CHAPTER - I

INTRODUCTION AND RESEARCH DESIGN
INTRODUCTION

Finance is regarded as the lifeblood of a business enterprise. In the modern money-oriented economy, finance is one of the basic foundations of all kinds of economic activities. It is the master key to all the sources of manufacturing and merchandising activities. It has rightly been said that business needs finance to make it profitable. However, it is also true that, money begets more money, only when it is properly managed. Hence, efficient management of every business enterprise is closely linked with efficient management of its finances.

A firm's success and its survival depend upon the efficient generation and management of finance. “Finance” is the management of the monetary affairs of a company. It includes determining what has to be paid for raising the money on the best terms available and devoting available funds to the best uses.

Financial management is that managerial activity which is concerned with the planning and controlling of the firm’s resources. It remained only a branch of economics till 1890 as a separate activity or discipline, it is of recent origin. Till today, it has no unique body of knowledge of its own. It relies heavily on economics for its theoretical concepts.
Concept of business capital can be studied from different points of views\(^1\). Economic capital is the part of wealth, which is used for further production. According to accounting concept, capital is viewed in a wider sense and is recognised as the 'net wealth' or 'shareholders’ equity' as accounting capital. Capital can also be classified according to the sources of capital; or according to application or uses of capital; or according to time duration for which capital is needed. According to time dimensions, capital can be classified as short-term capital, medium term capital and long-term capital.

Long-term capital is needed by every business for a longer period. The period may range between 7 years and 15 years or even more depending on the usage prevalent in various industries and different countries.

Importance of capital in the overall management of the company has been emphasised by Collin Brooks that, “bad production management and bad sales management have slain their hundreds but faulty finance has slain its thousands”\(^2\). Sound financial management is obvious in a developing country like India where financial resources are scarce. If proper financial management techniques are developed, most of the enterprises can reduce their capital employed and improve their return on

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investment. Financial authorities and experts differ in their views on the composition of funds in capital structure. Some believe that the capital structure is tantamount to the financial structure and hence, they say that the structure includes funds mobilised from both long term and short-term sources.

According to Richard C. Osborn, "the term capital structure is used to mean the financial plan, according to which all assets of a corporation are furnished. This capital is supplied by long and short term borrowings, the sale of preferred and common stock and the reinvestment of earnings". He further states that, "in analysing the capital structure of an enterprise, short term debt is often excluded from consideration". Many others include only long term sources of funds under the capital structure. Harry, G. Guthmann and Herbert E. Dougall have said "the phrase capital structure may be used to cover the total combined investment of the bond holders' investment including retained earnings as well as original investment".

The capital structure of a company may be either simple or compound or complex. A simple capital structure is composed of the single security base, for example, the equity share capital issued by a

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A compound capital structure indicates a combination of two-security base in the form of equity and preference share capital. The complex capital structure is made up of a multi security base, consisting of equity, preference share capital and a series of debentures or bonds and loans from other sources.

One of the most important phases of promoting a new business is the determination of the capital structure. Many businesses fail, particularly in their early years because of an unbalanced capital structure. The capital structure of these companies might be deficient because the amount of funds raised from permanent sources might have been insufficient for the requirements of the business. Most promoters are naturally optimistic and tend to over-estimate income and under-estimate expenses. Such a situation may result in failure within a short time, in working out the capital structure. Therefore, it is imperative that it provides for sufficient money to enable the company to carry on its operations.

Generally speaking, a stock issue will not cause a company to fail but a bond issue may do so. The company is not obliged to pay dividends on the stock or to repay the principal. But, both the interest and the principal of the bonds must be paid regardless of the earnings or else bondholders may take legal steps to foreclose the enterprise. An
Important item added to the capital of a growing concern is retained earnings.

Companies, which have been in existence for many years, can make the same kind of errors in determining their capital structures as the promoters of a new and untried business.

Generally speaking, most firms are found to become more conservative in their capital structure as they mature. This is due to the build-up of retained earnings.

Different factors like the state of capital market, the nature of business technology adopted, stability of earnings, credit standing and the attitude of the management influence the way in which capital is structured. Of all these factors, the attitude of management plays an important role in shaping the capital structure. When the firm has strong desire for assured and exclusive control, preference will be given to borrowing for mobilising capital in order to be assured of continued control. On the contrary, if the firm does not want to take risk it will not prefer issuing of bonds or debentures which may plunge the company into greater risks, and endanger its position.

The experienced firms which feel relatively secured and believe in the leverage principle will resort to higher level of borrowing is an tempt to improve the firm's earnings.
In theory, it is argued that the financing decision is irrelevant under perfect capital markets. When within the framework of perfect capital markets, taxes and bankruptcy costs are assumed, the financial economists argue that an optimum capital structure, which maximises the market value of the firm (or minimises cost of capital) can exist.

**STATEMENT OF THE PROBLEM**

The problem of efficient financial management is of crucial importance to all organisations, including that of paper industry undertakings. The potentiality of an enterprise is gauged in the forms of its financial success. Financial success is measured by a notion of profit. A sound financial base will depend upon the availability of adequate finance at smooth, regular and reasonable cost. For a bright success, management of capital structure is an important function of the finance manager of a paper industry.

Capital structure is made up of debt and equity. Judicious blend of debt and equity would maximise the value of equity or common stock. A financial manager has to plan a proper capital structure in such a way that the plan would give the industry the maximum benefits.

The capital structure of a business reflects the management’s decision over a long period of time and signifies a long-term financial strength of an organisation. Out of the two units under the study Tamil Nadu Newsprint and Papers Limited (TNPL) is a public sector
undertaking and Seshasayee Paper and Boards Limited (SPBL) is a private sector unit.

**SCOPE OF THE STUDY**

The scope of the present study confines to the capital structure of the Tamilnadu Newsprint and Papers Limited (TNPL) and Seshasayee Papers and Boards Limited (SPBL). The capital structure analysis is focused on debt equity ratio, financial leverage ratio and profitability ratio.

The term capital structure is generally employed to study only long term debt and total stockholder's investment. It refers to the mix of long term sources of funds, such as debentures, long-term debt, preference share capital and equity share capital including reserves and surplus.

A sound or appropriate capital structure should have the following features.

1. Return
2. Risk
3. Flexibility
4. Capacity
5. Control

When a study is conducted to compare the various years of operation of one undertaking, it is called Intra-Firm Analysis. On the other hand, if a comparative study of the performance of two or more firms belonging to the same industrial sector is made it is called Inter-Firm Analysis. The researcher is pursuing an inter-firm comparison taking the TNPL and SPBL for an intensive study.
Since financial institutions and other governmental agencies like the Controller of Capital Issues in India laid down certain norms in terms of debt-equity ratio, the financial manager has to see that the ratio of his undertaking does not violate these norms. By applying the financial tools of debt-equity ratio, the manager gets advantages like leverage benefit, tax benefit, high profitability etc. Besides these, the financial manager can fulfill the legal requirements of the government and the financial institutions.

REVIEW OF LITERATURE

Systematic research works comparing structures of companies based on their geographical location are not yet available. However there is research works on capital structure and the factors influencing the capital structure. The present researcher had gone through such research works carried out in India and a few works done abroad. The methodology and findings of these research works had been carefully studied and analysed by the researcher. The tips got from these research works have helped in putting the present research work in a proper perspective. The gists of some of the relevant research studies and research papers on capital structure are presented in the ensuing pages.
Chudson's (1945)\textsuperscript{5}, research paper on, "The pattern of corporate financial structure", provides direct evidence on the companies with high properties of fixed assets to use more long-term debt. The research also indicates that there is no simple linear relationship between corporate size and debt ratio.

Wippern Ronald (1966)\textsuperscript{6}, in his research paper on “Financial structure and the value of the firm”, concentrates on the cost of equity function instead of the overall cost of capital function. By doing this, he shows that the cost of equity function is significantly linear, and increases at an appropriate rate to exactly off-set the injection of debt into the capital structure and keep the overall cost of capital constant. Wippern has taken great pains to ensure that the book value or the market value weightings do not distort his financial leverage measure and to include almost all the other variables to be sure that the results are not biased by the omission of an important factor.

Sharma and Hanumantha Rao (1968)\textsuperscript{7}, in “Leverage and the value of firms”, were to employ the Modigliani and Miller’s model under Indian conditions to a non-regulated industry and to test the influence of


the debt on the value of the firm. They employed two stage least square methods (2 SLS) on the data of thirty Indian engineering firms for three years namely, 1962, 1964 and 1965. In their estimate, the leverage variable has a co-efficient greater than the tax rate. Thus, agreeing with the traditional view they have concluded that the cost of capital is affected by debt apart from its tax advantage.

Douglas Vickers (1970)\(^8\) in his article, "The cost of capital and the structure of the firm," has concentrated on the narrow but important set of issues namely, the nature and relevance to a firm at different optimisation points of the cost of capital:

Alberts W.W. and S.H. Archer (1973)\(^9\) presented a research paper on "Some evidence on the effect of company size on the cost of equity capital". The objective of this paper is to carry out tests of the general hypothesis, that the cost-of-equity capital of small industrial corporations is greater than that of large industrial corporations. Further, the paper proceeds by attempting to determine for a sample of companies and the extent to which there is a negative relationship between the size of these companies and the variability of their rate of return. They conclude that it is obviously a first step in determining the impact of horizontal and conglomerate growth on a company's cost-of-equity capital. If they are to

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erstand fully the nature of this impact, they cannot stop with a confirmation that there tends to be a negative relationship between size and variability.

Bhatt (1980)\textsuperscript{10}, conducted a study to ascertain the determinants of financial leverage under the Indian context. His paper concerns the impact of size, growth, business risk, dividend policy, profitability, debt service capacity and the degree of operating leverage on the leverage ratio of the firm. This study uses the multiple regression model to find out the contribution of each characteristic. Business risk, (defined as earnings instability) profitability, dividend payout and debt service capacity were found to be significant determinants of the leverage ratio.

In his (1981)\textsuperscript{11} study on, “Capital structure and the cost of capital”, Pandey I.M., attempts to determine the empirical relationship between cost of capital and capital structure using data of four industries viz. cotton (47) chemicals (32), engineering (32), and electricity generation (20). To account for the heterogeneous characteristics of the sample firms, he introduced a proxy for risk variable measured by the coefficient of variation of the net operating income. The other explanatory variable expected to influence the cost of capital were: size, growth, payout an


liquidity. Two measures of leverages were used. The first measure includes preference capital in debt, while the second measure treated it as a part of equity. Because of the substitutability of short term loans for long term loans in India, debt included both short-term and long-term ones.

Ronald W. Masulis (1983)\textsuperscript{12} in his research paper on, "The impact of capital structure change of firm value - Some estimates", reveals the valuation effects of leverage altering capital structure changes. Issue exchange offers and recapitalisations are analysed, because they do not involve simultaneous asset structure changes (in the form of cash inflows/outflows). Evidence was obtained indicating that (1) changes in stock prices are positively related to leverage changes. (2) changes in non-convertible senior security prices are negatively related to leverage changes, (3) the magnitude of leverage induced non-convertible senior securities of equal or greater seniority to those outstanding, (4) changes in firm value are positively related to changes in firm debt level, and (5) lower bound estimate of the firm valuation effect per dollar change in debt were found to be in the range of .23 to .45.

Peddina Mohan Rao (1985)\textsuperscript{13} has studied "The impact of debt-equity ratio on profitability-An exploratory study of Engineering Industry in India", in which he reveals that profitability had negative association to debt-equity ratio. In case of high debt-equity ratio profitability decreased due to large interest payment and in the case of low debt-equity ratio, profitability increased because of low-interest payment.

Khandelwal R.S. (1987)\textsuperscript{14}, in his study entitled, "Analysis of Capital Structure in Paper Industry of India", had probed into the capital structure of small and large paper units in India. The research study, which was submitted to Saurastra University, in 1987, had the objectives of

i) Examining the profitability in relation to the capital structure,

ii) Evaluating the value of the sample units,

iii) Making a comparative study of capital structure of large and small units and

iv) Empirically testing various theories of capital structure. The whole study was based on data collected for 14 large paper units and 24 small paper units. The relevant data were collected from annual reports of sample companies. The researcher also met some


of the executives of the sample companies for collecting information. The researcher had used analytical tools like ratio analysis, trend analysis, common size analysis, correlation, central tendency, etc. He had concluded that the value of a firm and its cost of capital were independent of each other. Large paper mills confirmed to Modigliani and Miller theory while the small units supported traditional views of capital structure. The capital structure of large units was more efficient than small units. The study was based on a smaller sample size of only 38 units. The thrust of the study was to compare large sized paper mills with smaller sized units.

Sharma R.P. (1988)\textsuperscript{15}, presented a research report on "Corporate financial structure" with the objectives as

i) analyse financial structure so as to assess the automobile companies in making sound financial decisions,

ii) Suggest ways to increase profitability without additional financial obligations,

iii) Suggest sources from which additional funds can be obtained and the uses which can maximise the welfare of the concern in particular and society in general and

iv) To test the long term and short term solvency or financial position of the companies in order to suggest ways by which the financial solvency of the automobile companies under study can be improved.

Sheridan Titman and Roberto Wessels (1988)\textsuperscript{16} in their study on "The Determinants of Capital Structure Choice", introduced a factor-analysis technique for estimating the impact of unobservable attributes on the choice of corporate debt ratios. While the returns were not conclusive, they served to document empirical regularities that were consistent with existing theory in particular; they found that debt levels were negatively related to the uniqueness of a firm's line of business. The evidence is consistent with the earlier belief that can potentially impose high costs on their customers, workers and suppliers in the event of liquidation of lower debt ratios. The results also indicate that transaction costs may be an important determinant of capital structure choice. Short-term debt ratios were shown to be negatively related to firm size, possibly reflecting the relatively high transaction costs small firms face when issuing long term financial instruments.

Michael Pinegar J., and Lisa Wilbricht(1989)\textsuperscript{17}, in their article, "What Managers Think of Capital Structure Theory", maintain that corporate managers are more likely to follow a financing hierarchy than to maintain a target debt-equity ratio. Further, models based on corporate and/or personal taxes and bankruptcy and other leverage-related costs are not as useful in determining the financing mix, as are other models. However, the importance managers attach to specific capital structure theories is not related to managerial perceptions of market efficiency. Thus most managers do not relate firm value with capital structure adjustments. In general, financial planning principles are more important in governing the financing decisions of the firm that are specific capital structure theories.

Anup Agarwal and Nandu J. Nagarajan (1990)\textsuperscript{18}, presented a research paper on, "Corporate capital structure, agency costs, and ownership control: The case of all-equity firms". In this study, they attempted to reveal that all equity firms (Firms which use no long-term debt over a continuous five-year period) exhibit greater levels of managerial stock holdings, more extensive family relationships among top management, and higher liquidity positions than a matched sample of levered firms. Further, it leads that, the managerial control of voting


rights and family relationships among senior managers are important factors in the decision to eliminate leverage. Their main findings are:

i) Managers of all-equity firms have significantly larger stock holdings than managers of similar-sized levered firms in their industry,

ii) There is significantly greater family involvement in the corporate operations of all-equity firms than in levered firms,

iii) Managerial ownership in all equity firms is positively related to the extent of family involvement, and

iv) All-equity firms are characterised by greater liquidity positions than levered firms.

Harish Hanoa (1990)\textsuperscript{19}, in his study entitled, "Capital Structure and Financing of Sugar Industry in India", had the objective of examining the capital structure of both joint stock sector and the co-operative sector sugar mills. It also examined the equity-debt proportion in the two segments with a view to determine whether they have evolved the optimal capital structure. Harish Hanoa collected data from the primary and secondary sources. The primary data were collected from the sample units. The secondary sources comprised Stock Exchange Official Directory, Indian Sugar Mills Association and IFCI. The sample

nsisted of 50 Units from joint stock sector and 25 units from co-operative sector. He used ratios and statistical techniques such as correlation and regression to analyse the capital structure. He concluded that the sample units had optimal capital structure and working capital requirements were met by short-term finance provided by banks and financial institutions. The capital structure of co-operative sugar mills differed from joint stock sugar mills. The single industry study did not look into the effect of cost of capital on the capital structure.

Matta N.S. (1990)\textsuperscript{20}, in his Ph.D., thesis entitled, "A Study of the Pattern of Corporate Financial Structure in India", aimed at studying

i) the pattern, if any, in the inter industries variation in financial structure, which are associated with the characteristics of different industries,

ii) the pattern of financial structure, if any, caused by the variation in corporate size, and

iii) the variation in the financial structure of companies caused by the different growth rates. He collected data from the 75 companies included in his sample from the published annual reports of the companies, RBI Monthly Bulletin, Reports of Industrial Credit and Investment Corporation of India, Kothari Economics and Industrial

\textsuperscript{20} Matta, N.S. "A Study of the Pattern of Corporate financial structure in India", An unpublished Doctoral dissertation, University of Delhi 1990
Guide, and Bombay Stock Exchange Official Directory. He used various statistical tools and ratio analysis to study the financial structure of companies. The result of his analysis revealed that two variables, viz., industry size and growth were the significant determinants of financial structure. The empirical findings of the study supported the hypothesis of capital structure's dependency on growth, size of industry, though in some cases the results were not as favourable as expected.

Milton Harris and Aruthor Raviv (1991) issued a paper on "The theory of capital structure" which surveys capital structure theories based on agency costs, asymmetric information, product / input market interactions, and corporate control considerations (but excluding tax based theories) for each type of model, a brief overview of the papers surveyed and their relation to each other is provided. They concluded that the theories surveyed have identified a great many potential determinants of capital structure (in addition to taxes). Based on the study, a fairly small number of "general principles" is evident. This area is still in infancy and is short on implications relating capital structure to industrial organisation variables such as demand and cost parameters, strategic variables etc. Nevertheless, it is essential that empirical work be directed specifically at sorting out which effects are important in various contexts.

Yesoda Devi (1992)\textsuperscript{22}, has studied "Cost of capital and capital structure of Indian industries" with the objectives of

i) analysing the components of capital structure of selected industries,

ii) studying the relationship between the capital structure and cost of capital and

iii) ascertaining the influence of selected ratios on cost of capital.

The study was a doctoral research work submitted to Bharathiar University, Coimbatore. She collected data from 87 sample units that were classified into ten categories. The required data were collected from the Bombay Stock Exchange Directory. The capital structures of sample units were analysed by using debt equity ratio, price-earning ratio, pay out ratio, etc. Simple statistical tools like mean and co-efficient of variation were used for analysis. She concluded that the extent of relationship between capital structure and cost of capital varied from company to company. The weighted average cost of capital was sensitive not only to the proportion of capital components but also to earnings per share, retaining ratios as well as market price of the shares. Debt equity ratio was one of the factors, which affected the cost of capital.

Subarna Sarkar (1993)\textsuperscript{23}, in her doctoral research work on “Capital structure and productivity of capital in Indian corporate sector” had the objectives of

i) analysing the pattern and distribution of capital structure,

ii) assessing the parameters revealing the productivity of capital,

iii) appraising factors that helps in ascertaining the optimum capital structure,

iv) evaluating the impact of such factors on the capital structure and its productive power, and

v) ascertaining the capital structure that yields the maximum capital productivity under given circumstances in the corporate sector. She had selected 15 companies from private sector and 14 from public sector in textile industry as samples for her study. The data for this study were collected from Bombay Stock Exchange Directory, Reports of Bureau of Public Enterprises Survey and Reports of the Textile Committees in India and other secondary sources.

She concluded that a greater debt oriented financing in public sector enterprises during the overall period and positive trends of private sector companies shows that such profits are retained in business for

augmenting the resources. The level of leverage directly reflects the distribution of capital structure. The total coverage and structural ratios of private sector companies has been better than those of public sector. Capital productivity measures indicates that the changes in the use of capital per unit of output which was influenced by a large variety of factors, many of whom are beyond the control of individual enterprises. Though the private sector and public sector were polls apart in terms of their approach to managerial problems, the study compared the capital structure of both the sectors.

Rajeshwari Rao (1994)\textsuperscript{24}, in her study entitled, "Impact of capital structure decisions of operating performance of State Enterprises in Andhra Pradesh", had the objective to analyse the impact of capital structure decisions in public sector enterprises Andhra Pradesh on their operating performance. Her study was based on data collected form 22 state enterprises. The data for the study were drawn from circulars, publications, consolidated annual reports published by the department of public sector undertakings of the Government of Andhra Pradesh. She analysed the capital structure by using debt equity ratio, current ratio, price earning ratio, proprietor's ratio, etc. She also examined the behavior of the above all variable by computing index number for ten years. She

concluded that the process of capital structure planning was not a one
time job, but needs revision and monitoring through time in different
situations. Her conclusion also clearly exhibits that finance executives of
state enterprises are not paying adequate attention to the multi-
dimensional implications for the capital structure decisions.

Greg Filbeck, Raymond F. Gorman and Dianna C. Preece (1996) submitted a research paper, titled, “Behavioural aspects of the Intra-
industry Capital Structure decision”, in which they examined that firms
may actually make financing decisions following the trend set by some
industry leader. In other words, a certain firm within an industry is a
“leader” and the other firms in the industry are “followers”, will try to
emulate the leader’s capital structure decisions. Applying the concepts of
prospect theory and self deception to financial manager’s decision
making may provide important insights into the way firms make choices.
However, this field is in its infancy and much work remains to be done.

and the Cost of Capital – A Suggested exposition”, has examined the
firm’s capital structure and the efficient opportunity curve of yield versus
risk. The capital structure theorem was formulated stating that the firm’s

25 Greg Filbeck, Raymond Filbeck, Raymond F. Gorman and Dianna C. Preece, “Behavioural aspects
of the intra-industry capital structure decision”, Journal of Financial and Strategic Decisions, Vol.9,
cost of capital is constant along with the range of efficient structure and rises at the inefficient range. Since the range of efficient capital structure was shown to depend on the market structure, interest rates, it followed that the shape of the cost of capital curve is determined by the interest rate structure. It was therefore concluded that, in a perfect capital market where the interest rate is constant and capital structure is efficient, the cost of capital is constant. When a firm’s borrowing rate rises and the investor rate is constant, the range of efficient capital structure is limited. The highest efficient financial leverage is determined where the firm’s marginal borrowing rate equals the investor rate. The cost of capital is therefore constant along with the range of efficient capital structure and rises along with the range of inefficient capital structure affecting the shape of the cost of capital curve. This analysis was carried out under the constraint that the investors have the opportunity to invest their own capital with any borrowed capital either in stocks or in riskless bonds.

Dev Prasad, Garry D. Broton and Andreas G. Merkas (1997)\textsuperscript{27} presented a research paper on “Long – run strategic capital structure” in which they analysed to confirm the link between capital structure and strategic posture of the firm. Specifically, managers were found to structure the selection of debt and capital intensity in a means consistent

with the strategic goal of long-run control of systematic risk. Therefore, the efficacy of a strategic perspective of capital structure will be examined by investigating the control of systematic risk in firms over long term through the adjustment of the firm’s capital structure. They concluded that their study demonstrates the relevance of the concept of long run strategic capital structure. Further, their empirical findings suggest that the interaction between asset and financial structure explains a large portion of the variation in beta. Managers do engage in trade offs to control and maintain the strategically selected level of systematic risk and that trade off is stronger at higher level of systematic risk.

Ramlcumar Kakani (1999)\textsuperscript{28}, in his study has analysed the debt structure of large Indian private manufacturing firms during pre and post liberalisation periods found that liberalisation, profitability, capital intensity and non debt tax shield are important determinants of capital structure.

Mahesh Chand Garg and Chander (2002)\textsuperscript{29}, has made the study on “The determinants of Capital Structure in India”. They have selected cotton, chemical, engineering and cement industries for analysing the debt structure that underlines the determinants of capital structure. They have concluded that assets composition, collateral value, life and


Corporate sizes are the significant factors in deciding the capital structure of these industries.

The studies reviewed in this chapter are all related to the capital structure of various industries and to the financial performance of some specific industries. Intense analysis has not so far been done with reference to the capital structure of paper industrial units, especially TNPL and that of SPBL.

This study systematically analyses the capital structure of the two companies from various angles. First in-depth analysis is done with reference to the capital structure of TNPL, which is a public sector undertaking. Then the capital structure of SPBL, which is one of the prominent private sector units is analysed in detail. Then the financial performance of both companies are compared and ratios are calculated. Statistical tool such as ‘t’ test is used for analysing the difference of means of units. This study is unique in this aspect and a pioneer in analysing the structure of two prominent paper industrial units in the State of Tamil Nadu.
OBJECTIVES OF THE STUDY

The following are the objectives of the present study.

1. To study the financial performance of TNPL and SPBL.
2. To examine the factors that influence the capital structure decisions.
3. To compare the capital structure of TNPL and SPBL.
4. To analyse the extent of debt used in the total capital structure of both the companies in order to know whether the companies utilise the leverage benefits to the fullest extent possible.
5. To offer suggestions for the betterment of the capital structure based on the findings of the study.

HYPOTHESES

The following hypotheses are framed and tested in this study:

1) Debt equity ratio significantly differs between SPBL and TNPL.
2) Capital gearing ratio significantly differs between selected sample units during the study period.
3) Return on investment significantly differs between the study units during the study period.
4) EBIT/Interest charges ratio significantly differs between SPBL and TNPL.
Apart from the above hypotheses, a few more are also framed and tested in this study.

METHODOLOGY

The methodology adopted in the present study is as follows.

Collection of data:

This study is based only on secondary data. The data required for the study was taken from the published annual reports of the TNPL and SPBL and the figures of the amount have been rounded off to its lakhs value. Appropriate information on both mills was also collected from other secondary sources like websites viz. www.tnpl.co.in. of TNPL, and www.spbltd.com. of SPBL.

Data also have been collected from Institute of Financial Management and Research, Chennai, which helped the researcher to widen his knowledge of the problem. The researcher also had fruitful and comprehensive discussion with senior officials of both TNPL and SPBL.

Statistical tools used:

Ratio analysis and variables related to capital structure like weighted average cost of capital and value of firm have been applied to analyse the capital structure and financial performance of the sample companies. The formulae used for analysing the collected data are given separately.
The data have been analysed by using financial ratios and interpreted through descriptive statistics such as mean, standard deviations etc., are used to study the selected financial parameters.

The growth of the company’s capital structure is analysed by applying growth rates and trend analysis.

Correlation and regression analysis has been applied to study the relationship among the variables, like, profitability, weighted average cost of capital and various ratios of capital structure aspects.

Further ‘t’ test for testing the equality of means for different ratios and is used to find whether there is any significant difference between the average financial performance of the companies under study or not.

Discriminant analysis is used in ratio groups for the purpose of analysing the discriminant function on linear combinations of independent variables.

And multiple regression analysis is used to find out the extent of relationship between a dependent and a group of independent variables.

PERIOD OF STUDY

This study covers a period of ten years from 1994-1995 to 2003-2004.
LOCATION OF STUDY UNITS

Location of TNPL

TNPL’s corporate office is located in Chennai and its factory is situated at Kagithapuram, in Karur District about 13 kilometers to the north of Karur on the south bank of the Cauvery.

Location of SPBL

SPBL is also located at the bank of river Cauvery and it is situated 40 kms to the west of Namakkal in Namakkal District.

LIMITATIONS OF THE STUDY

The researcher had taken all the necessary steps to carry out the research. The data and information published by these organisations, have been collected and used for this study. Every possible care has been taken for the analysis and data processing at various stages. But the study is confined to the financial planning consisting of performance, capital structure and cost of capital alone.

Profitability depends on many factors including operational efficiency. But the study is limited to examine how far the financing decisions can influence the profitability of both the organisations.

The study includes the two major paper industries in Tamil Nadu. Paper industry at the All India level is not referred to because it can be used only for comparison. Any profitability improvement based on factors other than capital structure is not within the purview of this study.
It is not within the scope of this study to look at the technical aspects of plant and machinery connected to profitability.

This study is restricted to TNPL and SPBL only. Of this TNPL is a state government undertaking and SPBL is a private sector unit in paper industries.

CHAPTER SCHEME

The study is presented in Seven chapters as follows:

The **first chapter** deals with introduction, statement of the problem, scope of the study, review of literature, objectives, methodology, collection of data, statistical tools used, location of the study unit, limitations of the study and chapter scheme.

The **second chapter** contains a broad outline on capital structure theories.

The **third chapter** presents an overview of paper industry and profile of the select companies.

In the **fourth chapter** an analysis of financial performance of TNPL is given.

An analysis of financial performance of SPBL is given in the **fifth chapter**.

The **sixth chapter** compares the capital structure of TNPL and SPBL.

The **final chapter** summarise the major findings, suggestions and conclusion of the study.