax shields (DeAngelo and Masulis, 1980)\(^14\). These costs become especially relevant in a situation of financial distress and have often been subsumed under costs of financial distresses. As against these costs the major benefit of debt financing is the tax shield of interest expense. The tax-based theory hypothesizes that the firms choose their debt equity ratio by trading off the benefits from tax reduction on interest payments against the costs of financial distress due to accumulating more debt.

The signaling theory is based on asymmetric information problems. The firms where individuals who supply capital do not run the firms themselves, there
exists two types of asymmetric information problems. The first problem arises when there is adverse selection. The controlling managers may possess some information that is unknown to outside investors. In such cases the financing method can serve as a signal to outside investors. Facing information asymmetry between inside and outside investors, firms end up having a financial hierarchy. First they try to use their retained earnings, and then move to debt when their internal funds run out. Equity is issued only when firms have no more debt capacity. This process is termed as ‘Pecking Order Theory’.

The agency cost theory is based on another problem due to information asymmetry that is the principal-agent conflict. The conflict arises when there is moral hazard inside the firm, which is called the agency costs of equity. Managers may pursue their own interests which may conflict with shareholders’ benefits. This agency problem can be solved by increasing management ownership because high management ownership aligns the interests of management and shareholders. Other possibilities include monitoring of management by large shareholders and the use of debt financing to discipline managers (Stulz, 1990). However, debt financing creates other agency costs. Jenesen and Meckling (1976) argue that managers on behalf of the existing shareholders are likely to appropriate wealth from their debt-holders by conducting asset-substitution behaviour. That is, they may invest in risky projects because if the project is unsuccessful, the costs will be shared. But, if it is successful, the existing shareholders will capture the gain. On the other hand Myers (1977) argue that firms with heavy debt may have to pass up their value-increasing projects merely because they cannot afford to pay their current debt. Therefore, in choosing their debt equity level, firms should trade off between the agency costs of debt and the agency cost of equity.

**Scope of the Study**

This study perhaps is very important for Indian paper industry, which explores the analysis of capital structure and profitability of selected large scale companies in Indian paper industry. The scope of the capital structure is very wide and broad based. For the theoretical understanding the meaning and definition of capital structure and various concepts related to capital structure, principles of
capital structure, and theories of capital structure are covered under the purview of study. The second part of the study is confined to the various approaches to the study of capital structure. For the analytical and technical study, tools and techniques such as ratios, mean, standard deviation, co-efficient of variation, compound annual growth rate, t-test, ANOVA, correlation, regression, Capital Asset Pricing Model and their interpretations are included in the study. The period of study has been confined to the period 1997-98 to 2009-10. Following the MM propositions, prominent empirical models and methodologies are followed to study the capital structure and profitability of selected large scale companies in Indian paper industry.

This empirical study attempts to analyze the trend and pattern of capital structure of selected large scale companies in Indian paper industry. It tries to analyze and describe the magnitude and direction of various profitability ratios like operating profit, profit after tax, return on capital employed, return on net worth, earning per share and market price per share. It also covers analysis of empirical relationship between capital structure and size and growth of selected companies. Analyses of empirical relationship between capital structure and profitability ratios are also included in this study. This study also evaluates the empirical relationship between capital structure and cost of capital. It also describes the magnitude and direction of relationship between leverage with the firm specific attributes viz., assets tangibility, corporate size, growth rate, profitability, liquidity, business risk, debt- service capacity and non-debt tax shield.

Statement of the problem

The Indian Paper Industry is among the top 15 global players of today, with an output of more than 6 million tonnes annually with an estimated turnover of Rs.1, 50,000 millions. Paper Industry in India is riding on a strong demand and on an expanding mood to meet the projected demand of 8 million tonnes by 2010 and 13 million tonnes by 2020. A large number of expansion programmes and expansion of capacities with an outlay of Rs. 10,000 crores have been announced covering the various sectors like paper, paperboard, newsprint etc. The Indian Economy is progressing well and targeting 8 per cent plus growth. The economic
reforms coupled with the liberalized Government policies, Indian paper industry today offers excellent business opportunity for investments.

In drafting financial plan, decision is not only taken in respect of amount of capital to be raised and its duration but also in respect of the make-up of capital so raised. Decision as to the composition of capital is reflected in capital structure, thus, what types of funds should a firm seek to meet its investment opportunities and in what proportion these funds would be raised are basic issues that a finance manager has to deal with under capital structure. The existing researches on the capital structure have been largely confined to the US and few other developed countries. Although the capital structure issue has received great importance in these countries, it has remained neglected in developing countries due to different economic and legal constraints. However, the economic liberalization and reformation processes since 1990’s in developing countries now have less institutional barriers. Research in this field will contribute to signify the importance of capital structure to value maximization objective of the firm. Thus, this study is an attempt to shed some light on the capital structure issues like the trend and pattern of capital structure of Indian paper industry.

A company should develop an appropriate capital structure, which is the most advantageous to the company and its owners. This can be done only when all the factors relevant to the company’s capital structure decisions are given due weightage. The capital structure should be planned generally keeping in view the interests of equity shareholders and the financial requirements of the company. The equity shareholders, being the owners of the company and the providers of risk capital (equity) would be concerned about the ways of financing a company’s operations. However, the interests of other groups such as employees, customers, creditors, society and government should also be given reasonable consideration. While developing an appropriate capital structure for the company, the financial manager should aim at maximizing the profitability and the market price of the share. Thus, an attempt is made by the researcher to analyze empirical relationship between capital structure and profitability variables of Indian paper companies.
Size of a firm plays an important role in the financing decisions of the management. Larger companies have more access to capital market and can raise funds from a variety of sources in comparison to small concerns. The size of a concern can be measured in many ways, i.e. by capital employed, paid-up capital, total assets, fixed assets, etc. For the study of capital structure, normally fixed assets and total assets are taken as the measures of size. Thus, an attempt has been made in this study to find the relationship between the size of the firm and the capital structure.

Growth is a pre-requisite for the long-term survival of the firm in an uncertain and constantly changing environment. The growing companies require an additional dose of capital for expansion and also for modernisation. Therefore, growth can be one of the significant variables of capital structure. In this study, sales are taken as a measure of growth to study the relationship between capital structure and growth of selected companies during the study period.

Financing the firm’s assets is a very crucial problem in every business and as a general rule there should be a proper mix of debt and equity capital in financing firm’s assets. While designing an optimal capital structure, the management has to keep in mind the objective of maximizing the value of the firm and minimizing the cost of capital. Measurement of cost of capital from various sources is very essential in planning the capital structure of any firm. The present study made an attempt to estimate the cost of capital and its empirical relationship with the capital structure.

The crucial problem faced by the companies while raising funds is whether to raise debt or equity. Though there is a continuing theoretical debate on this issue, relatively little empirical evidence exists on how companies actually select between financing instruments. Decisions on capital structure are not always based on a consideration of objective factors. Managements differ in their general attitude towards risk-taking, in their evaluation of the same risks and in their willingness to assume debt. The age, experience and personal ambitions of the management and its confidence in the information on which financial decisions are made, will influence its decisions towards or away from a conservative capital structure. In
spite of the fact that management makes its own decisions on its capital structure, there are certain general factors which seem to influence the capital structure of an enterprise. In general, companies needing funds issue equity, if they are above their target debt level and debt if they are below. In short, a company’s choice of financing instruments will depend on difference between its current and target debt equity ratio. The term institutional characteristics include the assets composition, business risk, corporate size, debt service capacity, growth rate, earning rate, cost of capital, tax rate, industry-class, the corporate ownership pattern etc. As far as the external factors are concerned, they include demand and supply of securities, general level of business activities, level of stock prices, policy of financial institutions, etc. The corporate capital structure is determined by observing its target debt levels which are themselves determined by the above discussed internal and external factors and thus, these variables may be the ultimate determinants of corporate capital structure. Thus, the present study made an attempt to analyse the various determinants of capital structure.

These are the days where industries have to really fight out for their survival; the prime factor to be monitored is capital structure. In the absence of perfect markets and in a world of taxes, capital structure does affect profitability of a company. In the real world, capital gains are taxed and interest on debt is a tax-deductable expense and companies have incentives if they have debt in their capital structure. Based on the above facts, the researcher has probed the following questions.

1. What are the different types of capital structure pattern followed by the selected large scale companies in Indian Paper Industry?

2. What is the quantum of profit earned by the selected large scale companies in Indian Paper Industry?

3. Is there any systematic relationship between size and capital structure of the selected large scale companies in Indian Paper Industry?

4. Is there any relationship between growth and capital structure of the selected large scale companies in Indian Paper Industry?
5. Is there any relationship between capital structure and cost of capital?

6. What is the relationship between capital structure and profitability of selected large scale companies in Indian Paper Industry?

7. What are the major determinants of capital structure choice in Indian context?

**Selection of Paper Industry**

In the knowledge based society, paper plays a crucial role for effective communication especially, in the transformation of information in the written form from one person to another. The government and other authorities accept only the written documents as valid evidence for all the purposes of administration. The written communication has been proved to be an effective and authenticated in the legal and official proceedings. In the news and information broadcasting industry also, print media has been successful from time immemorial. In the field of advertising, despite the introduction of new electronic media and various innovative advertisements, the advertisements through paper have a niche of their own. Paper is also used as a substitute product for polythene which pollutes the environment across the globe. Thus, paper is an integral part of everyday life. Paper is one of the important economic indicators of a country. Today, life cannot be imagined without paper. Paper remains the dominant and essential vehicle of modern communication. Paper industry in India is the 15th largest paper industry in the world. It provides employment to nearly 1.5 million people and contributes Rs. 25 billion to the government’s kitty. The government regards the paper industry as one of the 35 high priority industries of the country.

The Indian paper industry faced turbulent time during the post-liberalization era of the economy. As a consequence, trade barriers over the countries were reduced. However, the future of paper industry is governed by international trends. The performance of Indian paper industry is greatly influenced by global economic factors. Under these circumstances, the paper industry was engulfed in a great crisis due to a variety of reasons. The financial structure of the Indian paper mills has also been found to be unsatisfactory. Despite the core sector
status awarded to the paper industry, it is unfortunate that it is in deep operational and financial crisis. The industry is currently passing through the periods of trials and tribulations. It is disheartening to note that about 1/6 of the paper mills have been closed and few are operating under sick conditions.

The weak financial base coupled with their profitability has made things more difficult for these mills to tide over the current crisis. The crises are pronounced in small and medium paper mills and also in some of the large paper mills in most of the states. Many of the mills are continuously incurring losses and in some of them, the losses have been continuing from their very inception. Unfortunately, in certain cases the entire net worth has been completely wiped out due to continued operating losses. Majority of the paper companies are in perpetual financial crisis and for them securing additional funds is becoming very difficult. In this background, an attempt has been made to analyze the capital structure and profitability of the large scale companies in Indian paper industry.

The performance of small and medium size paper mills are severely affected by a plethora of problems such as acute shortage of working capital, uncertainties in raw materials availability, shortage of coal and power, obsolete technology, under utilization of capacity, inability to meet interest commitments, non-repayment of loans, and non-provision for depreciation, demand recession, absence of effective chemical recovery system, absence of sound infrastructural support, lack of skilled manpower, low prices of paper products, lack of research and development, high cost of production and managerial incompetence. Because of these factors ultimately small and medium scale paper companies were not taken into account for the present study. Thus, the financial problem of Indian paper industry has initiated the researcher to analyze the capital structure and profitability of the large scale companies in the Indian paper industry. The selected large scale paper companies included in the study are Andhra Pradesh Paper Mills Limited, Ballarpur Industries Limited, Hindustan Paper Corporation Limited, Hindustan Newsprint Limited, JK Paper Mills Limited, Mysore Paper Mills Limited, Rama Newsprint and Papers Limited, Seshasayee Paper and Boards Limited, Tamil Nadu Newsprint and Papers Limited and West Coast Paper Mills Limited.
Need and significance of the study

The whole Indian economy is based on industrial growth, accordingly the study of industrial units in any way particularly in the area of finance does matter. Finance constitutes the very base upon which the superstructure of modern corporate enterprise is erected. Finance is necessary for the commencement, continuance and growth of corporate enterprises. Hence, without adequate and timely finance made available through cheap and best resources, it would not be possible for the companies to successfully operate and grow.

Paper Industry is an important industrial sector having a bearing on the socio-economic development of the Country. The industry mirrors the country's economic growth. It creates economic wealth in the hands of the poor, by generating rural employment. Indian paper industry is an important vehicle to drive the Government's National Literacy Mission. It is an important contributor to greening India through Social Forestry Programs. It is highly an energy intensive industry. The fortune of paper industry is closely linked with the buoyancy in the economic development of a country because it provides employment to more than 0.12 million people directly and 0.34 million people indirectly.18

The importance of paper products in the modern life is so obvious that no other manufactured product possesses such diversity of use. Paper is a basic medium of communication and a source for dissemination of information. However, poor profitability is one of the challenges faced by paper industry. Under utilization of capacity, higher cost of production, industrial disputes and the performance of financial management are the factors that can be attributed to poor profitability of the industry. Some research studies have been undertaken to empirically investigate the design of capital structure of paper industry at the state level and a few studies relating to individual mills. But no study has been exclusively conducted to analyse the pattern of capital structure of paper industries. In this context an attempt has been made to investigate the design of capital structure of large scale companies in Indian paper industry for a period of thirteen years from 1997-98 to 2009-10.
As such, the study is expected to help the corporate management, the financiers, the investors and the government, to take valuable decisions at their own. The study has academic relevance too in so far as new theoretical and practical knowledge would be added to the existing stock of knowledge undoubtedly. The present study may act as a masterpiece on the subject for further research and development. There is no study exclusively on capital structure of paper industry after liberalization. Therefore, to cover the gaps in the earlier studies, the present study is undertaken to give an insight into the design of capital structure of selected Indian paper industry. It would also enable the shareholders, investors and investment analysts to identify the determinants of corporate capital structure. Further, it would provide insight to banks, financial institutions and long-term lenders to understand the financial structure and effectiveness of credit worthiness of the companies, moreover, it would open up new vistas to the industry association and the government in understanding the characteristics of the companies for inter and intra-firm comparison. It might also help the academic researchers, researchers in capital market instruments, researchers in industry and company by providing different perspective of the analysis.

References


