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**IMPACT OF CAPITAL STRUCTURE DECISIONS ON FINANCIAL PERFORMANCE OF INDIAN COMPANIES**

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**ABSTRACT**

*Capital structure is most significant discipline of company's operations. The main objective of this paper is to study the impact of capital structure decision of Indian companies and also to analyze the financial performance of capital structure. The present paper takes into consideration analysis of 10 companies listed on BSE Index are selected for sample for a 5 year period (2010-2014) is used. The main source of this study is from secondary data from firm's financial reports. Correlation and multipleregression analysis are used for present analysis. The results of study revealed that there is anegative correlation between capital structure and financial performance. And to study impact of capital structure on financial performance of the firms independent variables like gross profit, Net profit, Roce and Roa at significant level of 0.05 and 0.1 are used to test the financial performance. There is a negative association at is -0.574. Co-efficient of determination is 0.330. F and t values are 0.082 and -1.985 respectively. Therefore the present study results in insignificant level performance of listed companies in India by using more debt capital for business*

**Keywords:** Capital Structure, Cost of Capital Financial Performance, value of firm.

**INTRODUCTION**

The term "Capital Structure" in general refers to the proportion of debt and equity used to finance the assets of a business concern. The blend of debt and equity is likely to have an impact on the overall value of the business firm. Most of firms for making financial decision they prefer to see that debt is equal to equity so it can have an optimum capital Structure. Financial manager's job is to come out with an optimal capital structure which maximizes share holders value (opler, saron, titman1997) it is an important issue for managers how to minimize financial costs and maximize shareholders 'equity.

There are also some capital structure theories since starting of MM Theory (1958) to existing theories like tradeoff theory and agency theories attempted to determine optimal capital structure of firms which they need to pursue. Corporate finance theories which born with the publication of

Modigliani and Miller's (M&M) theory of corporate capital structure in 1958. The theory proves that the choice of a firm's capital structure will not affect its market valuation. When a capital market is free of taxes, transactions costs, and other frictions etc. According to Myers (2001) there is no unifying theory on the choice between debt and equity and no reason to expect one either, there are however several theories that are "conditionally useful" for explaining capital structure choice. The relationship between capital structure and financial performance is one that received considerable attention in the finance literature therefore the present paper concentrates on capital structure decisions of Indian firms and their financial performance.

#### LITERATURE REVIEW

The study on capital structure attempts to explain the mix of securities and financing sources used by companies to finance investments (Myers, 2001). Brigham, (2004) referred to Capital structure as the way in which a firm finances its operations which can either, be through debt or equity capital or a combination of both. According to Myers, (2001), there was no universal theory on the debt to equity choice but noted that there were some theories that attempted to explain the capital structure mix. Financial performance is a subjective measure of how well a firm can use its' assets from its' primary business to generate revenues. Erasmus, (2008) noted that financial performance measures like profitability and liquidity among others provided a valuable tool to stakeholders to evaluate the past financial performance and the current position of a firm. Brigham and Gapenski (1996) argued that in theory, the Modigliani and Miller model was valid however in practice, bankruptcy costs did exist and that these costs were directly proportional to the debt levels in a firm. This conclusion implied a direct relationship between capital structure and financial performance of a firm.

The study indicated that capital structure has little to no impact on a firm's performance. These results are inconsistent with other empirical studies such as Hadlock and James (2002) and Ghoshet *al.* (2000), which revealed a positive relationship between financial leverage and choice of capital structure. Other studies revealed a negative relationship such as Berger and Bonaccorsi di Patti (2006), Gleason *et al.* (2000) and Simerly and Li (2000) whereby lower equity capital ratio is associated with higher firm performance.

In an effort to validate MM theory in Kenya, Maina and Kondongo (2013) investigated the effect of debt-equity ratio performance of firms listed at the Nairobi Securities exchange. A census of all firms listed at the Nairobi Security Exchange from year 2002-2011 was the sample. The study found a significant negative relationship between capital structure (DE) and all measures of performance. This results collaborated MM theory that indeed capital structure is relevant in determining the performance of a firm. The study further found that that firms listed at NSE used more short-term debts than long term.

Abdul (2012) conducted a similar study to determine the relationship between capital structure decisions and the performance of firms in Pakistan. The study concluded that financial leverage has a significant negative relationship with firm performance as measured by ROA, GM, and Tobin's Q.

In another study, Javed and Akhtar (2012) explored the relationship between capital structure and financial performance. They concluded that there is a positive relationship between financial leverage, financial performance, and growth and size of the companies. The findings by Saeedi and Mahmoodi (2011) indicate that financial leverage may affect different measures of performance in different ways

**OBJECTIVES**

1. The present study focus on Capital Structure and financial performance of Indian firms.
2. To study the impact of capital structure on financial performance
3. To Evaluate the interrelationship between capital structure and performance

**HYPOTHESES**

The following hypothesis is formulated for the study

H0:-There is a negative relationship between capital structure and financial performance.

H1:- The capital structure has significant impact on financial performance.

H2:-There is positive relationship between capital structure and financial performance.

**RESEARCH METHODOLOGY**

In the present study the data has collected from listed companies in Bombay stock exchange and also collected data related to independent variables for each company like gross profit, Net profit, Roce and Roa to test the financial performance of the companies for 5years period(2010-2014) and conducted correlation co-efficient analysis is under taken to find out the relationship between capital structure and financial performance and Regression analysis is used to test the impact of financial performance on capital structure of the listed companies traded in Bombay stock exchange. Data is obtained from two sites such as [www.bse.com](http://www.bse.com) and [www.finance.yahoo.com.moneycontrol.com](http://www.finance.yahoo.com.moneycontrol.com)

**RESULTS AND DISCUSSIONS****Correlation Analysis**

Correlation is concern describing the strength of relationship between two variables. In this study the correlation co-efficient analysis is under taken to find out the relationship between capital structure and financial performance. It shows the amount of relationship exist between capital structure and financial performance.

**Table: 1.1**  
**Capital Structure Correlated with other variables like Gross profit, Netprofit, ROCE and ROA**

VARIABLES	R value	r2 values
GROSS PROFIT	-0.343	0.117
NET PROFIT	-0.965	0.932
ROCE	-0.353	0.125
ROA	-0.444	0.197
PERFORMANCE	-0.574	0.330

**Table: 1.2. Capital structure and variables**

Variables	Capital structure	Gross profit	Net profit	ROCE	ROA	Performance
Capital structure	<b>1</b>					
Gross profit	-0.343	<b>1</b>				
Net profit	-0.965	0.478	<b>1</b>			
ROCE	-0.353	0.401	0.264	<b>1</b>		
ROA	-0.444	-0.084	0.550	-0.540	<b>1</b>	
Performance	-0.574	0.070	0.685	-0.403	0.982	<b>1</b>

1. It shows the relationship between gross profit and capital structure variables. There is a weak negative relationship between two variables. The correlation is -0.3431. Significant level is 0.01. The co-efficient of determination is 0.117. That is only 17.7% of variance in the capital structure is accounted by the gross profit.

2. It indicates the relationship between Net profit and capital structure variables. There is a weak negative relationship between two variables. The correlation is -0.965. Significant level is 0.01. The co-efficient of determination is 0.932. That is only 93.2% of variance in the capital structure is accounted by the Net profit

3. It shows the relationship between ROCE and capital structure variables. There is a weak negative relationship between two variables. The correlation is -0.353. Significant level is 0.01. The co-efficient of determination is 0.125. That is only 12.5% of variance in the capital structure is accounted by the ROCE

4. It illustrates the relationship between ROA and capital structure variables. There is a weak negative relationship between two variables. The correlation is -0.444. Significant level is 0.01. The co-efficient of determination is 0.197. That is only 19.7% of variance in the capital structure is accounted by the ROA.

5. It explains the relationship between Performance and capital structure variables. There is a weak negative relationship between two variables. The correlation is -0.574. Significant level is 0.01. The co-efficient of determination is 0.330. That is only 33.0% of variance in the capital structure is accounted by the performance.

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**Regression Analysis**

Regression analysis is used to test the impact of financial performance on capital structure of the listed companies traded in Bombay stock exchange.

**Table: 1.3**

Model	R	R Square	Adjusted R Square	Std.Error of the Estimate
Capital structure and Gross profit	0.343	0.117	0.0074	0.8592
Capital structure and Net profit	0.965	0.932	0.924	0.2370
Capital structure and ROCE	0.353	0.125	0.015	0.8556
Capital structure and ROA	0.444	0.197	0.097	0.8194
Capital structure and Financial performance	0.574	0.330	0.246	0.748

The above table indicates the coefficient of correlation between the capital structure and gross profit. Multiple r2 is 0.117. Only 11.7% of variance of gross profit is accurate by the capital structure. But, remaining 88.3% of variance with gross profit is attributed to other factors

The Coefficient of correlation between the capital structure and Net profit. Multiple r2 is 0.932. only 93.2% of variance of Net profit is accurate by the capital structure. But, remaining 6.8% of variance with Net profit is attributed to other factors

The Coefficient of correlation between the capital structure and ROCE. Multiple r2 is 0.125. that is only 12.5% of variance of ROCE is accurate by the capital structure. But, remaining 87.5% of variance with ROCE is attributed to other factors

Coefficient of correlation between the capital structure and ROA. Multiple r2 is 0.197. that is only 19.7% of variance of ROA is accurate by the capital structure. But, remaining 80.3% of variance with ROA is attributed to other factors

Coefficient of correlation between the capital structure and Performance. Multiple r2 is 0.330 that is only 33% of variance of Performance is accurate by the capital structure. But, remaining 67% of variance with Performance is attributed to other factors

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**Descriptive Statistics**


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DESCRIPTIVE STATISTICS	CAPITAL STRUCTURE	GROSS PROFIT	NET PROFIT	ROCE	ROA	PERFORMANCE
Mean	0.46525	20.6876	16.1982	17.263	280.114	83.5657
Std Error	0.272735884	6.210773048	7.337182399	4.93586587	74.606605	19.19711688
Std Deviation	0.862466594	19.64018886	23.20220799	15.6085784	235.9268	60.70661383
Sample Variance	0.743848625	385.7370185	538.3424555	243.627718	55661.456	3685.292963
Range	2.834	65.676	82.528	48.4	715.004	199.238
Minimum	0	-4.178	-46.304	0	30.636	-4.528
Maximum	2.834	61.498	36.224	48.4	745.64	194.71

The above table shows the values of mean, range, minimum, maximum, and variance of independent, dependent variables. ROA has high mean value of 280.114% than other variables. It has high maximum value of 745.64 and high variance. 55661.45 at the same time according to the above table Capital structure have low maximum value and low mean value too than other variables. The maximum and minimum values for each performance measures indicate that the performance varies substantially among companies. Capital structure has low mean value compare to the financial performance.

### Testing of Hypotheses

#### Statistical Techniques Results

As per the present study Correlation is -0.574 and Co-efficient of determination 0.330.

Based on the empirical results of this study, **H1**: this hypothesis come false .Because in this study the empirical results shows that there is a insignificant negative relationship

**H2**: "There is a positive relationship between the capital structure and firm's financial performance".

At the first step of testing the hypothesis(H1), between the capital structure and firm's financial performance with the performance variables like Gross Profit ,Net Profit ,ROCE,ROA. H2 was rejected. Because research result is negative relationship between the capital structure and firm's financial performance.

**H0**: "there is a negative relationship between the capital structure and firm's financial performance". After the rejection of H1, the Null hypothesis (H0) was tested for its validity. H0 was accepted based on results. It has been identified that there is a negative relationship between the capital structure and firm's financial performance

### CONCLUSION

In Correlation analysis P value is 0.082 reject H1 hypothesis .There is a weak negative relationship between Gross profit, Net profit, ROCE and ROA and capital.it is analyzed by the results that of the relationship between the capital structure and financial performance was negative. There is a negative association at is -0.574. Co-efficient of determination is 0.330. F and t values are 0.082 and -1.985 respectively. Therefore the present study results in insignificant level performance of listed companies in India by using more debt capital for business.

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