CONCLUSION & RECOMMENDATIONS

Capital structure practices in India have taken a decisive and irreversible turn after the start of liberalization process. Equity Capital, which was so far artificially suppressed mode of finance has bounced back to surface as a predominant source. During the period, 1990-91 to 1994-95, the share of equity issues in the total issues has been steadily rising (see Table - 2.0). Debt finance, though expanding in absolute term, is losing its relative importance. In the increasing interest rate regime and lowering of inflation rate year by year, there has been low demand for debt.

In fact, the start of liberalisation process created a pressure in the market place for the Indian companies and they were made to compete openly with each other. This coupled with improved availability of the equity capital from the capital market as also private placement and so on created an equity rush from Indian companies. The freeing of banks from lending norms also broke the 2:1 D/E ratio mindset of the corporates as well as the lenders and they started looking at lower gearing. These effects are seen across the board in all the different types of industry segments - Group/Non-group companies; Fera/Non-Fera companies and all the small, medium and large sized corporates. This shows that when it comes to responding to any policy changes, all Indian companies are more or less a homogenous block as far as capital structure practices are concerned.

On the other hand, the laid-back approach of finance managers have also given way to search for newer ways of financing. Financial Institutions are now, aren't an automatic source of finance. This trend has some rationale behind it but, many of the reasons are not justifiable based on the economic criteria.
In particular, the absence of the pecking order behavior or the static optimality in the Capital Structure practices, explains the present response of the firms as that of opportunistic firms. While some of the equity rush can be explained as a response to the "suppression effect" of the past control, some of the behavior (100% equity firms) lacks any theoretical justification. The strong relationship of the Stock Exchange Index and the growth in equity (with a lag effect) clearly indicates the opportunistic behavior on part of the firm. This clearly indicates that the investors are not behaving rationally which will be corrected with the growth in capital markets. At that time, this trend may see a reversal.

As explained earlier, the developments in the capital structure practices are related to the liberalised policy measures which is based on macro-economic policy framework adopted by the government. As a result of these economic reforms, the Indian economy and financial markets are being integrated with global markets and are increasingly affected by the international developments. Till 1991, the investors had to look at a single criterion of company’s earning per share (EPS). Now, due to increasing importance of foreign portfolio flows and exposure of Indian companies to international competition as a result of reduction in import tariffs and removal of other barriers, the value of equity investment depends on a host of factors such as interest rates, political situation in countries, price trends and movements in exchange rates.

Therefore not surprisingly, the observations on capital structure practices followed by Indian firms give a feeling that there is a greater influence of the availability of finance in determining capital structure compared to the internal factors. In the developing countries like India where capital is
scarce, regulators try to prioritize the areas for investment for the country and accordingly frame the rules so that the capital flows in the areas of priority. This creates skewed growth of financial markets and the players operating in the market. In the following diagram, typical structure of the Indian financial market is presented. Each of these markets and the players within the market are governed by the rules and regulations framed by the regulatory authorities. These can be expressed in terms of the relationship between players indicated as R1, R2, R3, etc.

The characteristics of the relationship determines the flow of capital between one player to another. Any regulation which restricts the flow from one particular source to another creates a skew in the market place. These restrictions are based on the economic priorities of the nation. Therefore, if the regulations imposed on the capital flows from one source to another
can be logically inferred from the macro-economic situation of the country, it can certainly influence the capital availability to the corporates and resultantly will influence the capital structure decision. This can be called 'Supply Side Effect' on capital structure decision. This supply side effect is ignored by all the previous theories on capital structure decision. In other words, all the capital structure theories have a silent assumption that availability of capital is free while, the general observation is that, it is not so in the real life situation. Even the developed countries like U.S.A. will have regulations which create skews in the capital flows. Therefore, the optimal capital structure for the company must be arrived after considering the demand for capital and the supply of capital particularly, any restrictions on the supply of capital must be factored in before the optimal capital structure is arrived. As for the regulators, it is essential that the policy framework created to regulate the financial markets are based on sound macro economic factors and the desired growth factors in the economy as there is a definite link between the capital structure practices and the macro economic conditions prevailing in the country.

In fact, the entire resource mobilising scenario in the emerging context can be broken down into two parts, one is the demand side of the corporates and the other is the supply side from the markets. Compared to today's scenario, there is going to be paradigm shift. There will be a basic shift in the process of mobilising resources itself. On the market side, there will be an exhilarated integration of domestic market with the international markets which will bring some fundamental changes in the way the market operates and the size and liquidity of the market. Apart from that, there will be a substantial change in the credit delivery pattern from what it is today. More
and more debt financing will be in the form which provides easy liquidity like bonds, securitisation, etc. compared to present system of term loans, cash credit, etc.

Liberalisation has made a basic shift in the objectives of suppliers of capital mainly banks and financial institutions in our country. From the earlier social objective based financing, the supplier of capital is now forced to become bottom line oriented and made responsible to their own shareholders. As a result, the present policy of the 'partners in progress' i.e. syndication, lead institutions, etc. concepts will undergo a change where they will start competing in the market place with each other. This will change the basic method of taking risks and the way credit is dispensed by these institutions. In fact, the risk management will become the key success factor for these institutions in future. As the complexity in the market increases, the retail money going directly to manufacture will become lesser and lesser i.e. the sources like fixed deposits, direct issues, etc. will gradually phase out. There will be an increase in the financial intermediation and pooling of resources like mutual funds, etc. Today the small investors are too used to invest directly in the companies and are not willing to pay anything extra for the expert advice. With the complexities increasing, this will gradually change and small investors will have to rely on expert fund managers. It means that, the financial intermediation in general will increase not only in terms of the volumes of business but, also in qualitative terms there will be a substantial change in the role played by the intermediaries like merchant bankers, financial advisors, NBFCs, etc. They will have to provide an active link between the requirements of the investors and borrowers especially in the equity market.
Coupled with the changes in the supply side of capital, the demand side is also likely to witness a lot of changes. Free trade regime like GATT will force the Indian companies to have global size operations which will require massive funding. Infrastructure financing will also change the scale and the structure of financing compared to the present scenario. In fact, during this period of structural adjustments of the economy, there will be a qualitative change in the business scenario and the competition in the market place which will force the Indian corporates to relook into their existing method of capital structuring. Free competition will create a polarisation towards efficient companies and the weaker players will be marginalised. This will give rise to a lot of corporate re-structuring by way of mergers and acquisitions, strategic alliances, management buy-outs, etc. These factors are going to play a significant role in capital structuring.

The role of regulatory authorities in future will be to ensure that the markets are fair to both borrowers and lenders. Regulations will be mostly in the form of protecting the interests of the weaker of the two in the market place.

Global integration of the Indian market would give birth to lot of new financing instruments. These instruments will basically be designed to meet the specific risk-return liquidity criteria of general investors like floating rate bonds, debt-commodity, debt with warrants and so on. The boundary between debt & equity will become more and more hazy. Lot of hybrid-type instruments like preference shares, equity-linked debentures will emerge in the market. Financing strategy will become more and more integrated with business strategy and new instruments like commodity linked bonds etc. will be available to corporates to optimize the overall business strategy.
Apart from this, the risk management will become easier in future when floating rate bonds/notes are allowed to be issued by the corporates.

All the above developments are going to happen in a phased manner and the markets will remain unpredictable during the transition period. Guided by the availability, the corporates will respond to these changes in isolated manner, and the capital structure practices in India will remain in the state of the flux till the time our markets are mature and integrated with the world market. Phased Liberalization Agenda will create imbalances in the state of development of financial markets, and the finance managers will have to respond to capitalize on the opportunity as it will take a long time for a capital scarce country like India to balance the supply side equation.

However, in the long-term, when corporates have fully adjusted to the liberalisation process and move towards perfect functioning of capital market, pecking order of financing will persist.

Hypothesis: For further research

1. There is strong supply side influence on the capital structure practices of the firms in (developing countries) India.

2. The macro-economic policy of the government determines the state of development of financial markets which has direct relationship with the capital structure practices.

3. The “free regulatory framework” assumption is not tenable in developing countries. Government regulations create bias for/against a particular type of finance which gets reflected in the capital structure.