CHAPTER 3-THE FINANCING DECISIONS

3.1 INTRODUCTION

The most crucial function managing the corporate finance function is the Financing Decisions. Every corporate has many options of raising funds, viz. making use of internal accruals, Selling Equity, Creating a liability by issuing a bonded debt or term loans from Financial institutions. Each of these options has its advantages and disadvantages. The short term as well as long term implications of these decisions is to be visualized before any decision on the financing is finalized.

The option or source which may be most relevant for one corporate may not be so for other corporate. The management thinkers have developed several theories in regard to the financing decisions. Each of these theory/Approach or concept focuses on a specific angle of the financing decisions.

3.2 THEORIES / CONCEPTS / APPROACHES IN FINANCING DECISIONS

Ad hoc Approach: The advocates of this approach state that, firms rely on the rule of thumb rather than the discounted cash flow. Dews (Nigel Dews, John Hawkins and Tracey Horton, 1992) et al advocated ad hoc approach. As the name indicates this approach lacks the generality. Ad hoc approaches are considered to compensate the anomalies not anticipated by the theory in its unmodified form. The supporters of this approach state, the firms do not have a specific preference for any particular type of source of finance. The financing decisions of the firms, following ad hoc approach, are based on the circumstantial situations, case to case basis, or for a specific purpose.
Particularly the following normative statement/s is / are being considered by the researcher during this study.

FD-1.Smaller Firms rely on Rule of thumb rather than the discounted cash flow methods.

**Agency Cost Theory:** The personal aspirations are prioritized over objectives of the company and expectations of shareholders. In professional organizations, the distinct categorization between ownership and Control is followed. The shareholder’s are the owners of the firm and the professional managers are (which may include the executive directors of the firm) appointed to run the organization in accordance with, the objectives of the firm. Ideally the objectives of the firm like wealth maximization or value of the firm should also be the objective of the said employee hired by the owner. Typically, owners are called as principals and the employees are called as the Agents. As ownership and Control differs, the conflict between the agents and principals may take place. The individual goals of the agent, when differs that from the principal, which is explained by the agency cost theory. The short term objectives of the managers may be prioritized against the long term goals of the organization. This may have implication on the composition of the capital of the Firm.

Particularly the following normative statement/s is / are being considered by the researcher during this study.

FD-2.Agency costs and asymmetric information as well as corporate control considerations seem to affect the capital structure of firms.

FD-3.External Financing issuing debt is better than issuing stock, when the managers have superior information.

FD-4.Entrenchment has no effect on Leverage

**Asymmetric Information:** When one of the party in transaction, is having, superior information than the other one then it is termed as asymmetric information. With the
advancement of technology and increased data communication speed. Asymmetric information is on decline. This asymmetry leads to adverse selection and moral hazard. While deciding the capital structure, Information Asymmetry may have implication on the capital structure of the firm.

Particularly the following normative statement/s is / are being considered by the researcher during this study.

FD-5. Asymmetries in information leads the firms to under-invest due to problems in communication the credibility to outsiders.

FD-6. Firms systematically adjust their Capital Structure to the target level.

FD-7. Asymmetric information regarding firms prospects causes dilution leading to adverse selection and insufficiencies in market.

Bankruptcy Cost: These are the increased costs of financing, particularly the debt financing, when the probability of bankruptcy increases the cost of financing also goes up. When the firm is on the verge of bankruptcy. Higher the possibility of bankruptcy, higher would be the expectation of the investor (lender). It is clear that, the firms, having less market standing, firms yet to prove their creditworthiness, would have the higher bankruptcy costs.

Particularly the following normative statement/s is / are being considered by the researcher during this study.

FD-8. Banks finance themselves with Deposits only Specialize in lending to one sector

C A P M (Capital Asset Pricing Model): The Required rate of return of an asset can be calculated with the help of C A P M model, if the asset is added in the existing portfolio. The model says expected return of a security or a portfolio is equal to risk free rate of return plus
the risk premium. If the expected rate of return does not match with the required rate of return, then such investment should not be considered. A model that describes the relationship between risk and **expected return** and that is used in the pricing of risky securities.

\[
\bar{r}_a = \bar{r}_f + \beta_a (\bar{r}_m - \bar{r}_f)
\]

Where:
- \( \bar{r}_f \) = Risk free rate
- \( \beta_a \) = Beta of the security
- \( \bar{r}_m \) = Expected market return

The riskiness depends on the beta of the security. Securities having high Beta are perceived to be risky.

Particularly the following normative statement/s is / are being considered by the researcher during this study.

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FD-9.CAPM usually assumes either that the returns on assets are **normally distributed or that investors have quadratic utility functions.**

**Cost of Capital:** The cost of using funds is the cost of capital. Funds include own funds as well as borrowed funds. The investor’s expectation from the firm is the cost of capital. The Cost of Equity is

\[
Ke= \left( \frac{D}{P} \right) + g
\]

where: D is dividend per share

\( P \) is Market Price per Share

\( g \) is Growth expected (in \%) 

\( K_p \) = Cost of preference Share
\[
\frac{D + \frac{(M.V. - N.P.)}{n}}{\frac{1}{2} (M.V. + N.P.)}
\]

Where D = Annual Dividend  
MV = Maturity Value of the Preference Share  
NP = Net Proceeds of the Preference Share  
n = Number of Years

Kd = Cost of Debt

\[
\frac{I + \frac{(M.V.-NP)}{n}}{(M.V. + N.P)/2}
\]

Where I = Interest Payable per Debenture  
MV = Maturity (Redemption value)  
NP = Net Proceeds per Debenture  
n = No. of Years

Particularly the following normative statement/s is/are being considered by the researcher during this study.

FD-10. Cost of Debt would be uniform irrespective of the size of the Firm.

FD-11. Large, Liquid, Profitable firms with low distress costs use debt conservatively.

**Debt Equity Ratio:** As the name indicates the ratio is a measure of companies indebtedness to the lenders. This ratio can be further classified into long term debt and short term debt with the equity. The nature of business / type of industry does matter, while analyzing the D/E ratio. D/E ratio of 10 can be considered as normal in case of a firm which is in banking / financial services business, however the same ratio is not desirable for a manufacturing company. It is but natural, that the companies having high D/E ratio, are stressed because of the burden of high interest payment and repayment of the capital.

Particularly the following normative statement/s is/are being considered by the researcher during this study.
FD-12. The distribution of holding the Debt and Equity is not Country Specific.

FD-13. The Firm always Selects its Optimal Debt Equity ratio to minimize its Weighted Average Cost of capital irrespective of the Risk attitude of the firm.

FD-14. The target Debt-Equity ratio changes over time as, firms profitability and Stock price Changes.

FD-15. Equity Ratio is directly correlated with the Value of the Firm.

FD-16. There is a Strong relationship between Debt Ratio and ROA.

**Efficient Market Hypothesis (EMH):** it is believed that the markets are efficient. Which means all the necessary information needed by an investor is available to him, to take investment decision. There are three forms (Versions) of EMH viz. Weak, Semi Strong and Strong EMH. The Weak form believes that, prices of assets being transected (Viz. Property, Stocks, Debt) already reflect the information available. The Semi Strong form believes that, though the prices are reflecting the available information, prices would suddenly change to new information available. The Strong form of EMH believes, prices suddenly change even to any hidden or insider information. EMH and random Walk hypothesis are closely associated.

Efficient market hypothesis gained prominence in 60’s. This hypothesis believes that in absence of any change in the fundamental information the price of asset moves randomly.

Particularly the following normative statement/s is / are being considered by the researcher during this study.

FD-17. The efficient markets hypothesis holds that a market is efficient if it is impossible to make economic profits by trading on available information.

FD-18. Evidence for efficient markets model is extensive

**Financing Decisions:** The Theories / Concepts / Approaches in the area of financial decisions which cannot be further classified into any theory related to financing, has been grouped in general as, Financing Decisions.
Particularly the following normative statement/s is / are being considered by the researcher during this study.

FD-19. Development of Modern Capital Market Theory has an empirical evidence
FD-20. Shareholders have an incentive to substitute 'Risky' for 'Less Risky' operating and Investment policies.
FD-21. Stock prices decline due to wealth transfers to from current stockholders to purchasers of new convertible Debt, can be empirically explained.
FD-22. Significant negative abnormal returns accrue on average to common stockholders of the firms offering new offerings of convertible and straight debt.
FD-23. Firms Borrow more to invest in Structures than in Equipments
FD-25. Financing and Investment Decisions are in general, independent.
FD-26. Small Recapitalization cost would lead to wide swings in firm's Debt Ratio, overtime.
FD-27. Increase in average level of indebtedness across firms may cause the economy to become more vulnerable macroeconomic Shocks.
FD-28. Assets with high liquidation Costs lead the firms to choose Capital Structure that makes Financial Distress Less likely.
FD-29. Theoretical underpinnings of observed correlations are largely resolved.
FD30. Profitability is negatively related to leverage.
FD-31. Tangibility, Size, Profitability and Growth opportunity are the Consistent Variables for Capital Structure.
FD-32. The relationship between Capital Structure and Profitability of a firm can not be established.
FD-33. Debt and Lease contracts are independent.
FD-34. Increase in lease financing has no effect on the Optimal Leverage Ratio.

FD-35. Leverage and Debt maturities are independent of macroeconomic factors.

FD-36. Capital Structure and Dividend payment is independent.

FD-37. FDI has no correlation with the maturity period of Debt.

Financial Performance Management: Performance of the firm is measured and compared with the benchmark, to assess the efficiency. In Financial Performance Management, for assessment and comparison purpose ratios are extensively used. Four broad types of ratios, viz. Liquidity Ratios, Profitability Ratios, Capital Structure (Leverage) Ratios and Activity/ Efficiency / Turnover Ratios. While assessing the financial performance, the relevant benchmark Standards are considered. For different Industries the parameters would differ. While evaluating the Financial Performance of a firm, the comparison of Historical data is important.

Particularly the following normative statement/s is / are being considered by the researcher during this study.

FD-38. Cost of capital and value of firm do not change with a change in leverage.

FD-39. Firms use their investment in fixed assets as a strategic variable to affect profitability.

FD-40. Change in Capital Structure and Value of the firm are Correlated.

Modigliani and Miller Approach: After extensively studying the Capital Structure theories, Modigliani and Miller proposed the irrelevance model. The professors observed that, the mode of financing of Capital Structure is irrelevant as far as the value of the firm is concerned. According to them the market value of the firm depends on the earning power of the firm. The model proposed following assumptions, There are no taxes, no transaction and bankruptcy costs, there is no information asymmetry.

In reality none of the assumptions would be possible. Modigliani and Miller proposed MM-II, which deals with the WACC (Weighted Average Cost of Capital).
The M M approach justifies the possibility of almost unlimited debt, in reality such a scenario would be very complex and may lead to undesirable situation.

Particularly the following normative statement/s is / are being considered by the researcher during this study.

FD-41. As the degree of leverage increases, the ratio of less expensive source of funds (debts) increases; while that of equity (involving higher cost) decreases.

FD-42. The investors (arbitragers) are able to substitute personal or home made leverage for corporate leverage (MM APPROACH)

FD-43. The relationship between a firm's debt level and that of its industry does not appear to be of concern to the market.

FD-44. The expected future financial deficit is a significant determinant of the current choice of debt versus equity, and profitable firms have a higher target leverage.

FD-45. Firms would issue as much secured debt as possible.

FD-46. The firm's leverage is independent of the industry.

FD-47. Value of Debt is relatively insensitive to firm's performance

FD-48. The Capital Structure is dynamic and the persistent of leverage changed over the period of time.

**Mergers and Acquisitions**: Buying one company by other company is Merger. The Acquiring Company controls the target company. When the taking over of Target Company is willful, it is considered as friendly merger where as when the same is forceful it is termed as hostile merger. Merger is a complex process. The real objective is synergizing the operations of both the entities. One the basis of the synergy, further the merger can be of Horizontal, Vertical, diversified conglomerate merger, Co generic mergers, Cross border merger and like. Merger and Acquisition in a prudent way of growing inorganically.
FD-49. Threat of Hostile takeover motivates Managers to avail Debt, which otherwise they would not have availed.

FD-50. Capital structure is relevant, as a change in it will lead to a corresponding change in the cost of capital and the total value of the firm. (NI APPROACH)

Particularly the following normative statement/s is / are being considered by the researcher during this study.

FD-51. Capital structure is irrelevant, as an increase in the proportion of debt would lead to Increased financial risk of shareholders, who would expect higher rate of return. (NOI APPROACH)

FD-52. 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.

FD-53. The currently popular real business cycle paradigm proceeds under working hypothesis that financial structure is irrelevant.

**Net Income Approach:** This approach states the relationship between the value of the firm and Capital structure of the firm. The Capital Structure influences the cost of capital as well and hence the value of the company. Here, Cost of Capital is , W A C C . This approach believes increasing leverage (Debt) will not increase risk. It also assumes Cost of Debt (Kd) is Less than Cost of Equity (Ke)  Kd< Ke. It assumes there is no income tax. N I Approach proposes that , WACC would be minimum when high amount of debt is used in capital structure which would increase the value of the firm. The Company would be having High value ,when WACC is minimum , and this happens when the firm is financed almost entirely by the debt.

Particularly the following normative statement/s is / are being considered by the researcher during this study.

FD-54. Capital structure is relevant, as a change in it will lead to a corresponding change in the cost of capital and the total value of the firm. (NI APPROACH)
**Net Operating Income Approach (NOI):** This approach is opposite of the NI approach. NOI approach believes, Kd, Cost of Debt is Constant, WACC is also constant. Corporate income tax does not exist. This approach proposes higher debt would increase the risk, in turn, it would increase the cost of Equity. The supposed benefit of low cost of equity would be compensated by the higher cost of equity. Value of equity = Total Value of Firm - Value of Debt.

Particularly the following normative statement/s is/are being considered by the researcher during this study.

FD-55. Capital structure is irrelevant, as an increase in the proportion of debt would lead to increased financial risk of shareholders, who would expect higher rate of return.

FD-56. 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.

FD-57. The currently popular real business cycle paradigm proceeds under working hypothesis that Financial structure is irrelevant.

**Optimal Capital Structure:** It is that ratio of Debt and Equity, where the cost of Capital is minimum. Ideally, higher proportion of Debt in the overall capital Structure would reduce the cost of capital, but it will increase the risk. In real life it is very difficult to find out and maintain an optimal capital structure.

Particularly the following normative statement/s is/are being considered by the researcher during this study.

FD-58. Unique Optimal Capital Structure exists in the steady State if non debt Corporate tax Shields like Depreciation Deductions, Investment Tax Credit are Introduced.

FD-59. Optimal Debt levels are similar to those observed in practice.
FD-60. Determinants of Capital Structure are universal across the Companies.

Pecking Order Theory: It was observed by Donaldson, that firms utilize internal financing over external one. The firms use retained earnings, when external financing is tapped, firms issue debt rather than issuing the equity. The corporate adhere to the hierarchy for financing. Myers and Majluf proposed the theory on the basis of Information Asymmetry. When managers are assumed to know more about the position of the company, and issue new equity, the investors perceive that managers are aware that the firm is over valued. Then in such a situation the investors would place low value to the new equity issue.

Particularly the following normative statement/s is / are being considered by the researcher during this study.

FD-61. Firms which prefer to finance their investment activities through self-finance are More profitable than firms which finance investment through borrowed capital.

FD-62. When and Why firms issue common stock is not fully understood as yet.

FD-63. Firms Follow Pecking order While Offering the Securities through the IPO.

FD-64. Pecking Order Model has greater confidence level than Trade-Off Model.

FD-65. Conservative Firms follow Pecking Order style of Financing Policy.

FD-66. The Financial Structure of Quoted and Unquoted Firms is as per Pecking Order theory.

FD-67. Larger firms have better access to External Finance than Smaller Firms.

Signaling Theory: The basis of this theory is in information asymmetry. Information is not available to all the parties at the same time. This may lead to low valuation of the firm. This theory believes that, that corporate finance decisions are the signals sent by the companies managements to the outsiders(investors). These signals counter attack the information
asymmetry. Certain corporate finance decisions like declaration of dividend, is perceived as future profitability of the company.

Particularly the following normative statement/s is / are being considered by the researcher during this study.

FD-68. Signaling theory suggests a positive relationship between a firm's financial leverage and Cash flow, while pecking order behavior implies a negative relationship.

FD-69. Capital Structure does matter and is consistent with Information Signaling Hypothesis and Agency Cost Hypothesis.

**Stakeholder’s theory:** This theory proposes, objective of any business is to create value. The business managers need to keep the interests of all the stakeholders’ viz. Shareholders, employees, customers, vendors etc. in line with the objective of creating and sustaining the value of the firm. This theory has major focus on what is the purpose of the firm ? and What responsibility the management have to stakeholders?

Particularly the following normative statement/s is / are being considered by the researcher during this study.

FD-70. Extent of leverage in Capital Structure and the Wage policy of a firm are independent.

FD-71. Human Assets Specificity has no co relation with the Firm's Capital Structure.

**Tax Shield:** Inclusion of debt component in the total capital structure would reduce the corporate tax liability of the firm is tax shield.

Particularly the following normative statement/s is / are being considered by the researcher during this study.

FD-72. The Tax advantages of Debt must be balanced against Bankruptcy and Agency Costs.

3.3 – **CHRONOLOGICAL REVIEW OF RESEARCH PAPERS STUDIED**
The Research papers and Academic text has been reviewed in detail in the domain of the financing decisions taking into account the above referred theories/ Approaches.

Dews (Nigel Dews, John Hawkins and Tracey Horton, 1992) et al advocated ad hoc approach. As the name indicates this approach lacks the generality. Ad hoc approaches are considered to compensate the anomalies not anticipated by the theory in its unmodified form. The supporters of this approach state, the firms do not have a specific preference for any particular type of source of finance. The financing decisions of the firms, following ad hoc approach, are based on the circumstantial situations, case to case basis, or for a specific purpose.

In their study Jensen (Michael C Jensen and William H Meckling., 1976) says millions of people have invested billions and billions of Dollars (Amount) of personal wealth to the care of managers. The growth in the market value of corporations suggests that up till now creditors and investors have not been disappointed, despite the inherent agency cost. Hence agency cost does not affect the capital structure of the firm.

In the study of effects of firm’s investment decisions on the welfare of it’s security holders Fama (Eugene F Fama, 1978) he noted that Modigliani and Stiglitz(1972) found that firms can issue risky debt, the market value rule for investment decisions of firms is ambiguous. With risky debt stockholders wealth, bondholders Wealth and combined bondholder’s and Stockholder’s wealth imply three different business decisions. So as per Fama’s study Cost of Capital and value of the firm do not change with changing leverage does not hold true.

In his study of determinants of Corporate borrowing Myers (Stewart C Myers, 1976) observed the corporate borrowing is inversely related to the proportion of market value accounted for by real options and so cost of capital and value of the firm does change with change in leverage.

Researchers tried to find the probable causes of difference between the internal and external costs of finance. The important agenda in finance is to study whether difference between
internal and external finance is caused because of information asymmetries, poor contracting
conditions, agency problems or government policies. Desai et al. (Mihir A. Desai, C. Fritz
Foley and James R. Hines Jr, 2003). The study revealed that affiliates of multinational parent
companies, working in underdeveloped capital market conditions and weak creditor protection
face higher interest rates, than their counterparts in other countries. To tackle this situation
firms borrow less from the external sources and more from the parent companies. Their result
confirms that because of lower affiliate leverage and greater affiliate borrowing from parent
and substitution between internal and external funds countries with poor creditor protection
norms and weak capital markets offer more advantage to multinational firms than local firms.
Affiliate to parent lending is significant factor in deciding the capital structure of such firms.
Capital Structure has been studied by many, and the lateral views are examined by the
researchers in the field. Managerial Entrenchment is one of the aspects studied by the
researchers in the field of corporate finance. Managerial entrenchment occurs, as described by
Weisbach(1988) “when managers gain so much power that they are able to use the firm to
further their own interests rather than interests of shareholders”. This may lead to investment
decisions by such managers, which may be valuable under themselves, rather than other
managers. Such investments may not maximize the value of the firm and hence benefit the
shareholders. Capital structure decision and entrenchment issue has been studied by berger
et, al by analyzing a panel data of 434 firms between 1984-91. Jensen and Meckling theory of
agency cost is followed by the researchers, which proposes that managers do not always adopt
a capital structures with value maximizing level of debt. Berger et, al (Philip D Berger, Eli
Ofek and David L Yermack, 1997) found, leverage levels are lower when CEO’s do not face
pressure from either ownership and compensation incentives or active monitoring. They also
found leverages are lower when CEO’s have long tenure in office. The study infers that
entrenchment does have an effect on leverages.
Managers of the firm play significant role in deciding the composition of capital structure. The percentage of leverage and the further classification such as availing short term or long term debt is decided by the management. Entrenchment has already been studied by other researchers in this compilation. Managerial entrenchment and its effect on the capital structure has been studied by Wang (Hao Wang, 2006). His study shows quantitatively, the degree to which managerial entrenchments negatively influence the values of firm, debt and equity. Further his findings show managers make leverage choices and undertake dividend payout decisions to optimize their own utility and prevent shareholders from exercising their threat to fire managers. He has challenged the conventional thought that managers are always close to shareholders. As the firm approaches bankruptcy the shareholders and managers interests start alignment. This study categorically states that managerial entrenchment has definite effect on firms leverage.

Carpenter concluded in his study that, information asymmetry would lead firms to under-invest due to problems in communicating the firm’s prospects to outsiders and these asymmetries would lead to over investment as managers purchase investment projects that maximize their utility rather than maximizing the value.

Capital structure is static or dynamic? Researchers are studying this aspect since long. In case of a dynamic capital structure how do firms behave in managing their capital structure? Researchers are revisiting the works done by other scholars in the field. Roberts (Michael R. Roberts, 2000) did filtering and modifications of the results of Harvey and Stock (1985).It were observed by him that firms systematically adjust their capital structure to the target level. This target level to which firms adjust the capital structure is a function of firms characteristics.

In the working paper on moral hazard theory Williamson (Scott Williamson, 1979) proposed that, the development of optimal capital structure theory is based on the premise that, value of
the equity maximizes at a level of debt which maximizes market value of the firm. However there is a breakdown of this observation under certain possible conditions. Those conditions produce conflicts between the stockholders and bondholders, which leads to the term application of moral hazard. So relation between company’s debt level and that of the industry to which company belongs does matter to the market.

The information asymmetry has adverse effect on the investment. What would be the effect of such a thing on the convertible security? Would it be adverse or otherwise? Would it cause dilution? Such aspects were studied by Chakraborty and Yilmaz (Archishman Chakraborty and Bilge Yılmaz, 2004). They observed if financial market obtains information about the firm overtime, issuing callable convertible securities, with restrictive call provisions, is optimal.

Bank finance are also a source of capital. Can it substitute the equity financing? Will it be favorable for the firm? What would be the risk perception of the lending bank? All these factors are studied by Allen and Carletti (Franklin Allen and Elena Carletti, 2012). The study observed that when the bankruptcy costs are high, banks finance to only one sector. When bankruptcy costs are low banks diversify in lending. It was observed that equity capital is more costly than bank finance. It was observed in their study that bankruptcy cost of the firm is major factor for the lending bank.

Calomiris and Habbard (Charles W Calomiris and R Glenn Hubbard, 1988) developed a model in which different loan contracts were offered to different types of borrowers. The extent to which loan can be offered was dependent on distribution of internal finance. This shows that financing and investment decisions are interdependent.
Firm derives tax benefits when debt is issued. There are non debt tax benefits called as N D T S, which includes depreciation, investment tax credits. This suggests that debt component in the capital structure is not the only avenue to reap the tax benefit. Graham (John R. Graham, 2000) studied the real effect of tax on the companies decision of selecting the debt in its capital structure. He observed that, large, liquid profitable firms having low distress cost use debt conservatively, also he stated product market factors, growth options, low asset collateral, and future expenditures lead to conservative debt usage. The conservative debt policy is persistent.

The demographic influence is seen on the capital structure. In the preceding research study it has been noted that Indian firms rely more on debt or external finance. Are Chinese counterparts different? Yes. The stake holding pattern in the Chinese firms are different than that of Indian firms. Majority of the Chinese firms have state ownership. The study has been done by Huang and Song (Samuel G. H. Huang and Frank M. Song, 2002). They noted that Chinese firms prefer to issue equity because, once listed these stocks command good price. Second probable reason cited by them is, Chinese bond market is in nascent state. The state own firms never experience financial crises hence equity issuance is preferred by these firms. Banks are the only source for external finance hence firms have to rely on equity financing and trade credit. It clearly observed from this study, that distribution of debt and equity is country specific and not universal across the globe.

The extent and internationalization and the components of the capital has been studied. Is there any effect of cross border transactions, on the capital structure? In turn, does it cause any impact of the overall cost of capital has been studied by Singh and Nejadmalayeri (Manohar Singh and Ali Nejadmalayeri, 2003). These researchers studied the data of French firms and
observed that international diversification positively associates with higher total and long term debt ratios. Their results are consistent with earlier studies, confirming firms having higher internalization have higher debt financing. The higher debt reduces the overall cost of capital despite higher equity risk. The reason for this is MNC’s use foreign currency dominated debt as a hedging instrument. Hence distribution of debt and holding of debt does depend on the extent of internationalization.

Leverage and profitability is studied at length by many researchers. The presence and extent of debt and its effect on profitability is an interesting phenomenon. Further what would be the effect of short term debt on the profitability? Do larger firms have different debt ratios than the smaller firms? Such aspects were studied by Salawu and Oyesola (Salawu and Rifu Oyesola, 2007). Researchers used panel data for 50 non finance companies in Nigeria for the study of the capital structure between 1990-2004. It was observed, Nigerian Companies are financed by equity and short term debt. The access to long term debt in that country is limited. The six determinants of capital structure studied were profitability, tangibility, growth opportunity, size, NDTS and Dividend. They observed that larger firms can better support the higher debt ratios than smaller firms. Further they noted, leverage is negatively correlated with profitability. Tangibility is positively correlated with long term debt but negatively correlated with short term debt. Researchers recommend the government of Nigeria to pursue sectoral allocation and policy should be made to lengthen the maturity of debt.

While assessing the uniformity of the factors affecting capital structure, researchers not only compared the firms on cross border basis, the size and function of the firm was also taken into account. Are there any firm specific factors affecting the capital structure. The demographic or regional specificity was also studied. Kuciac (Marta Kuciac, 2008) studied the large region.
The study was for Small and Medium Industries. This exhaustive study observed that the determinants of capital structure of SME’s differ from that of large firms. For SME’s five firm specific factors are information asymmetry, growth, tangibility, agency problem and bankruptcy. The study noted that, fiscal and bankruptcy aspects affect leverage level of SME most, because SME’s are almost always financed by banks. All SME’s finance their operations on Maturity Matching principle, which means they use tangible assets as collateral for long term debt and current assets as collateral for short term debt. all the SME’s studies were supporting the trade-off theory. Country specific factors determining the capital structure of SME’s are ease of getting credit and efficacy of judicial system. So the study highlights that even for SME’s country specific factors affect the capital structure.

The risk appetite or risk aversion of the management of a corporate is reflected in its capital structure. The bold and at times hyper aggressive managements give preference fulfillment of the need of financial resource. In such case the above discussed pecking order or trade off models are not followed. There are situations where the outcome of any decision is unpredictable. The element of uncertainty sets in. Uncertainty is a state of having very limited knowledge, where possible future outcome cannot be predicted. It is essential to understand and differentiate risk. Risk is a state of uncertainty, where the possible outcome may have undesirable effect. Almost always risk and uncertainty go hand in hand. Broll and Wong (Udo Broll and Kit Pong Wong, 1999) noted that irrespective of the risk attitude of the firm and multiple sources of uncertainty, the firm always chooses its optimal debt equity ratio to minimize its weighted average cost of capital.

Targets are set to be achieved. Once the desired result is reached, then emphasis would be on the maintaining the previously achieved targets. This is how the corporates manage their
capital structures. Here the capital structures are dynamic and changing towards the target ratio. How about changing the target ratios? Hovakimian et al (Armen Hovakimian, Tim Opler and Sheridan Titman, 2001) observed that in contrast to the empirical work and dynamic models, firms may change their target debt ratio. Further, these researchers have observed that, stock price of the firm plays a major role in deciding the capital structure. Firms which experience large positive change in their stock prices are more likely to issue equity and retire debt. This is consistent with the idea that increase in stock price is generally associated with the growth opportunities, which lowers the firm’s optimal debt ratio.

In their research paper on bankruptcy and secured debt Smith and Warner (Clofford W Smith Jr and Jerold B Warner, 1979) have questioned the notion of issuance of secured debt which would increase the firm value by James Scott. Smith and Warner have commented that such an issuance of secured debt would not alter the firm’s value. Their findings are not in line with that of Scott’s.

Effect of Equity ratio, debt ratio on the value of the firm has been studied by Velnampy and Pratheepkanth (Velnampy.T & Pratheepkanth.P, 2012). He studied select Sri Lankan companies on the basis of data from 2006-2010. Researcher found that Equity and Debt ratios have significant impact on the value of the firm. Further they proved that 68.8 % of the variation in equity is explained by the two predictor variables. The researchers have used vary basic ratios like debt equity ratio, EPS, P/E. They used correlation technique for their study. Hence equity ratios are directly correlated with the value of the firm.

One more study concerned with the value has been done for the selected listed companies from TSE (Tehran Stock Exchange) by Esfahani and Mohd Ali (Kobra Sadat Salek Esfahani and Mohammad Ali Ghasanfarymojarad, 2013). The researcher selected a panel data for 128...
companies, representing 11 industries for the period of 2005-2010. Researchers used correlation coefficient method for their study. They observed a strong and significant correlation between debt ratio and return on assets. They also noted the weak relationship between debt ratio and sales growth.

While studying the Information Asymmetry and Capital Structure, Leland and Pyle (Hayne E. Lelend and David H. Pyle, 1977) contradicted the notion of efficient markets hypothesis which says that a market is efficient if it is impossible to make economic profits by trading on available information. The moral hazard prevents the direct transfer of the information between the market participants. Without information transfer the markets are likely to perform poorly.

Jensen (Michael C Jensen, 1978) observed with the availability of better data, like daily stock prices and as economic sophistication is increasing researchers are finding inconsistencies with the efficient market hypothesis. In this paper he has brought tighter the scattered pieces of anomalous evidence regarding the efficient market hypothesis. He further advocates the need of reviewing the acceptance of efficient market theory and the methodological procedures. The efficient market theory has been doubted and a relook on the same is warranted in this paper.

Fama (Eugene F Fama, 1969), while studying the efficient capital market noted, Ideal is a market in which prices provide accurate signal for resource allocation, that is market in which firms can make production-investment decisions and investors can choose the securities that represent ownership of firms’ activities under the assumption that security prices are any time fully reflect all available information. Such a market is called as efficient market. In this study Fama observed exhaustive evidence of efficient market.
Fama (Eugene F. Fama, 1991) candidly points out that the sequel can not be as effective as the original. He revisited the phenomenon of efficient capital market, after 20 years of his first paper on the subject. His observation is based on the work of other researchers as well. He found no strong evidence for the efficient market theory.

Underpinning strengthens the existing structure. It reinforces the basic format. When strength is provided to the foundation, almost always such underpinnings are beneath and invisible, however the visible portion of structure is robustly standing because of the underpinnings. Same holds true for theories. The expression of the theory is the visible structure and the reinforcement is done by theoretical underpinnings. In order to understand the theories explicitly, the foundation needs to be in line with the expression of the theory. A lot of work has been done by management thinkers in the area of Capital structure, however very little is known about the empirical evidence of the theories. A systematic effort has been made by Rajan and Zingales (Raghuram Rajan and Luigi Zingales, 1995). It was observed that, at aggregate level the firm leverage is similar across G-7 countries. They feel the relationship between the theoretical model and its empirical evidence need be strengthened. It is possible with more detailed data. Study suggests, theoretical underpinnings of observed correlations are largely resolved.

Jensen, (Michel C Jensen, 1972) in his study of capital market theory observed, mean-variance asset pricing model is empirically testable. He further states “We now have substantial empirical documentation of the process generating the returns on assets, and there are at least several potential theoretical explanations of these empirical results.” However he further observes simple version of the asset pricing model (cf. Sharpe (1964), Lintner(1965a), Mossin
\( (1969) \), and Fama (1968) does not provide an adequate description of the structure of security returns.

The incentives associated to the shareholders with the increased risk to substitute for less risk for operating and investment policies are concerned is studies by Green (Richard C Green, 1984).

The Convertible debt issuance and its impact on the return was studied by Dann and Mikkelson (Larry Y Dann and Wayne H Mikkelson, 1984) it was observed by them that common stockholders earn significantly negative abnormal returns at the initial announcement of convertible debt offering and also at the issuance date where as average valuation effect on common stock on the announcement of non-convertible debt offerings is only marginally negative and zero at issuance. The evidence suggests that convertible debt offerings convey unfavorable information about issuing firms; however specific nature of such information remains unidentified.

In his study to focus on the real determinants of the Corporate Leverage Auerbach (Alan J. Auerbach, 1985) has studied the long term as well as short term determinants of borrowing. In
this study of 200 corporations, it was observed that tax laws plays central role in most models of corporate leverage.

Brander and Lewis (James A Brander and Tracy R Lewis, 1986) found that product markets and financial markets have important linkages. They found limited liability may commit a leveraged firm to more aggressive output stance, because firms would have incentives to influence the output market, which demonstrates a new determinant of debt equity ratio.

Calomiris and Habbard (Charles W Calomiris and R Glenn Hubbard, 1988) developed a model in which different loan contracts were offered to different types of borrowers. The extent to which loan can be offered was dependent on distribution of internal finance. This shows that financing and investment decisions are interdependent.

Cantor (Richard Cantor, 1990) in his study observed that when leverage increase is widespread, corporate sector is likely to become volatile and more responsive to sales and cash flow fluctuations. Increase in leverage is observed because of increased cyclical variability of investment and employment. Firms leverage is not independent of the industry.

Bradley, Jarrell and Kim (Michael Bradely,Gregg A Jarrell and E Han Kiim, 1983) at the onset of their paper state that theory of capital structure is one of the most contentious issue in the theory of finance, in past quarter century. In their research they have proposed that optimal firm leverage is related inversely to expected cost of financial distress and to amount of non debt tax shield. They also noted the relation between the industry average of debt and company debt.
Harris and Raviv (Milton Harris and Aurther Raviv, 1991) have taken the stock of almost all the significant theories pertaining to financing decisions; it is the compilation of the work done by the researchers. Harris and Raviv observed that, extent of external financing has increased overtime, Total leverage has steadily increased since world war II, Capital structure is used to protect control, firms are more likely issue debt if current debt levels are below target,

Persistent of leverage and its extent has been of great relevance. If a firm is highly levered presently, would it remain highly levered even after a few years? And other wise as well. Is there any co relation between the persistence of leverage and the Initial Public offer by the firm? These aspects were studied by Lemmon et al. (Michael L. Lemmon, Michael R. Roberts and Jaime F. Zender, 2005). This study claims that firms having high leverage at present would continue to have high leverage even in future. Same holds true in case of firms having low leverage. Their study predicts that this trend of high / low leverage would continue for twenty years. This persistence is because of firm specific factors. Further it was observed by them that, difference in firms leverage persists back prior to I P O of the firm.

The extent of leverage is studied aggressively by many researchers. For arriving at a firm conclusion, researcher has to study a large data, for long period. Such studies are carried out with the help of a panel data. One such study was made by Song (Han-Suck Song, 2005). He studied about 6000 Swedish firms from 1992-2000. it was observed that Swedish firms are highly levered. Short term debt comprises a considerable part of the total debt. Most of the determinants suggested by the capital structure theories are relevant in case of Swedish firms. Song suggests that future research should be focused on short term debt. This observation that
the capital structure of the Swedish firms is not dynamic and short term debt predominates the capital structure.

Modigliani and Zeman (Franco Modigliani, Morton Zeman, 1952) in this study Modigliani and Zeman also observed the difficulty in measuring the cost of equity, they felt computing the cost of debt is relative easy in comparison with that of cost of Equity. In their study it was observed that there is no fixed relationship between the firms debt level.

Later Modigliani with Miller (Franco Modigliani and Merton H Miller, 1958) proposed that The investors (arbitragers) are able to substitute personal or home made leverage for corporate leverage. The paper states that, the cost of capital is looked at by three different classes of economists

(1)The corporation finance specialist concerned with the techniques of financing firms so as to ensure their survival and growth; (2) the managerial economist concerned with capital budgeting; and (3) the economic theorist concerned with explaining investment behavior at both the micro and macro levels.' and that of the Industry, the firm belongs to, appear to be the concern of the market. It was also noted that the firms use their fixed investments as a strategic variable to affect their profitability.

Further the same researchers (Franco Modigliani and Merton H. Miller, 1963) endorsed the finding as noted in earlier paper, that, The investors (arbitragers) are able to substitute personal or home made leverage for corporate leverage.

Debt as a defense is used by some firms. Firms which are unprotected, potential target of acquirer may try to appear less attractive in the eyes of a corporate raider. Most preferred way of the acquirer is cash tender offer to the existing shareholders of the target company. USA enacted Williams Act, 1968 to prevent hostile takeover. The said act provides an opportunity to present their cases to the management of the target company as well as the acquiring
company. The strategies applied by the small, gullible firms to avert the takeover threat are poison pills, corporate charter amendments, golden parachutes. Such strategies would make the target firm less vulnerable to the hostile takeover bid. Garve and Hanka (Gerald T. Garvey and Gordon Hanka, 1999) observed that firms which are vulnerable to take over attack issue more debt, which otherwise they would not have issued. As well, firms which are protected by the second generation anti takeover law reduce the use of debt.

Net Income Approach advocates, that the capital Structure is relevant and change in capital structure would change the cost of capital and in turn would change the value of the firm. Durand (David Durand, 1952) At the onset Durand has noted the notion of ‘Cost of Capital’ needs to be sharpened furthermore the sharpening process indicates that the conceptual ground work is inadequate to deal with many problems, including capital cost. He further asserts that, to form a working definition of capital cost needs necessitates reformulating a good deal of basic and generally accepted economic theory. In this paper it was concluded that capital structure is not relevant and change in the same may not lead to change in the cost of capital and value of the firm.

Hatfield et al (Gay B. Hatfield, Louis T.W. Cheng, and Wallace N. Davidson, III, 1994) tested the hypothesis of Masulis(1983) which says, firms which issued debt are moving towards the industry average from below the market, will react more positively than when firm is moving away from industry average. They classified the firms as above and below the industry average before issuing the new debt and found relationship between the firm’s debt level and that of industry does not appear to be the concern of the market.
The traditional thinkers advocated that, value of the firm can be increased by using the debt in the capital structure. Higher the component of debt higher would be the bankruptcy cost. Miller stated that the tax advantage earned at corporate level is counterbalanced by the tax disadvantage at personal level, so at steady state equilibrium the corporate gain is zero. In their study DeAngelo and Masulis proved that optimal capital structure exists, in steady state if non debt corporate tax shield like investment tax credit or depreciation deduction. These observations were compiled by (Ghassem Homaifar, Joachin Zietz and Omar Benkato, 1994).

The financing decisions and investing decisions go hand in hand. In investing decisions the firm decided on purchasing and allocation of assets. Nature of business would decide the type of assets, firm needs to allocate. Liquidation means, monetizing the company’s assets. Liquidation may be considered because of various issues such as, retirement of debt or for personal gain or in response to declaration of bankruptcy. The costs associated with liquidation of the assets are liquidation costs. Typically costs such as advertising the asset/s to be liquidated, insurance costs, professional liquidator’s charges, and cost of disbursing the asset. The firm specific assets would have higher liquidation costs and secondary market for such assets is thin. When the value of the asset to be liquidated is less than their value in current use, then the liquidation costs are high.

Further studying the effect of corporate debt Brennan and Schwartz (M J Brennan and E S Schwartz, 1977) observed that there is no co relation of debt issued by the firms, as per industry average or otherwise, with the value of the firm. Inclusion of debt may increase or decrease the value of the firm.

T.Noel (Thomas H Noe, 1988) has studied the signaling effect and pecking order for capital structure. He observed that when insiders have perfect information of firm’s future cash flow
then debt financing dominates equity financing. However when insiders observe cash flows imperfectly, then the equity financing dominates over debt financing, breaking down the pecking order.

The role of banking system in the country and the capital structure is discussed by D ‘souza. Is there any inherent difference in funding pattern between the firms of developing countries and firms of developed countries? In line with the preceding papers research findings D’Souza (Errol D'Souza, 2002) studied Indian firms and noted that in developing countries firms are far less dependent on the internal finance, in particular he observed that, Indian firms rely more on external finance (debt) than their counterparts in U S . he attributes the reason, that is Indian banking System rely on relationship lending. The Indian banking system is protected against failure, is contributor for the reliance on debt by the Indian firms.

Decisions regarding capital structure and its composition are taken by the managers of the firm. Researchers are studying this aspect in the light of three main theories of capital structure viz. pecking order Theory, Trade-off theory and Agency Cost Theory. Tsuji (Chikashi Tsuji, 2011). The study is in the form of compilation of earlier research on the subject. This researcher finds Myers(2003) study of agency cost theory and endorses on the view that even though managers are shareholder’s agents, managers would act in their personal interest, and in extreme cases direct acquisition of assets. Shareholders can monitor manager’s actions but it very costly and may not be possible every time. Hence perfect monitoring is impossible. Myers opines if agency costs are taken seriously then Pecking Order and Trade-off models seem to be less important because, both the models assume that, managers behave solely in the interest of Shareholders. This notion hints that the capital
structure theories are not universally acceptable, as they are. This scholar also suggests that
capital structure theories are relatively insufficient and further research needs to be done.

Devereux and Schiantarelli (Michael Devereux, Fabio Schiantarelli, 1990) studied the size of
the firm and age of the firm for their study on Asymmetric Information, Corporate Finance
and Investment. The results indicate cash flow is significantly associated with investment. It
was observed that large firms have significantly lesser cash flow. Because of higher
information asymmetry for the younger(Newer) firms cash flow matters more than the older
firms. Cost of debt would not be uniform irrespective of firm size.

The determinants of capital structure have been studied extensively by many researchers. The
comparison of these determinants on the basis of firm size, private and publically held firms,
as well as comparisons between the firms of two different countries have been done. It was
observed by the researchers that the predominance of certain determinants is more in specific
country. The researchers also tried to assign the reasons for such convergence. One such study
was undertaken by Nguyen and Wu. (Tho Neuyen and Jian Wu, 2011). These researchers
observed that EBIT, market to book ratio, depreciation expense, firm size, tangible assets, R
& D expenses, Credit Ratings and dividend yields are the determinants of capital structure of
US firms. For Japanese firms EBIT, Depreciation and amortization, firm size are significant
determinants of capital structure. They also found that US firms adjust towards target capital
structure quickly than Japanese firms. The reason for this adjustment was closer relationship
with banks and hence easy availability of funds. It was observed that trade-off theory provides
appropriate frame work to assess capital structure of the firm. They did not find any support
for Pecking Order Theory.
The demographic influence is seen on the capital structure. In the preceding research study it has been noted that Indian firms rely more on debt or external finance. Are Chinese counterparts different? Yes. The stake holding pattern in the Chinese firms are different than that of Indian firms. Majority of the Chinese firms have state ownership. The study has been done by Huang and Song (Samuel G. H. Huang and Frank M. Song, 2002). They noted that Chinese firms prefer to issue equity because, once listed these stocks command good price. Second probable reason cited by them is, Chinese bond market is in nascent state. The state own firms never experience financial crises hence equity issuance is preferred by these firms. Banks are the only source for external finance hence firms have to rely on equity financing and trade credit. It clearly observed from this study, that distribution of debt and equity is country specific and not universal across the globe.

Is there any specific order or convention followed when firms issue securities? This was studied by several researchers. Such an attempt has been made by Dhankar and Bhoora (Raj S Dhankar and Ajit S Boora, 1996). Is there any co relation between capital structure and value of the firm? If so, what is that? Such questions are puzzling the researchers, studying the capital structure. M M model has shown the irrelevancy of capital structure, under perfect market conditions. In the realm of reality perfect market is not possible. This paper claims no significant work has been done in Indian context, and tries to examine whether Optimal Capital Structure exists in Indian companies.

The hierarchy of selection of financial resource has been studied by Pecking order theory. This advocates a specific order or sequence in which the corporate would raise the financial resources. In this order the internal accrual is given the first preference and issuance of equity is considered at last. Sunder and Myers (Lakshmi Shyam-Sunder and Stewart C. Myers, 1999)
tested the pecking order model with trade-off model. Trade off model suggests each firm adjusts gradually towards optimum debt ratio. The empirical results show pecking order model is excellent first order descriptor. Trade off model also performs well when tested independently. Their overall results suggest greater confidence in pecking order than in trade off model. These researches expect that sharper models are required for the study of capital structure.

Pecking order model enthuses the researchers in the field of corporate finance. Like almost all other models proposed by the thinkers of the field, Pecking order model as well does not show consistent results with its preposition. Does pecking order universally applicable to all the firms, issuing securities, irrespective of their sizes, profit abilities, lines of businesses, geographical boundaries? This question has been tested by Seifert and Gonenc (Bruce Seifert and , 2006). These researchers chose four countries, US ,UK, Germany and Japan. The study observed that except Japan US, UK and Germany issue equities frequently. The researchers have stated that their findings are not at all consistent as far as Pecking order hypothesis is concerned. They further state that there is no evidence that pecking order hypothesis holds for market-based systems. Their results did not support the international evidence for pecking order theory.

Capital structure studies have been revolving around Pecking order model and Trade-off model. The new paradigm tries to check the efficacy of the theories with respect to the firm size and age of the firm. Heider (Florian Heider, 2003). He observed that pecking order model works fine when it should not and does not work fine when it should. He stated that pecking order provides a good first order description of the time series of debt finance for large mature firms. But it cannot explain why small, growth firms issue equity, particularly when they have
ability to access debt market. Researcher observes that the firm issuing more equity relative to
debt, becomes less sensitive to adverse selection problem, if outside investors in addition to
being imperfectly informed about value, become more concerned about not knowing the risk
as well.

The applicability and evidence of Packing Order Theory (P O T) and Trade-Off Theory (T O
T) has been studied by lot many researcher studying the capital structure. Quereshi
(Mohamed Azim Quereshi, 2008) studies these theories. It was found that P O T and T O T
should not be considered as competing theories, instead if firms follow the synergy of these
two theories, rather than isolating these theories, firms would out perform. This approach was
presented by very few researchers, generally researcher, on the basis of the data, try to find the
evidence of the theory and rank the theory accordingly.

One more study on Pecking order theory. This study claims that the emotional bias aspect of
CEO’s.

The researchers did study on one hundred Tunisian CEO’s. Ali and Anis (Azouzi Mohamed
Ali and Jarbou Anis, 2012). The emotional bias was measured with the help of questionnaire.
Their finding is in favor of Pecking order theory. Behavior analysis of these CEO’s reveals
that, internal funds are their first choice of funding and they give preference to equity as last
option.

The capital structure determinants of Micro, Small and Medium enterprises were studied by
Mateev et al (Miroslav Mateeva,*, Panikkos Poutziourisb,1, Konstantin Ivanovc, 2012). The
researchers studied 3175 companies panel data from 2001-2005 for Central and Eastern
Europe. They found significant and positive evidence in favor of Pecking Order theory. They
observed that larger firms having sufficient cash flow use less external funding, as compared with the smaller firms.

What are the reasons behind financial conservatism? The policy of financial conservatism is constant throughout the life of the firm? These are the questions puzzling the scholars probing into the capital structure decisions of the firms. The researcher has narrated a study which deals with the dynamic optimal capital structure. Many firms carry much lesser debt than predictions of the dominant theories of the capital structure. Naturally these are under-leveraged firms. Minton and Wruck (Bernadette A. Minton and Karen H. Wruck, 2001) studied the conservatism aspect of such firms and observed conservative firms follow pecking order style financial policy. These firms have high cash balances and high flow of funds surplus relative to more leveraged firms. These internal funds are sufficient for meeting the operations expenses as well as discretionary outlays. However one inconsistent finding is these low leverage firms at times do not follow pecking order model. These firms have large cash balances and simultaneously raise funds externally. These firms stock file financial slack / debt capacity. They dig these stock piles when the internal funds fall. Low leverage firms have transitory capital structure. And finally they observed financial conservatism is not an industry based phenomenon.

Almost all the findings compiled till now are pertaining to the non Indian demography. At times scholars of Indian origin are doing the empirical research in foreign land. Green et al. (Christopher J. Green, Victor Murinde and Joy Suppakitjarak, 2003) attempted to study the corporate financial structure in India. It was observed that Indian quoted non financial companies’ financial structure is differing from their counterparts in OECD (Organization for Economic Co-operation and Development) counterparts. Needless to say that OECD countries
are economically strong than India. They also noted that Indian Unquoted firms rely on equity than debt. The quoted firms rely on debt. This is consistent with the argument that firms go public to gain access to debt. Their observations are inconsistent with the pecking order model of capital structure. Unquoted firms have experienced significant rise in their inter group assets, which is quite in line with the concept of insider control.

In the study of the signaling theory Ross (Stephen A. Ross, 1977) observed if managers possess inside information then the choice of managers incentive schedule and of a financial structure signals information to the market and in competitive equilibrium the inferences drawn from the signals will be validated.

Relation between capital structure and information signaling hypothesis and agency cost hypothesis is studied by Taranto (Mark Allen Taranto, 2002). He observed that Capital Structure does matter and is consistent with Information Signaling Hypothesis and Agency Cost Hypothesis. Wealth transfers between the bond holders and shareholders affect the return when leverage is high.

The human capital and capital structure is studied by the researchers. Is there any relation with the pay package to the employees and capital structure? In reality the emoluments and compensations are based on the performance of the employee, and more so, on the profitability of the company. Dictum is, companies having higher profitability ratios, generally pay higher salaries. Berk et al. (Jonathan B. Berk, Richard Stanton and Josef Zechner, 2005) Studied human capital and capital structure of the company. This paper specifies that bankruptcy costs borne by the employees of the firm are significant and still hardly any attention was given to it. The study says highly levered firms should pay higher
wages to their employees. The notion of independence of leverage, capital structure and wages is not in line with this study.

The capital structure theories are laterally studied. Different angles such as demographic, size of the firms, listed versus unlisted firms, comparison of capital structures of firms across the globe, parent affiliate relationship and capital structure were studied. However the human capital and firm leverage has been studied by Fairchild (Richard Fairchild, 2009). The researcher investigated stakeholders theory of capital structure from the perspective of firms relationship with its employees. The results suggest human asset specificity is important consideration when financing decisions are made by the firms. The study found that the firms friendly with their employees maintain low debt ratios.

Masulis (Ronald W Masulis, 1983) observed the changes in stock prices are positively related to changes in leverages as well changes in firm value are noted in positive relation to changes in firm debt level. The study is supporting the optimal capital structure theory with respect to tax based models.

The optimal capital structure enthuses many a researchers, the components of optimal capital Structure, the category of debt and its relevance in optimizing the capital structure is studied by Leland and Toft (Hayne E. Leland and Klaus Bjerre Toft, 1996). In earlier study Leland assumed the infinite life debt, while studying the optimal capital structure. In reality infinite life debt is a restriction. Not only the quantum of debt but the maturity is responsible for the optimal capital structure. While issuing the debt aspect of Agency costs need to be considered. Holistically, the size of firm, size of debt, maturity of the debt, presence of agency costs and bankruptcy costs are taken into account. Leland and Toft observed that, even though longer term debt increases firm value, firms issue shorter term debt because it reduced agency costs. Firms tend to issue highly rated short term debt than long term debt. They observed that,
equity holders of the firms issuing short term debt will not have any incentive to raise firm
risk, so short term debt holders need not have to protect themselves by demand higher coupon
rates. Their results suggest when agency costs are present riskier firms should issue short term
debt, in addition to using lesser debt.

3.4 – FINDINGS AND CONCLUSIONS ABOUT FINANCING

DECISIONS

Table No: 6

<table>
<thead>
<tr>
<th>Theory / Concept / Approach</th>
<th>Mean Value</th>
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<tr>
<td>Ad hoc Approach</td>
<td>0.00462963</td>
</tr>
<tr>
<td>Agency Cost Theory</td>
<td>0.00154321</td>
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<tr>
<td>Asymmetric Information</td>
<td>0.00308642</td>
</tr>
<tr>
<td>Bankruptcy Cost Theory</td>
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<tr>
<td>C A P M</td>
<td>0</td>
</tr>
<tr>
<td>Cost of Capital</td>
<td>0</td>
</tr>
<tr>
<td>Debt Equity Ratio</td>
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</tr>
<tr>
<td>Efficient Market Hypothesis</td>
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</tr>
<tr>
<td>Financing Decisions</td>
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<tr>
<td>Financial Performance Management</td>
<td>-0.00154321</td>
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<tr>
<td>M M Approach</td>
<td>-0.00405</td>
</tr>
</tbody>
</table>
These results signify that, none of the theory under consideration is fully rejected neither accepted. Because when the theory is fully accepted the mean value would be 1. When the theory is totally rejected then the mean value would be -1, where as 0 denotes a status where the theory is neither accepted nor rejected. 0 signifies a neutral status.

From the above data it is observed that, Ad hoc Approach, Agency Cost Theory, Asymmetric Information and merger and acquisition are yielding positive mean values where as Bankruptcy cost theory, Debt Equity Ratio, Efficient Market Hypothesis, Financing Decisions, Financial Performance Analysis, M M Hypothesis, Net Income Approach, Net Operating Income Approach, Optimal Capital Structure, Pecking Order Theory, Signaling Theory, Stake Holder Theory and Tax Shield are showing negative mean values. Where as
C A P M and Cost of Capital are showing 0 mean values. This signifies none of the theory / Concept / Approach studied under Financing Decisions, is fully accepted or fully rejected.