6.1 The main objective of the this study has been to bridge the gap that exists between the financing practitioners' viewpoint and the viewpoint the various capital structure theories hypothesize which constitute the driving force behind corporate long-term financing decisions. There is no need here to summarize all the empirical results of the last three chapters. The central conclusion which emerges from our investigation is that although there are wide variations in the capital structures among the business firms, these structures are quite peculiar to developing countries and are different in very important ways from those found in the advanced countries. The significant conclusion that can be drawn from the results of the various chapters is that the theories of capital structure propounded for advanced economies are not operational in developing countries like India mainly due to the presence of regulation and control which the government has been enforcing over the investment and financial resources. In such economies where there is general scarcity of resources, where investors/savers are risk averse and have limited opportunities for investing their savings, and where trade and speculation take precedence over manufacturing, there is the need for some kind of social control over the allocation of resources. Moreover since the state plays a dominant role
in economic affairs, it itself is vying with the private corporate sector to pre-empt the surplus of the financial system. However, in spite of competition from the government, well established companies and to some extent new companies in high growth areas have successfully raised capital from the capital market. It is this segment of the capital market that is the focus of the study.

6.2 WHAT THE THEORETICAL MODELS PREDICT

We saw in the Chapter II that the financial capital structure of an economy's business corporations, either individually or in the aggregate, is the joint product of decisions taken by claim-holding investors (the market) on the one hand and the claim issuing corporations on the other. Theories of corporate leverage begin with the observations that corporate taxation appears to bias the choice of financial policy completely towards debt but this does in no way explain why no firm has financed its assets entirely with borrowed funds. Miller (1977) suggested the answer to this question when he argued that the presence of progressive personal income tax with favourable treatment of equity income (because of the partial exclusion and deferral advantage associated with capital gains taxation) would lead to an equilibrium with firms facing the same cost of capital for debt and equity. In this equilibrium, the tax advantages of debt would be just offset by a lower before-tax return to equity holders. As a
result in equilibrium, the original Modigliani-Miller (1958) proposition that financial policy is irrelevant would hold good. It seems that certain additions must be made to Miller's model to explain actual firm behaviour.

The solution is given to a certain extent by the bankruptcy/agency cost models according to which the risk of potential bankruptcy discourages firms to use large proportions of debt, as the attendant costs such as legal fees, court fees, liquidation expenses etc., would more than offset the tax advantages of using debt. In dynamic models where investment and financial decisions occur at different times, additional costs associated with bankruptcy arise because of the inability of the lenders of capital to constrain the behaviour of the corporate managers (the agency problem). The inefficiency induced by this moral hazard is a social cost that presumably be borne by the firm and its owners ex-ante in the form of higher interest rate (or coupon payments) to holders of long-term debt. It would clearly be in the shareholders' interest to constrain the firm's behaviour in order to avoid such costs. While mechanisms to overcome such cost do exist (like bond covenants restricting future borrowings, convertibility clauses) it would be costly if not impossible to replicate the desired outcome. Myers (1977) suggests that the moral hazard problem is more acute for firms whose value derives from anticipated rents from future investment opportunities rather than from existing assets or those that the firm is committed to purchase.
Generally the implications are that risky firms would borrow less, fast growing firms should borrow less because of the higher ratio of growth opportunities to existing capital and because of the greater tax shield from depreciation and investment tax credits. The chapter has also introduced firm level determinants of corporate leverage which have been found by researchers in other countries to influence debt decisions apart from bankruptcy cost, tax shields and the agency cost associated with debt.

6.3 WHAT THE EMPIRICAL FINDINGS REVEAL

A significant finding reported in the Chapter III was that although the Indian corporate sector used relatively more debt than equity finance, more than 30 percent of its growth has been financed by internal generations. Where external finance was resorted to the proportion of borrowed funds from financial institutions was high at over 75 percent. This pattern of external financing of growth stands in striking contrast to that found in the leading advanced countries including Japan, France and Italy, where corporations largely employ capital market debt and to a very small extent equity finance. The important finding is that in spite of the marked improvement in the capital market environment with the corporations having a wider range of resources and instruments through which to tap funds, financial institutions continue to be the primary lenders of capital. The average business firm's marked preference to borrowed funds from the financial institutions and the reliance on
internal generations and finally external equity would appear to support the argument of Myers that firms follow an hierarchy in financing growth. As long as borrowing firms do not already suffer from "debt overhang" and hence have the capacity to borrow additionally to fund investment, Myers' prediction holds true. Otherwise, in the case of over-debted firms, it will not be possible to subordinate old debt with new borrowings. Past borrowing in the case of firms without heavy debt burden are not significant determinants of future borrowings which is determined based on the availability of funding sources and attendant risk associated with that form of financing.

Scarcity of funds being universal in the Indian economy, the study finds that greater profits lead to greater investment. Inflation has been a major factor which the economy had to contend with, Adjustments for inflation in the flow of funds showed that corporations had in fact financed their new investment more out of internal funds and equity issues. Firms had continued to rely on borrowed funds due to its ready availability at lower rates of interest than short term rates. In the presence of inflation in the economy, the financial officers of firms would have to undertake roll-over of credit at much higher rates, which their present levels of profitability may not permit. This would make borrowing un-attractive for low NPV projects. The structure of personal taxes has been such that the relative aversion of investors to debt financing by
corporations has reduced over the years. The growth of the equity culture has been triggered by the tax reforms brought about in the recent past and the liberalization of issue procedures for corporations issuing securities and the innovation itself in the primary capital market, what with the advent of a large number of firms. The rise of the new and numerous middle class and the advent of consumerism in the country has created a need for the average investor to look towards more profitable avenues for the investment of their savings as they have found returns from the traditional government supplies risk free securities/savings instruments not fetching the desired returns. The middle class is however not willing to take the full blast of market fluctuation. The mutual fund by spreading the risk over a wide portfolio and assuring investors of reasonable returns give the answer to the investors' predicament in circumventing risk. As a result of the above the multiple regression results reported in Chapter IV show that the factors hypothesized to influence capital structure choice in advanced economies would not be significant in developing countries. Debt-equity choice is determined in the Indian economy more by factors exogenous to the firm as the rationing of capital is severe in the financial markets and the government is itself the biggest borrower of capital. Firm level attributes can determine debt level only to a limited extent. Growth is a result of the urge of firms to take advantage of investment opportunities which is dependent to a large extent on the governmental policies at that time. This policy again varies
from industry to industry. As most Indian firms are highly diversified, the opportunities available to them are innumerable, and the quantifiable attributes which would be expected to influence leverage would not influence all firms alike.

The questionnaire survey results reported in Chapter V strongly suggest that debt decisions in India are strongly determined by market forces. These forces are exerted by the various providers of external capital—The Financial Institutions on the one hand being the major provider of capital (debt), the governmental regulations which in fact are the guiding force behind the institutions as they stipulate their own norms for the level of debt which a firm can borrow rather than let the institutions rate their own borrowers and scale their lendings accordingly. This has led, more than often, to the financing institutions simply enforcing the debt-equity norms more as a rule than as a guideline. The institutions do not carry out any of the following exercises that are expected of them. Viz.

1. Rating of the borrower
2. Analysis of the failure risk of the project
3. Pegging of the rate of interest to the risk of the asset (lending)
4. Linking of the rate of interest to the anticipated inflation
5. Carrying out their entire credit analysis on the basis of real value of assets, profits, etc.
On the part of the business corporations itself, there is no awareness of the state of the art of capital structure theories. The practicing managers do not appear to base their debt decisions on any accepted principles. Rather they adopt the "pecking Order" approach. The preference of the firms to borrowed funds is prompted by the tax advantage of debt. However, in view of the financial environment in which they are functioning, they are not able to obtain the entire funds needed from only the Financial Institutions who have their own lending norms. As the funds from this source is thus limited, the next source for these firms are the convertible debentures which have found good investor support in recent times as they give the option to the investor to dislodge them from their portfolio if they are not satisfied with the company's performance at a later date. Thereafter the company resorts to equity issues which are the riskiest but give higher returns to the investor.

6.4 LIMITATIONS OF THE STUDY

The study was undertaken during the changing phase of the financial market environment in which corporations in India operate. With the deregulation of certain controls in the economy and the liberalization of issue procedures, the average Indian corporation is now at a very vantage situation as far as the capital raising capacity is concerned. The financial innovation in the security market, the leveraged buy-outs, acquisitions and mergers of companies in the private corporate sector saw the rise of
innumerable merchant banking institutions and new methods of finance which is prompted by the financial market. Recent times saw the opening up of the doors of the economy to foreign financial investors as a result of which a large number of International Conglomerates and Non-Resident Indians have brought in capital from abroad. The availability frontier for funds has widened considerably. The full impact of all the changes in the financial market and innovations on the debt-equity choice with data needs to be studied. There is also further scope for undertaking further research in the area of financial instruments and their influence on the capital structure.

The present study has been carried out without taking into account international dimensions. Financial management at the corporate level is fast becoming sophisticated because of internationalisation of finance. Beginning from the seventies international parallel markets have grown very fast. This growth became a source of jealousy for various national markets which culminated in their de-regulation in the eighties. The current gross size of the market is reported to be of the order of U.S.$ 6,000 billion. A large number of corporate units all over the world tap this market to meet their financial needs. The corporate debt and equity structure is fast becoming a mix of multiple currencies. The moment any debt assumes the character of being a multi-currency debt it makes financial management rather complicated. What is involved here is that the corporate treasurer has to cope with fluctuating interest rates and
fluctuating interest rates. To overcome the risks associated with this complication international markets now offer a series of derivative instruments like interest futures, currency futures, currency swaps, interest swaps, and put and call options. This study does not take account of the impact of these innovations on the financial management at the corporate level. Even in the West studies are yet to appear bearing on the impact of these changes on corporate financial management. In India these changes are occurring in bits and pieces and they are of very recent vintage. Some more time has to elapse before the impact of these changes can be taken account of. This is a task we leave to the future researcher.