CHAPTER – II
THEORETICAL ASPECTS OF CAPITAL STRUCTURE AND
REVIEW OF LITERATURE

2.1 INTRODUCTION

The term “business” relates to the state of being busy either as an individual or society as a whole, doing commercially viable and profitable work. This term has at least three usages, depending on the scope; one is to mean a particular company or corporation, the generalized usage to refer to a particular market sector or the broadest meaning to include all activity by the community of suppliers of goods and services.

Business is an economic activity as it is concerned with earning money and acquiring wealth through the production and distribution of goods and services. Businesses are predominant in capitalist economies, most being privately owned and formed to earn profit that will increase the wealth of its owners and grow the business itself. The main objective of any business owner or operator is to generate a financial return in exchange for work and acceptance of risk.

There are several common forms of business ownership like sole proprietorship, partnership, corporation and cooperative. In order to generate a financial output, a financial input is most important. This financial input is termed as capital in business.

In economics, capital or capital goods or real capital refers to factors of production used to create goods or services that are not themselves significantly consumed in the production process. Capital goods may be acquired with money or financial capital. In finance and accounting, capital generally refers to financial wealth especially that used to start or maintain a business.

Financial capital represents obligation, and is liquidated as money for trade, and owned by legal entities. It is in the form of capital assets, traded in financial markets. Its market value is not based on the historical accumulation of money invested but on the perception by the market of its expected revenues and of the risk entailed.

Financial capital can refer to money used by entrepreneurs and businesses to buy what they need to make their products or provide their services to that sector of the economy based on its operation, i.e. retail, corporate, investment banking, etc.
Financial capital refers to the funds provided by lenders (and investors) to business to purchase real capital equipment for producing goods/services. Real capital comprises physical goods that assist in the production of other goods and services.

The financial capital which is required by entrepreneurs can be obtained through various sources. There are long term sources like share capital, debenture capital, venture capital, mortgage, retained profit, etc. Financial capital can also be obtained through medium term sources like term loans, leasing, etc. and through short term sources like bank overdraft, trade credit, factoring, etc.

Capital contributed by the owner or entrepreneur of a business, and obtained by means of saving or inheritance, is known as own capital or equity. This capital that owners of business provide can be in the form of

- Preference shares/hybrid source of finance
  - Ordinary preference shares
  - Cumulative preference shares
  - Participating preference shares
- Ordinary shares
- Bonus shares
- Founder’s shares

That capital which is granted by another person or institution is called borrowed capital, and this must usually be paid back with interest. This capital which the business borrows from institutions or people includes debentures:

- Redeemable debentures
- Irredeemable debentures
- Debentures to bearer
- Ordinary debentures

Thus, the sources of financing will, generically, comprise some combination of debt and equity. Financing a project through debt, results in a liability that must be serviced and hence there are cash flow implications regardless of the project’s success. Equity financing is less risky in the sense of cash flow commitments, but results in a dilution of ownership and earnings.
Deciding which source of capital should be tapped so that the entrepreneur gets a fair return, is a type of financial decision and a part of financial management. It is a very important component of corporate finance.

2.2 MEANING OF CAPITAL STRUCTURE

The term “Financial Management” connotes that fund flows are directed according to some plan. It connotes responsibility for obtaining and effectively utilizing funds necessary for the efficient operation of an enterprise.¹

A formal definition of financial management would be the determination, acquisition, allocation and utilization of financial resources, usually with the aim of achieving some specific goals. To be more specific financial management is about analyzing financial situations, making financial decisions, setting financial objectives, formulating financial plans to attain those objectives, and providing effective systems of financial control to ensure plans progress towards the set objectives.

Financial decision-making includes strategic investment decisions, such as investing in new production facilities or the acquisition of another company, and strategic financing decisions, like the decision to raise additional long-term loans.

Thus, a financial manager is primarily concerned with two main types of interrelated decisions, i.e. investment decisions and financing decisions.

Investment decision includes:

- Strategic investment decision
- Tactical/operational investment decisions

Similarly financing decision also includes:

- Strategic financing decision
- Tactical/operational financing decisions.

The strategic financing decision typically involves deciding the most appropriate mix of equity and long-term debt finance in the firm’s capital structure, also called as the capital structure decision. The tactical financing decision is related with ways to finance the firm’s investment in its medium and short-term assets respectively.²
Capital structure refers to the combination of debt and equity capital which a firm uses to finance its long-term operations. Capital in this context refers to the permanent or long-term financing arrangements of the firm. Capital is the aggregation of the items appearing on the left hand side of the balance sheet minus current liabilities.3

Corporate finance is an area of finance dealing with the financial decisions corporations make and the tools and analysis used to make these decisions. The primary goal of corporate finance is to maximize corporate value while managing the firm’s financial risks.

The main concepts in the study of corporate finance are applicable to the financial problems of all kinds of firms. The discipline can be divided into long-term and short-term decisions and techniques. Capital investment decisions are long-term choices about which projects receive investments, whether to finance that investment with equity or debt, and when or whether to pay dividends to shareholders. On the other hand, the short term decisions can be grouped under the heading “Working capital management”.

Capital investment decisions are long-term corporate finance decisions relating to fixed assets and capital structure. Decisions are based on several inter-related criteria. Corporate management seeks to maximize the value of the firm by investing in projects which yield a positive net present value when valued using an appropriate discount rate. These projects must also be financed appropriately. If no such opportunities exist, maximizing shareholder value dictates that management returns excess cash to shareholders. Capital investment decisions thus comprise an investment decision, a financing decision, and a dividend decision.

Achieving the goals of corporate finance requires that any corporate investment be financed appropriately.

The ratio between debt and equity is named leverage. It has to be optimized as high leverage can bring a higher profit but create solvency risk. As above, since both hurdle rate and cash flows (and hence the riskiness of the firm) will be affected, the financing mix can impact the valuation. Management must therefore identify the “optimal mix” of financing – the capital structure that results in maximum value.
The optimum capital structure has been expressed by Ezra Solomon in the following words:

“Optimum leverage can be defined as that mix of debt and equity which will maximize the value of a company, i.e., the aggregate value of the claims and ownership interests represented on the credit side of the balance sheet.”

Capital structure policy involves a choice between risk and expected return. The optimal capital structure strikes a balance between these risks and returns and thus examines the price of the stock.

The pattern of capital structure of a firm has to be planned in such a way that the owner’s interest is maximized. There may be three fundamental patterns of capital structure in a firm:

1. Financing exclusively by equity stock.
2. Financing by equity and preferred stock.
3. Financing by equity, preferred stock and bonds.

### 2.3 GUIDING PRINCIPLES OF CAPITAL STRUCTURE

Which of the above patterns would be most suited to the company can be decided in the light of the fundamental principles. The guiding principles of capital structure decision are:

1. **Cost principle**: According to this principle ideal pattern of capital structure is one that tends to minimize cost of financing and maximize the earnings per share. Cost of capital is subject to interest rate at which payments have to be made to suppliers of funds and tax status of such payments.

2. **Risk principle**: This principle suggests that such a pattern should be devised so that the company does not run the risk of bringing on a receivership with all its difficulties and losses. Risk principle places relatively greater reliance on common stock for financing capital requirements of the corporation and forbids as far as possible the use of fixed income bearing securities.

3. **Control principle**: While deciding appropriate capital structure the financial manager should also keep in mind that controlling position of residual owners
remains undisturbed. The use of preferred stock and also bonds offers a means of raising capital without jeopardizing control.

4. **Flexibility principle**: According to this principle, the management should strive towards achieving such combinations of securities that the management finds it easier to maneuver sources of funds in response to major changes in needs for funds. Not only several alternatives are open for assembling required funds but also bargaining position of the corporation is strengthened while dealing with the supplier of funds.

5. **Timing principle**: Timing is always important in financing and more particularly in a growing concern. Maneuverability principle is sought to be adhered to in choosing the types of funds so as to enable the company to seize market opportunities and minimize cost of raising capital and obtain substantial savings. Depending on business cycles, demand of different types of securities oscillates. In times of boom when there is all-round business expansion and economic prosperity and investors have strong desire to invest, it is easier to sell equity shares. But in periods of depression bonds should be issued to attract money because investors are afraid to risk their money in stocks which are more or less speculative.⁵

### 2.4 FACTORS INFLUENCING CAPITAL STRUCTURE DECISION

A number of factors influence the capital structure decision of a firm. These factors can be categorized in to three categories, i.e., as per characteristics of the economy, characteristics of the industry and characteristics of the company. ⁶

**Characteristic of the Economy**

1. **Tempo of the business activity**: If the economy is to recover from current depression and the level of business activity is expected to expand, the management should assign greater weightage to maneuverability so that the company may several alternative sources available to procure additional funds to meet its growth needs and accordingly equity stock should be given more emphasis in financing programmes and avoid issuing bonds with restrictive covenants.
2. **State of capital market**: Study of the trends of capital market should be undertaken in depth since cost and availability of different types of funds is essentially governed by them. If stock market is going to be plunged in bearish state and interest rates are expected to decline, the management may provide greater weightage to maneuverability factor in order to take advantage of cheaper debt later on.

3. **Taxation**: The existing tax provision makes debt more advantageous in relation to stock. Although it is too difficult to forecast future changes in tax rates, there is no doubt that the tax rates will not be adjusted downwards.

4. **State regulation**: Decision as to the make-up of capitalization is subject to state control. For e.g. Control of Capital Issues Act in India has preferred 4:1 ratio between debt and equity and 3:1 between equity and preferred stock.

5. **Policy of Term-Financing Institutions**: If financial institutions adopt harsh lending policy and prescribe highly restrictive terms, the management must give more significance to maneuverability principle and abstain from borrowing from those institutions so as to preserve the company’s flexibility in capital funds.

**Characteristics of the Industry**

1. **Cyclical variations**: There are industries whose products are subject to wider variations in sales in response to national income, whereas some products have low income elasticity and their sales do not change in proportion in variation in national income. The management should attach more significance to flexibility and risk principle in choosing suitable sources of funds in an industry dealing in products whose sales fluctuate very markedly over a business cycle so that the company may have freedom to expand or contract the resources used in accordance with business requirements.

2. **Degree of competition**: Public utility concerns are generally free from intra-industry competition. In such concerns the management may wish to provide greater weightage to cost principle. But in industry which faces neck to neck competition, risk principle should be given more consideration.
3. **Stage in life cycle:** In infant industry risk principle should be the sub-guide line in selecting sources of funds since in such industry the rate of failure is very high. During the period of growth flexibility factor should be given special consideration so as to leave room open for easy and rapid expansion of funds used.

**Characteristics of the Company**

1. **Size of the business:** Smaller companies confront tremendous problem in assembling funds because of poor credit worthiness. In this case, special attention should be paid to flexibility principle so as to assure that as the company grows in size it is able to obtain funds when needed and under acceptable terms. This is why common stock represents major portion of the capital in smaller concerns. However, the management should also give special consideration to the factor of control. Larger concerns have to employ different types of securities to procure desired amount of funds at reasonable cost. To ensure availability of large funds for financing future expansion larger concerns may insist on flexibility principle. On the contrary, in medium sized companies who are in a position to obtain the entire capital from a single source, leverage principle should be given greater consideration so as to minimize cost of capital.

2. **Form of Business Organization:** Control principle should be given higher weightage in private limited companies where ownership is closely held in a few hands. In case of public limited companies maneuverability looms large because in view of its characteristics it finds easier to acquire equity as well as debt capital. In proprietorship or partnership form control is an important consideration because it is concentrated in a few hands.

3. **Stability of earnings:** With greater stability in sales and earnings a company can insist on leverage principle and accordingly it can undertake the fixed obligation debt with low risk. But a company with irregular earnings will not choose to burden itself with fixed charges. Such company should pay greater attention to risk principle.

4. **Age of company:** Younger companies find themselves in difficult situation to raise capital in the initial years. It is therefore worthwhile to give more
weightage to flexibility principle so as to have as many alternatives open as possible in future to meet the growth requirement. Established companies should insist on cost principle.

5. **Asset structure of company**: A company which have invested major portion of funds in long lived fixed assets and demand of whose products is assured should pay greater attention to leverage principle to take advantage of cheaper source of fund. But risk principle is more important in company whose assets are mostly receivables and inventory.

6. **Credit standing**: A company with high credit standing has greater ability to adjust sources of funds. In such a case, the management should pay greater attention too flexibility principle.

7. **Attitude of management**: Attitude of persons who are at the helm of affairs of the company should also be analyzed in depth while assigning weights to different factors affecting the pattern of capitalization. Where the management has strong desire for exclusive control, preference will have to be given to borrowing for raising capital in order to be assured of continued control. If the principal objective of the management is to stay in office, they would insist more on risk principle. But members of the Board of Directors who have been in office for pretty long time feel relatively assured and they would prefer to insist on cost principle.

### 2.5 CAPITAL STRUCTURE THEORIES

There are different viewpoints on the impact of the debt-equity mix on the shareholder’s wealth. There is a viewpoint that strongly supports the argument that the financing decision has major impact on the shareholder’s wealth, while according to others, the decision about the financial decision is irrelevant as regards maximization of shareholder’s wealth.

A great deal of controversy has developed over whether the capital structure of a firm as determined by its financing decision affects its cost of capital. Traditionalists argue that the firm can lower its cost of capital and increase the market value per share by the judicious use of leverage. Modigliani & Miller, on the other hand, argue that in the
absence of taxes and other market imperfections, the total value of the firm and its cost of capital are independent of capital structure.

There are four major theories explaining the relationship between capital structure, cost of capital and value of the firm:

1. Net Income Approach
2. Net Operating Income Approach
3. Traditional Approach
4. Modigliani-Miller Approach

There are certain underlying assumptions made in order to present the theories in a simple manner. The assumptions are as follows:

1. The firm employs only two types of capital- debt and equity.
2. There are no corporate taxes. This assumption is removed later.
3. The firm pays 100% of its earnings as dividend.
4. The firm’s total assets are given and they do not change, i.e. the investment decisions are assumed to be constant.
5. The firm’s total financing remains constant.
6. The operating earnings are not expected to grow.
7. The business risk remains constant and is independent of capital structure and financial risk.
8. All investors have the same subjective probability distribution of the future expected operating earnings for a given firm.
9. The firm has a perpetual life.

**Net Income Approach**

The approach has been suggested by David Durand. According to this approach, the capital structure decision is relevant to the valuation of the firm, i.e., a change in the capital structure will lead to a corresponding change in the overall cost of capital as well as the total value of the firm. If the ratio of debt to equity is increased the weighted average cost of capital will decline, while the value of the firm as well as the market price of ordinary shares will increase. Conversely, a decrease in the leverage will cause an increase in cost of capital and a decline in the value of the firm as well as the market price of equity shares.
The Net Income Approach is based on three assumptions:

1. There are no taxes.
2. The cost of debt is less than the equity-capitalization rate or cost of equity.
3. The use of debt does not change the risk perception of the investors.

The implication of the above assumptions is that as the degree of leverage increases, the proportion of an inexpensive source of funds, i.e., debt in the capital structure increases. As a result the weighted average cost of capital tends to decline, leading to an increase in the total value of the firm. Thus, the cost of debt and cost being constant, the increased use of debt will magnify the shareholder’s earnings and thereby the market value of the ordinary shares.

With a judicious mixture of debt and equity, a firm can evolve an optimum capital structure will be the one at which value of the firm is the highest and the overall cost of capital is the lowest. At that structure the market price per share would be maximum. If the firm uses no debt the overall cost of capital will be equal to the equity-capitalization rate. The weighted average cost of capital will decline and will approach the cost of debt as the degree of leverage reaches one.

We can graph the relationship between the various factors with the degree of leverage. The degree of leverage is plotted along the X-axis while the percentage rates for cost of debt, equity and overall cost are on the Y-axis. Due to the assumption that cost of debt and equity are constant as the degree of leverage changes, we find that both the curves are parallel to the X-axis. But as the degree of leverage increases, the overall cost decreases and approaches the cost of debt where leverage is one. At this point the firm’s overall cost of capital would be the minimum. The significant conclusion is that the firm can employ almost 100% debt to maximize its value.

Net Operating Income Approach

This approach is also suggested by David Durand. It is diametrically opposite to the Net Income Approach. The essence of this approach is that the capital structure decision of the firm is irrelevant. Any change in leverage will not lead to any change in the total value of the firm and the market price of shares, as the overall cost of capital is independent of the degree of the leverage.
The Net Operating Income Approach is based on the following propositions:

1. Overall cost of capital is constant: The overall cost of capital remains constant for all degrees of leverage. The value of the firm, given the level of EBIT is determined by \( V = \frac{EBIT}{k_o} \).

2. Residual value of equity: The value of equity is residual which is determined by deducting the total value of debt from the total value of the firm.

3. Changes in cost of equity capital: The cost of equity increases with the degree of leverage. With the increase in the proportion of debt the financial risk of the shareholders will increase. To compensate for the increased risk, the shareholders would expect a higher rate or return.

4. Cost of debt: The cost of debt has two parts: explicit and implicit cost. The explicit cost is represented by the rate of interest. Irrespective of the degree of leverage the firm is assumed to be able to borrow at a given rate of interest. This implies that the increasing proportion of debt in the financial structure does not affect the financial risk of the lenders and they do not penalize the firm by charging higher interest. Increase in the degree of leverage causes an increase in the cost of equity. This increase in cost of equity being attributable to the increase in debt is implicit part of cost of debt. Thus the advantage associated with the use of debt supposed to be a cheaper source of funds in terms of the explicit cost is exactly neutralized by the implicit cost represented by the increase in cost of equity. As a result the real cost of debt and the real cost of equity according to Net Operating Income are the same and equal to overall cost.

No matter what the degree of leverage is, the total value of the firm will remain constant. The market price of shares will also not change with the change in the debt-equity ratio. There is nothing such as an optimum capital structure. Any capital structure is optimum according to Net Operating Income Approach.

**Traditional Approach**

The Traditional Approach or the Intermediate Approach is a mid-way approach between the Net Income and Net Operating Income approach. It partly contains features of both the approaches.
The traditional approach accepts that the capital structure of the firm affects the cost of capital and its valuation. However, it does not subscribe to the Net Income approach that the value of the firm will necessarily increase with all degrees of leverages.

It subscribes to the Net Operating Income approach that beyond a certain degree of leverage, the overall cost of capital increases resulting in decrease in the total value of the firm. However, it differs from Net Operating Income approach in the sense that the overall cost of capital will not remain constant for all the degree of leverages.

The essence of the traditional approach lies in the fact that a firm through judicious use of debt-equity mix can increase its total value and thereby reduce its overall cost of capital. According to this approach, up to a point, the content of debt in the capital structure will favourably affect the value of the firm. However, beyond that point, the use of debt will adversely affect the value of the firm. At this level of debt-equity mix the capital structure will be optimum.\(^7\)

The Modigliani-Miller theorem, proposed by Franco Modigliani and Merton Miller, forms the basis for modern thinking on capital structure, though it is generally viewed as a purely theoretical result since it assumes away many important factors in the capital structure decision. The theorem states that, in a perfect market, the value of a firm is irrelevant to how that firm is financed. This result provides the base with which to examine real world reasons why capital structure is relevant, that is, a company’s value is affected by the capital structure it employs.

If capital structure is irrelevant in a prefect market, then imperfections which exist in the real world must be the cause of its relevance. The theories below try to address some of the imperfections, by relaxing assumptions made in the M&M model.

One of the main theories of how firms make their financing decisions is the Pecking Order Theory, which suggests that firms avoid external financing while they have internal financing available and avoid new equity financing while they can engage in new debt financing at reasonably low interest rates.\(^8\) The pecking order theory is based on the assertion that managers have more information about their firms than investors. This disparity of information is referred to as asymmetric information. Other things being equal, because of asymmetric information, managers will issue
debt when they are positive about their firms’ future prospects and will issue equity when they are unsure. Another major theory is the Trade-Off Theory in which firms are assumed to trade-off the tax benefits of debt with the bankruptcy costs of debt when making their decisions. An emerging area in finance theory is right-financing whereby investment banks and corporations can enhance investment return and company value over time by determining the right investment objectives policy framework, institutional structure, source of financing (debt or equity) and expenditure framework within a given economy and under given market conditions. One last theory about this decision is the Market timing hypothesis which states that firms look for the cheaper type of financing regardless of their current levels of internal resources, debt and equity.

Trade-off theory allows the bankruptcy cost to exist. It states that there is an advantage to financing with debt (namely, the tax benefit of debts) and that there is a cost of financing with debt (the bankruptcy costs of debt). The marginal benefit of further increases in debt declines as debt increase, while the marginal cost increases, so that a firm that is optimizing its overall value will focus on this trade-off when choosing how much debt and equity to use for financing. Empirically, this theory may explain differences in D/E ratios between industries, but it doesn’t explain differences within the same industry.

This theory maintains that businesses adhere to a hierarchy of financing sources and prefer internal financing when available, and debt is preferred over equity if external financing is required. Thus, the form of debt a firm chooses can act as a signal of its need for external finance. The pecking order theory is popularized by Myers (1984) when he argues that equity is a less preferred means to raise capital because when managers (who are assumed to know better about true condition of the firm than investors) issue new equity, investors believe that managers think that the firm is overvalued and managers are taking advantage of this over-valuation. As a result, investors will place a lower value to the new equity issuance.

The determination of capital structure in practice involves considerations in addition to the concerns about earning per share, value and cash flow. A firm may have enough debt servicing ability but it may not have assets to offer as collateral. Attitudes of firms with regard to financing decisions may also be quite often
influenced by their desire of not losing control, maintaining operating flexibility and have convenient timing and cheaper means of raising of funds.

According to Ezra Solomon and John Pringle, financial leverage affects both the magnitude and the variability of earnings per share and return on equity. For any given level of EBIT, the effect of increase in leverage is favourable if the percentage rate of operating return on assets is greater than the interest on debt and it is unfavourable if it is less. When EBIT varies over time, financial leverage magnifies the variation in earnings per share and return on equity.\(^{13}\)

A great deal of controversy has developed over whether the capital of a firm as determined by its financing decision, affects its cost of capital. Traditionalists argue that the firm can lower its cost of capital and increase market value per share by the judicious use of leverage. Modigliani and Miller, on the other hand, argue that in the absence of taxes and other market imperfections, the total value of the firm and its cost of capital are independent of capital structure. This position is based on the notion that there is a conservation of investment value. No matter how you divide the pie between debt and equity claims, the total investment value of the firm stays the same. Therefore, leverage is said to be irrelevant.\(^{14}\)

Hence, the proposed study makes a critical study of the capital structure of various companies over a period of a time. There are various industries like cement, pharmaceuticals, sugar, steel, petroleum, fertilizer, automobile etc. From among these, the proposed research shall study few companies in the pharmaceutical and engineering industry.

### 2.6 INTRODUCTION TO REVIEW OF LITERATURE

Theoretical and empirical research suggests that financial planner should plan optimal capital structure. In practice, financial management literature does not provide specified methodology for designing a firm’s optimal capital structure.

A number of research studies have been conducted regarding the choice of debt equity mix in the total capitalization of a firm in the International as well as Indian context.

These studies have revealed the following:
2.7 INTERNATIONAL CONTEXT

Franco Modigliani and Merton Miller (hereafter called M-M) were the first to present a formal model on valuation of capital structure. In their seminal papers (1958, 1963), they showed that under the assumptions of perfect capital markets, equivalent risk class, no taxes, 100 % dividend-payout ratio and constant cost of debt, the value of a firm is independent of its capital structure. When corporate taxes are taken into account, the value of a firm increases linearly with debt-equity ratio because of interest payments being tax exempted. M-M’s work has been at the centre stage of the financial research till date. Their models have been criticized, supported, and extended over the last 35 years.15

David Durand (1963) criticized the model on the ground that the assumptions used by M-M are unrealistic. Solomon (1963) argued that the cost of debt does not always remain constant. When the leverage level exceeds the accepted level, the probability of default in interest payments increases thus raising the cost of debt.16

Stiglitz (1969, 1974) proved the validity of the M-M model under relaxed assumptions whereas Smith (1972), Krause and Litzenberger (1973), Baron (1974, 1975), and Scott (1976, 1977), supported the M-M model, but only under the conditions of risk free debt and costless bankruptcy. When bankruptcy has positive costs, there exists an optimal capital structure which is a trade-off between tax advantage of debt and bankruptcy costs.17

This trade-off theory was challenged by Miller (1977). He argued that bankruptcy and agency costs are too small to offset the tax advantage of debt. But when personal taxes are taken into account, this advantage is completely offset by the disadvantage of personal tax. Thus, in equilibrium, the value of a firm is independent of its capital structure, even when the market is imperfect.18

But Miller’s model was rejected by De Angelo and Masulis (1980). They argued that even if bankruptcy, agency and related costs are ignored, introduction of non-tax debt shields is enough for a firm to have an optimal capital structure. And even if these costs are taken into account, an optimal capital structure exists, irrespective of availability of non-debt tax shields.19
Masulis (1980, 1983), Brennen and Schwartz (1978) and Jensen and Meckling (1976) also advocated the existence of an optimal capital structure in an imperfect market, while using different mechanisms.20

Empirical work by Bradley, Jarrell and Kim (1984), Long and Malitz (1985) and Titman and Wessells (1985) largely supports bankruptcy costs or agency costs as partial determinants of leverage and of optimal capital structure. DeAngelo and Masulis demonstrated that with the presence of corporate tax shield substitutes for debt, each firm will have a “unique interior optimum leverage decision with or without leverage related costs”.

The findings of Allen N Berger (Oct.2002) are consistent with the agency costs hypothesis- i.e. higher leverage or a lower equity capital ratio is associated with higher profit efficiency, all else equal. He also concluded that under the efficiency-risk hypothesis, the expected high earnings from greater profit efficiency substitute for equity capital in protecting the firm from the expected costs of bankruptcy or financial distress, whereas under the franchise-value hypothesis, firms try to protect the expected income stream from high profit efficiency by holding additional equity capital.21

Chudson (1945) provides direct evidence on the industries with high proportion of fixed assets tending to use more long-term debt.22

Remmer et al (1974) suggested that certain institutional variables, earning rate seem to be more important as determinants of debt ratio internationally.23

Toy et al (1974) reported that the corporation size and the industry-class do not appear to be determinants of debt ratio.24

Scott and Martin(1975) concluded that industry-class is indeed a determinant of financial structure. They also concluded that corporate size is the determinant of firm’s financial leverage ratio.25

Elsamma Lulose (1976) recommended that the concern should reduce the proportion of borrowed funds either by conversion of debts into equity or by retiring part of debt capital through the issue of further shares.
Carelton and siberman (1977) concluded that higher the variability is in rate of return on invested capital, the lower will be the degree of financial leverage adopted. They also found the return on investment to be negatively correlated with the debt ratios.26

Ferri and Jones (1979) found that the industry-class was linked to a firm’s leverage, but not in a direct manner than what has been suggested in other researches.27

Harris, Rodney, Roenfeldt and Cooley (1983) stated that financial leverage clienteles play an important role in the determination of the capital structure.28

Richard Kolondy and DianeRizzule Suher(1985) indicated that no relationship is shown between shareholders return and the company’s pre-issue degree of financial leverage.29

KoseJohn (1987) revealed that, in the pure signaling case the equilibrium is characterized by direct contractual precommitments to implement investment policies, which riskier than pare to-optimal levels.30

Mathew (1991) pointed out that the optimum debt level balances, a decrease in the profitability of acquisition against a higher share of the synergy for the target’s shareholders.31

Ronen Israel (1991) pointed out that the optimum debt level balances, a decrease in the profitability of acquisition against a higher share of the synergy for the target’s shareholders.32

Chungchang (1992) found that the leverage can be used as an instrument to transfer wealth between investors and employees. The transfer can go in either direction.33

Hull (2002) found that the industry debt to equity norms are significantly more negative than returns for the firms moving closer to these norms.34

Rajan and Zingales (2002) found that the extent to which firms are levered is fairly similar across the G-7 countries, with only United Kingdom and Germany being relatively less levered.35

Nissim and Penman (2003) stated that the financial statement analysis distinguishes leverage in financing activities from leverage in operations.36
Josef Zechner & Laurie Simon Bagwell in their paper analyzed the role of capital structure in the presence of intra-firm influence activities. The hierarchical structure of large organizations inevitably generates attempts by members to influence the distributive consequences of organizational decisions.\(^{37}\)

There emerges an optimal capital structure that trades off the costs of influence activities against the costs of making poor divestiture decisions. The findings suggest that capital structure can also be chosen to control influence activities that arise under less extreme motivations. The study has identified several key factors that determine the optimal capital structure: the top management's prior assessment of the likelihood that it will be optimal to divest a specific division; the costs of influence activities to the firm and to the divisional managers; and the difference in the valuation of the division's assets in the current firm under alternative uses.

Jianjun Miao in his paper provides a competitive equilibrium model of capital structure and industry dynamics. In the model, firms make financing, investment, entry, and exit decisions subject to idiosyncratic technology shocks. The capital structure choice reflects the tradeoff between the tax benefits of debt and the associated bankruptcy and agency costs. The interaction between financing and production decisions influences the stationary distribution of firms and their survival probabilities. The analysis demonstrates that the equilibrium output price has an important feedback effect. This effect has a number of testable implications. For example, high growth industries have relatively lower leverage and turnover rates.\(^{38}\)

James H. Scott, Jr. in his paper titled “A Theory of Optimal Capital Structure” presents a multi-period model of firm valuation derived under the assumptions that bankruptcy is possible and that secondary markets for assets are imperfect. Given the assumption that the probability of bankruptcy is zero, the model is formally identical to that proposed by Modigliani and Miller. Under plausible conditions the model implies a unique optimal capital structure. Comparative statics analysis is used to obtain a number of testable hypotheses which specify the parameters on which optimal financial policy depends. Implications for the debt policy of the regulated firm are also considered.\(^{39}\)

Salman Shah and Anjan V. Thakor examined in their study the financing and incorporation modes for new projects. It aims at two things, firstly to provide a theory
of optimal capital structure that links risk, leverage, and value and is particularly applicable to large firms. Counter to conventional wisdom, it shows that riskier firms acquire more debt, pay higher interest rates, and have higher values in equilibrium. Secondly, it provides an economic rationale for project financing which entails organizing a new project legally distinct from the firm's other assets. We explain why project financing involves higher leverage than conventional financing and why highly risky assets are project-financed.40

Ruben D. Cohen in his paper presented an analytical process for generating the firm’s value [FV] and the weighted-average cost of capital [WACC] curves, with intent to locate the optimal capital structure. The method takes into consideration the relationship between debt, equity and taxes, and places emphasis on the effects of default risk, as well as on the assumptions that underlie the curves. In relation to the proposed approach, it is shown that the conventional one, which is used more commonly in practice, is flawed.

It was found that in high tax-rate environments, firms may be able to achieve their optimal capital structure at a lower credit rating. In low tax-rate environments, however, they may not be so lucky. The reason for this is that taxes can create benefits in ways other than increasing the firm value or reducing the WACC. These other benefits could include an added flexibility for the firm to aim for a lower rating and, still, be able to optimize its capital structure.41

In the presence of frictions, firms adjust their capital structure infrequently. As a consequence, in a dynamic economy the leverage of most firms is likely to differ from the "optimum" leverage at the time of readjustment. This paper presented by Ilya A. Strebulaev explores the empirical implications of this observation. The author has used a calibrated dynamic trade-off model to simulate firms' capital structure paths. The results of standard cross-sectional tests on these data are consistent with those reported in the empirical literature. In particular, the standard interpretation of some test results leads to the rejection of the underlying model. Taken together, the results suggest a rethinking of the way capital structure tests are conducted.42

Guihai HUANG and Frank M. SONG employ in their paper a new database containing the market and accounting data (from 1994 to 2003) from more than 1200 Chinese-listed companies to document their capital structure characteristics. It was
found that as in other countries, leverage in Chinese firms increases with firm size and fixed assets, and decreases with profitability, non-debt tax shields, growth opportunity, managerial shareholdings and correlates with industries. The study also found that state ownership or institutional ownership has no significant impact on capital structure and Chinese companies consider tax effect in long-term debt financing. Different from those in other countries, Chinese firms tend to have much lower long-term debt.43

Francis Chittenden, Graham Hall and Patrick Hutchinson in their article investigate the financial structure of small firms with an emphasis on growth and access to capital markets. Neo-classical economic, life cycle, pecking order and agency theory perspectives are reviewed in order to formulate testable propositions concerning levels of long-term, short-term and total debt, and liquidity. Regression results indicate significant relationships between financial structure and profitability, asset structure, size, age and stock market flotation but not growth except when rapid and combined with lack of stock market flotation. Analysis of stock market flotation as an interactive dummy reveals major differences between listed and unlisted small firms. The results indicate that the variety of financial structures observed in practice may reflect rational trade-offs of various costs on the part of small firm owner-managers but that the over-reliance on internally available funds and the importance of collateral, in the case of unlisted small firms, are likely to be major constraints on economic growth.44

Marjorie Thines Stanley in his paper reviews recent developments in models dealing with capital structure and cost of capital for the multinational firm. A number of issues which bear upon the financing decisions of the multinational corporation are addressed, and related to underlying theoretical and empirical questions with regard to the degree of segmentation or integration of international money and capital markets and the efficiency of the foreign exchange market. Data problems, areas of conflict, and topics for future research are identified. The paper concludes with a summary of financial policy prescribed for the firm by the present state of knowledge.45

Hayne E. Leland in his article examines corporate debt values and capital structure in a unified analytical framework. It derives closed-form results for the value of long-term risky debt and yield spreads, and for optimal capital structure, when firm asset
value follows a diffusion process with constant volatility. Debt values and optimal leverage are explicitly linked to firm risk, taxes, bankruptcy costs, risk-free interest rates, payout rates, and bond covenants. The results elucidate the different behavior of junk bonds versus investment-grade bonds, and aspects of asset substitution, debt repurchase, and debt renegotiation.\(^{46}\)

Sheridan Titman and Sergey Tsyplakov presents in their paper a continuous time model of a firm that can dynamically adjust both its capital structure and its investment choices. In the model we endogenize the investment choice as well as firm value, which are both determined by an exogenous price process that describes the firm's product market. Within the context of this model we explore cross-sectional as well as time-series variation in debt ratios. We pay particular attention to interactions between financial distress costs and debtholder/equityholder agency problems and examine how the ability to dynamically adjust the debt ratio affects the deviation of actual debt ratios from their targets. Regressions estimated on simulated data generated by our model are roughly consistent with actual regressions estimated in the empirical literature.\(^{47}\)

This study conducted by Gay B. Hatfield, Louis T.W.Cheng and Wallace N. Davidson tests DeAngelo and Masulis' (1980) and Masulis' (1983) theory that a firm would seek an "optimum debt level," and that a firm could increase or decrease its value by changing its debt level so that it moved toward or away from the industry average. Our results do not find support for the argument. We defined industry using two different databases (Value Line and COMPUSTAT) and calculated the leverage ratio based on book and market values for equity, but the results did not change. Our overall conclusion is that the relationship between a firm's debt level and that of its industry does not appear to be of concern to the market. A single post-event interval (day 2 to 90) depicted a slow, negative effect following the debt issue (a 3.2% loss). The High Debt firms had significant negative market reactions for several intervals; however, the difference between this group and the Low Debt firms was not statistically significant. These results suggest, overall, that the market does not consider industry averages for leverage as discriminators for firms' financial leverage. The findings were surprising. The above review of empirical research cited numerous studies which had documented a relationship between industry membership and capital structure. Firms in a given industry tend to have similar capital structures.
Our study shows that the market does not appear to consider the relationship between a firm's leverage ratio and the industry's leverage ratio important. This finding is consistent with the original Modigliani and Miller (1958) proposition that financial leverage is irrelevant to the value of the firm. Further research that employs additional leverage ratios and alternate industry classifications will provide additional evidence and insight into this problem.

DeAngelo and Masulis (1980) demonstrated that the presence of corporate tax shield substitutes for debt implies that each firm has a "unique interior optimum leverage decision..." Masulis (1983) argued further that when firms which issue debt are moving toward the industry average from below, the market will react more positively than when the firm is moving away from the industry average. We examine this hypothesis by classifying firms' leverage ratios as being above or below their industry average prior to announcing a new debt issue. We then test whether this has an effect on market returns for shareholders. Our overall finding is that the relationship between a firm's debt level and that of its industry does not appear to be of concern to the market.48

Zelia Serrasqueiro and Paulo Macas Nunes in this paper investigates whether the main capital structure theories—Pecking Order, Trade-off, Agency and Signaling theories—could explain the determinants of debt for a panel data covering 162 Portuguese companies for the period 1999-2003. A better understanding of the determinants of debt in a relatively small, open, and industrialized economy of a less developed country may shed further light on Portuguese companies’ capital structure decision. The results have mixed evidences. A negative relationship between profitability and debt confirms the Pecking Order theory while a positive relationship between size and debt, confirms the Trade-off and Signaling theories. On the whole, the results seem to support the capital structure theories in explaining the determinants of corporate debt.49

Jon Tucker (2007) investigated whether industry-optimal gearing ratio targeting behaviour arises in the long run while a hierarchy of financing (or pecking order) arises in the short run. The relationship between components of common corporate gearing ratios is investigated using a Johansen cointegration methodology. Evidence of target adjustment is found, though only with respect to certain gearing ratios.
Further, adjustment speed coefficients of the error correction representation imply that UK firms close the majority of any deviation from the target with retained earnings rather than external financing. However, while firms in mature industries appear to close the second largest part of any deviation with debt, firms in younger industries appear to close the second largest part of any deviation with equity. A general version of the pecking order theory can reconcile these results.50

2.8 INDIAN CONTEXT

Traditional view, that the cost of capital is affected by the debt and equity mix still holds good. The study conducted by Sharma and Rao (1968) and Pandey (1981), confirmed this view point. Chakraborty’s study (1977) on debt-equity also revealed this fact. According to his study, the average cost of capital for all the consumer goods industry was the highest while it was the lowest for the intermediate goods firms. This was primarily because of low debt content in the total capital structure in case of former category of industry as compared to the later.

As per a study conducted by Sharma. M. L. (1986) on the financial appraisal of Industrial corporations in India, concluded that there could not be a uniform capital structure which will suit the requirements of all the companies. Capital structure has to be tailored to suit the needs of every individual company. However, it is possible to frame a model capital structure for a group of companies having similar characteristics.51

Another study conducted by B. R. Choyal (1986) concluded that the funded debt constituted the major source of financing the total assets employed in three of the corporations under study. All five state level warehousing corporations under study adopted a conservative policy of financing by keeping the debt-equity ratio below the norm of 1:1. The management also relied more on borrowed funds to finance the fixed assets in these corporations.52

According to the study conducted by Prasanna Chandra (1975), a significant relationship existed between the share price and the variables like return, risk, growth size, leverage, etc. Thus, leverage or the debt-equity mix in the capital structure is also one of the factors affecting the value of a share of a firm.
The earlier studies conducted by Bhatt (1990) and Pandey (1984) revealed that corporate managers generally prefer borrowings to owned funds because of the advantage of the lower cost and no dilution of existing management control over the company. However, in a recent study conducted by Babu and Jain (1998) it has been found that the corporate firms in India are now showing an almost equal preference for debt and equity in designing their capital structure. Freedom in paying dividend and ease in raising money are the reasons cited for equity preference. However, due to increasing competition, returns have become uncertain. Hence, companies would not prefer debt over equity though debt is a cheaper source of finance because of tax advantage.

Sharma and Rao (1969) tested the M-M model using cross-sectional analysis for engineering companies, wherein the value of a firm was found to be independent of its capital structure after allowing for tax advantage. But the results could not be generalized as the sample was homogenous.53

The other work by Pandey (1992) observed that the M-M theory is not fully valid under Indian conditions. He concluded that, initially, cost of capital and value of a firm are independent of the capital structure changes, but they rise after a certain level.54

Venkatesan (1983) found that only debt coverage ratio was found to be the important variable significantly affecting the financial structure of the firm.55

Pandey (1988) revealed that the tendency of large size companies is to concentrate in the high-level leverage class, but it was difficult to conclude that the size has an impact on the degree of leverage.56

Rao. P and Mohana (1989) concluded that there is a negative correlation between retained earnings and the debt-equity ratio in the sense that a company with higher volume of retained earnings had low debt equity ratio.57

Krishnaswami and Narayanasamy (1990) stated that capital structure theories, by and large, conclude that leverage is beneficial to private enterprises and debt is the cheapest source of finance for them.58
Subarna Sarkar (1994) found that a greater debt-oriented financing in public sector enterprises and private sector companies shows that the profits are retained in business for augmenting the resources.\textsuperscript{59}

Ram Kumar Kakani (1999) found that diversification strategy and size were found to be of significant strategy and sizes were found to be of insignificant in deciding the leverage level of the firm.\textsuperscript{60}

Kotrappa (2000) stated that the choice between debt and equity sources of capital for a corporate borrower is greatly influenced by factors viz., taxes on corporate income, inflation, controlling interest and capital market reforms.\textsuperscript{61}

Alam and Hossain (2000) found that the capital structure management of Khulna Shipyard Ltd. was in a poor shape because the interest coverage ratio was negative, as there is the possibility of non-payment of interest charges to creditors.\textsuperscript{62}

Sacheendran V in his paper “Capital Structure Decision: Emerging Trends” analysed the trends in pattern of sources of funds for Non Government non-financial public limited companies in India.

The conclusions of this study were that the sources available for companies to meet their financial needs are plenty. The sources have their respective cost-risk-control features. Hence, an appropriate capital structure has to be designed based on their underlying features matched with the peculiarities related with companies. The pattern of sources of funds the companies analyzed here shown an increasing trend towards internal sources in their capital structure. Among external sources, bank borrowing assumed greater share.\textsuperscript{63}

The study on “Determinants of Capital Structure in Public Enterprises” conducted by Vunyale Narender & Abhinav Sharma was an attempt to understand the capital structure policies adopted by the profit making Central Public Enterprises and the study has been conducted for the period 1994-95 to 2004-05. The study inferred that the growth is not a major factor in the determination of the capital structure of the public enterprises, tangibility of assets plays a significant role in determining the leverage of the public enterprises, the results for NDTS(Non-debt tax shield) and TAX, lead them to infer that the PEs are not utilizing debt to pay less tax; internal resources form a major chunk of resources for the PEs in expansion and financing, the
PEs are mobilizing long-term, resources for meeting short-term requirements, and the PEs are following the pecking order theory in the process of mobilizing funds.64

Pitabos Mohanty in this paper discusses some of the important papers in the category of capital structure theory based on the assumption of information asymmetry. Then an attempt is made to see if these theories can explain the capital structure of the Indian companies. It has been found that some of the predictions made by these theories appear to hold in the Indian context. Particularly, it has been found that leverage is negatively related with profitability both within an industry as well as within the economy. However, contrary to the predictions made by these theories, it was found that companies that spend a larger sum of money on advertisement and research and development expenditure are the least levered. Similarly, companies where the ratio of value to total tangible assets is less are also found to be more levered. It was observed that the most profitable companies in each industry are less dependent on debt than the less dependent on debt than the least profitable companies.

It was also found that the highly levered firms are less valuable than the low levered firms. It found an evidence that shows that as the information asymmetry increases the leverage decreases. This is against the pecking order theory. The paper concluded that some of the predictions of the pecking order hypothesis do hold in India, but it is alone not enough in explaining everything.65

Raj S Dhankar and Ajit S Boora conducted an empirical study on the Cost of Capital, Optimal Capital Structure, and Value of Firm in respect of Indian Companies.

This paper examines whether there exists an optimal capital structure in Indian companies, both at the micro and the macro level and whether financing decisions affect the value of a firm.

No significant relationship was found between change in capital structure and the value of a firm, at the micro level. This is because of the fact that the value of a firm is affected by a multiplicity of factors and capital structure is just one of them. Many of these factors like the reputation of promoters, management of the company, economic and political conditions, role of bulls and bears, government policies, etc., are not measurable as they are qualitative in nature. Because of this problem, their effect cannot be segregated, and hence, an exact relation-ship between change in capital
structure and value of a firm could not be established. However, at the macro level, the relationship was statistically significant at 5 per cent level of significance ($r = 0.706$). The above factors may result in undervaluation or overvaluation of shares at the micro level but when we take the aggregate; their positive and negative effects neutralize one another. So, the market value at the macro level acts as the true index of financial performance of all the companies. The results clearly advocate the existence of an optimal capital structure at the macro level but in the absence of a model on capital structure, it is not possible to determine its exact range. However, the ‘$r’ value of 0.706 for a weighted average D/C ratio of 0.666 is high and statistically significant. What it implies is that a higher level of debt in the capital structure of these firms will not affect their values adversely. As a matter of fact, the additional debt will help increase their values.

Companies were found to differ significantly in capital structure irrespective of whether they belong to the same industry group or different groups. This is because of the fact that the magnitude of the effect of determinants of capital structure vary from company to company. In general, change in capital structure and cost of capital was found to be negatively related, but the results were not statistically significant. These results suggest that though cost of capital decreases when leverage increases, this decrease is very moderate and not proportional to debt level.66

This study conducted by Gulnur Muradoglu and Sheeja Sivaprasad is an empirical work that investigates whether capital structure is value-relevant for the equity investor. In this sense, the paper links empirical corporate finance issues with investment analysis.

The study acknowledges the fact that debt requirements for each risk class differ and that certain heavy industries require a higher leverage, while also acknowledging that average leverage levels within an industry may differ due to macroeconomic factors such as interest rates, yet each company within a risk class may have its own unique reasons for a capital structure preference. Firms’ capital structure policies appear to be largely consistent with the existence of leverage targets. Because capital structure is endogenous, we argue that the optimal financial policy is one that advocates low leverage, so as to mitigate agency problems while preserving financial flexibility. Profitable firms may keep their leverage levels low so as to prevent too a proportion
of profit being used for interest payments. This notion leads to another school of thought: i.e., whether firms, in their attempt to keep leverage levels low, avoid taking on profitable opportunities and investments, hence throwing away their firm value. The negative relationship between returns and leverage could also be due to the market’s pricing of the firm’s ability to raise funds if need be.\textsuperscript{67}

The paper presented by Manohar Singh and Ali Nejadmalayeri examines the relationship between international diversification, financial structure, and their individual and interactive implications for the combined debt and equity cost of capital for a sample of French corporation. It was reported that the degree of international diversification positively associates with higher total and long-term debt ratios. It was also found that internationally diversified firms support higher level of debt financing that directly results in reduction of overall cost of capital despite higher equity risk. More significantly, the study found that even after controlling for the effects of the degree and composition of debt financing, equity risk, firm size, managerial agency costs, and asset structure, higher degree of international diversification results in lower overall—combined debt and equity—cost of capital.\textsuperscript{68}

R.Azhagaiah and S.Gangadevi in their paper aimed at analyzing the companies’ financial decision based on corporate leverage. They have concluded in their study that it is desirable that a company has low operating leverage and a high financial leverage.\textsuperscript{69}

Mitali Sen and J. K. Pattanayak (2005) examined the issue of corporate financial structure and its determinants by studying the association between observed leverage and a set of explanatory variables. The result suggested that liquidity, size, efficiency and growth, quality of assets, profitability and service diversification are the most critical factors influencing the capital structure of the Indian banking firms.\textsuperscript{70}

Sudhansu Mohan Sahoo and G. Omkarnath (2005) have attempted to find the determinants of capital structure by taking into consideration three measurements of debt-equity choice such as short-term, long-term and total debt ratio respectively. It was found that some of the variables were significant for some specific dependent variables. Their study found out that profitability, asset structure were most significant factors deciding the capital structure instead of firm size and growth opportunity.\textsuperscript{71}
Balram Dogra and Shaveta Gupta (2009) conducted a study to examine the sources of funds of SME sector operating in the state of Punjab. The study tried to find out the existence of the relationship between capital structure of the firm and its characteristics. The Pearson chi-square statistics in this regard revealed that there was a highly significant association of capital structure with the type of firm, age of the firm, growth of the firm, degree of competition and level of capital investment and not by owner’s qualification.

Patitosh Chandra Sinha and Santanu Kumar Ghosh (2010) tried to examine the adjustment speed in the dynamic capital structure choice of the firms. The study tried to explore whether firms’ recapitalization policy allows dynamic adjustments in leverage revision through two decision variables, i.e., the target leverage and the adjustment speed. They found that the firms’ recapitalization is subject to changes in the firm-specific as well as macroeconomic variables, where both the target leverage and the adjustment speed are determined by firms’ reactive and/or proactive adjustment behaviours.

Venkatamuni Reddy R and Hemanth Babu P have discussed the corporate financial structure in Indian capital market, and how the corporate sectors raise their finance: Whether they raise their finance through internal sources or external sources within India. The main objectives of this study are, firstly, to find the nature and pattern of Indian corporate finance in general, and secondly to study the structure of selected pharmaceutical companies in India registered in the National Stock Exchange (NSE). This paper tests the hypotheses associated with the objectives through target adjustment model and pecking order model. The results obtained by them contradicted the pecking order model and supported the target adjustment model. Firstly, the study finds that the companies are financially stable and mostly finances their investments from retained earnings, and for the rest, they depend more on equity rather than debt finance. Secondly, the paper inferred that Indian pharmaceutical companies finance their investments mainly through internal funds and the rest is financed through equity share capital.

All these studies have helped to understand the dynamics of this crucial issue better but have not been able to come to a definite conclusion as to how firms determine their optimal capital structure. So, the present study was planned to make another
attempt to resolve this contentious issue. It may be pointed out that the study has not included the effect of factors like agency and bankruptcy costs, as they are difficult to measure in the Indian scenario.
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