Chapter - I

INTRODUCTION

Capital is needed for the business enterprises for their establishment and also to run their business activities. Capital has, been considered very essential part of all business ventures.

Conventionally, the term 'capital' refers to the total investment in the business enterprise as characterized by the total assets. In this sense the term net capital has been used by the businessman to indicate the tangible net worth of an enterprise. Some businessman also uses it as the actual wealth shown by the total assets tangible or intangible. Accordingly the net capital is synonymous with the net worth of an enterprise. Term 'capital' is also used in legal terms to denote the liability as an assets. In the sense of liability, it has been used by them to denote the amount received from the sale of shares. Whereas in terms of assets, it has been used as a fund which is available for the protection of creditor's claims. The economists also use the term capital as factor of production.
The term capital has also been used to denote the total property of the business enterprise employed to earn profit. A business enterprise may employ not only owned property but also, if necessary, other's property to attain the main goal of profit. On the other hand, as per the accounting concept, capital is shown in the liabilities side of the balance-sheet. Most accountants prefer to use the term capital to indicate aggregate ownership interest of the business enterprise.

The meaning of the capital reveals that it has a basic purpose in the business enterprise and its proper management is also necessary to gain profit form the concerned industry. There are two concepts of capital, i.e., fund concept and assets concept. According to fund concept, the capital of a firm is the sum of the total fund that has been employed for its operation. It corresponds to the idea of total capital and may also be described as financial capital. The fund concept recognises the separate entity of a firm and considers it as a liability. The assets concepts refer to the investments in fixed assets and current assets. There is a controversy over the difference between capital and capital structure.

The term capital structure refers to the total composition of preference share capital, equity share capital, long term loans, reserves and surpluses. Generally, it is treated at par with the financial structure. But there is slight difference between both the concepts. Accordingly, financial structure refers to the manner in which the assets of a firm are
financed where as the capital structure refers the structure of sources of financing. In this way capital structure is a part of over all financial structure of business firm. The financing of an industrial enterprise requires proper assessment of the capital structure. The question of capital structure can be examined in terms of the proportion of debt to equity. The basic purpose to analyze the theory of capital structure is to know about the structural equilibrium of the capital coterminous with the investment and dividend decisions at the industry.

The capital of the industrial enterprises may be categorized as "owned" and "borrowed" capital. A owned or equity capital furnishes definite and permanent funds to the enterprises over which the management can exercise full control and use at its discretion during the life time of the company. It may assume the form of share capital or stock. The investment in the equity fund from the point of view of the investors is liquid, being transferable; it can be liquidated in the stock exchange. Equity capital consists of two types of shares, i.e., ordinary and preference. The ordinary shares are those shares which do not get any privilege or right in respect of priority for the payment of dividends as repayment of capital. On the other hand, the preference shares are those share which are entitled in payment of dividend and repayment of capital. They have no voting rights in the Company. The articles of association
may confirm a participating right to them. These shares are liable to be redeemed by the Company after the expiry of the stipulated time period.

Borrowed funds provide short term finance to the Company, either expiry of the year as after a certain year. Their stake in the company is not permanent and they have no voting right but they can force the winding up of the company. The employment of these funds restricts the freedom of the management in carrying out its functions. An enterprise using such fund incurs an obligation to pay yearly a certain sum in the form of interest.

Working capital is that part of capital which is available for regular business operations such as purchase of raw materials, payment of direct and indirect expenses carrying out production, investment in stock and store, receivables and maintained cash is generally known as working capital. Financial experts have used the term working capital in both narrow and wide sense. In a narrow sense it is the net working capital arriving at the excess of current assets over the current liabilities. In the broad sense, the term working capital is used to denote the total current assets on the total working assets. In this context the term working capital bifurcated into gross working capital and net working capital. In the other sense working capital includes current assets and current liabilities. Current assets are those assets which can be converted into cash within a short period of time (not more than one year). Current liabilities are used
to denote such liabilities as are intended to be paid during the accounting period. From the financial management point of view a good working capital ratio assumed a good umbrella for credits against rainy day.

Working capital may also be studied in terms of permanent working capital and variable working capital. Permanent working capital are those capital which is minimum amount should always be there in the business to carry out its activity. This capital is more or less a permanent type. In the absence of such capital the business may run the risk of insolvency or liquidation as the flow of regular operation. A business expands the requirements of regular working capital also increase. When a particular time the demand of the product goes up, additional funds will be needed to purchase additional raw materials hire more labour, etc. The is know as variable working capital.

Working capital provides short term financial requirement of business enterprise. Without working capital no any business runs easily. If it becomes weak the firm can face a lot of problems, the need for maintaining the working capital, just as circulation of blood in human life, smooth flow of fund is very necessary to maintain the health of an enterprise. Every activity of the business directly or indirectly affects the current position of the enterprise and so its needs showed be properly estimated and calculated.
OBJECTIVES OF THE STUDY

In any enterprises the flow of actions like purchase, production and marketing is planned, measured and evaluated in terms of financial resources or capital structure. Financial resources provide the economic power to the any industrial enterprises for enabling it to carry on its operations. The combination of all sources of financing of the resources acquired by the enterprises is commonly referred to financial structure. Financial structure is affected by among other factor, growth rate of future sales, stability of future sales, competitive structure of enterprises, assets structure of the industry and owners attitude towards firm and industry.

The capital structure affects the firms cost of capital, the financial risk of an industrial enterprises undertaken vis-s-vis the profitability of the undertaking. The credit standing and the capability of the enterprises to raise additional funds as and when required. The management of profit and increase the profitability are also influenced by financial structure.

This is what the present study aims at.

Main objectives of the study are:

(i) To examine the overall composition of capital structure of industrial enterprises in India.

(ii) To appraise the leverage effects of capital structure in the industrial enterprises.
(iii) To analyses the impact of the capital structure on the profitability of industrial enterprises.

(iv) To appraise the inter-industry differentials in the capital structure of industrial enterprises.

(v) To study the trends in various ratios related to capital structure vis-a-vis profitability of industrial enterprises.

**SCOPE OF STUDY**

The present study is confined to the study of capital structure and profitability of twenty industries such as classified into basic industry, capital goods industry, intermediate goods industry, consumer goods industry and other industry. It covers period of five years from 1991-92 to 1995-96 during which the process of industrialization in the country was affected sizably due to several policy formulation. It incorporates mainly on the data relating to capital structure and profitability of these units. Other functional areas were also correlated with these data as and when it was required.

**RESEARCH METHODOLOGY**

The data for the present study has been collected from the Annual Reports of several industrial enterprises of the country and also from the Financial Performance of IDBI Assisted Units published by IDBI. Reports of Bureau of Public Enterprises, relevant journals and newspapers, appropriate statistical tools, such as measures of central
tendencies variances, trends and several ratios and percentages have been used for analyzing, interpreting and inferring fruitful conclusions from the data, thus, collected.

**HYPOTHESIS -**

This study has following Hypothesis-

1- Capital Structure of Public undertakings in India is not educate.

2- Profitability of Public undertakings in India is not satisfactory.

3- Financial passion of Public undertakings in India is like while elephant (A costly thing but having less utility)

4- Others.

**PLAN OF THE STUDY**

First chapter introduces the subject and present the objective, scope, research methodology and plan of study.

Second chapter deals with the theoretical framework of capital structure of corporate enterprises with special emphasis on the theory of Capital Structure and determinants of optimum Capital Structure. Theories of profit of profitability have been described in the third chapter. The description of this theoretical framework of profitability emphasis on the factor of profit earning capacity of industrial enterprises in India. The fourth chapter deals with financing pattern of industrial enterprises in
India categorized in to long term and short term sources. Efforts have also been made to analyze the financing pattern of sample companies of India.

Leverage impact on profitability of industrial enterprises. Impact of leverage on profitability of industrial enterprises have been discussed in fifth chapter profitability analysis of industrial enterprises in India has been analyzed in the sixth chapter. The last chapter summarizes the whole study and offered few suggestions.

Limitations?