This study was undertaken with a view to ascertain whether changes in capital structure affects the profitability of a company and if so in what manner & to what extent.Another object was to go through the existing literature on the subject and to apply it to the company under study.The nature of financing & the instruments of financing were also proposed to be studied in view of the liberalisation of Indian economy since 1991.With the removal of restrictions in many areas of industrial licensing,FERA provisions and lowering of import tariff,lowering of domestic tax rates both direct and indirect and removal of unreasonable restrictions on trade and industry it was expected that the Indian companies would take full benefit of the liberalisation and expand their operations by efficiently utilising the resources at their command.

The conclusions of this study are stated under the following headings :

1. Nature of instruments through which the funds are raised
2. Maximisation of wealth of the shareholders
3. Financial Management
4. Countering Business Risks

1. NATURE OF FUND RAISING INSTRUMENTS :

As stated above with the liberalisation of Indian economy since 1991 corporates started raising funds with a view to raise them economically and cheaply.This was made possible bv removing many restrictions on the issues of shares, debentures and on raising funds abroad.The corporates could easily raise funds in foreign currency abroad at very attractive rates & they could go in for joint ventures with foreign companies with the liberalisation of FERA provisions.

The company under study also adapted itself to the changing business conditions.The shares of the company were listed in the Mumbai stock exchange in 1990.During the boom of 1992 the shares of the company were listed at Rs.300.This enabled the company to issue shares at a premium of Rs.173 per share in 1994-95.The total share premium collected was Rs.433.50 lacs.This share premium was later utilised in 1995-96 to issue bonus shares in the proportion of 1:1.

Apart from the issue of shares the company raised term loans from the Financial Institutions ,State Financing Agencies which are less costly.Further being located in industrially backward zone the company availed interest free sales tax loan repayable over a period of 15 years.In addition the company raised & renewed fixed deposits from public under section 58 A of The Companies Act,1956 which are also quite cheap as compared to cash credits from banks.The leasing & hire purchase mode of raising finance was also adopted for purchase of vehicles and machinery. The deffered payment guarantee scheme of the IDBI was also availed for purchase of machinery.Though the year was not covered by this study it is worth mentioning that the company made issue of Non Convertible Debentures of Rs.258 lacs on private placement basis.

Taking into account the size of the company and its funds requirements there were certain inherent limitations on the company to go in for Euro issue of securities or External Commercial Borrowings.Similarly the scale of the company did not permit raising of foreign currency loans since the risk of currency devaluation is quite threatening.The company had technical foreign collaboration with Black & Decker USA with equity participation from the foreign partner till 93-94.

It can be said that the company was well aware of the changes taking place in the financing patterns in the country.It tried to keep pace with the changes taking place to a large extent.One notable feature of fund raising was the absence of loans in foreign currency.The reason might be the small scale of operations or the phase wise expansion made which reduces the size of loans to be raised at a time. Also comparatively the fixed deposits from public formed quite insignificant portion of the total debts raised.

Thus keeping in view the size of the company it can be said that the company was responsive to the changes in the domestic fund raising scenario during the last six years.

2. MAXIMISATION OF WEALTH :

This topic is proposed to be covered by studying the following norms :

i) Returns to the shareholders :

The returns to the shareholders consist of two types :

a.Dividend &

b.Capital Appreciation

Though control of ownership is a relevant aspect in case of ordinary shareholders this aspect is not significant for the purposes of this study.On both the counts the company performed satisfactorily over the years.The dividend was paid consistently at a higher rate since the year ending on 31.03.1991.

(See point 5.2)

As stated above the shares of the company showed tremendous appreciation in its market value since its listing.In the boom of 1992 the shares of the company were listed at Rs.300 for the Rs.10 paid up share.Even on 9 th September 1996 the shares of the company were listed at Rs.48 on the Mumbai Stock Exchange.The present market value of the share is around Rs.20 per share.Thus on both the counts the company performed exceedingly well though the market value of the share kept going down consistently since 1996 after the issue of bonus shares.

Further the company rewarded the shareholders with a liberal bonus issue of 1 : 1 in 1995-96.

ii) Earning Per Share :

As stated above in point 5.4 the EPS of the company grew each year from a meagre 1.83 in 1989 to 15.31 in 1995.The EPS came down to 8.71 in 1996 on account of 1:1 bonus issue made by the company in 1995-96.However the growth in EPS was not consistent and as the details shown under point 5.4 above the EPS declined in 1992 & 1994 on account of increase in tax provisions and slow growth in sales coupled with growth in expenses respectively.Still on the whole the growth in EPS can be said to be satisfactory.

iii) CHANGES IN PROFITABILITY :

One of the objects of this study was to see if over a period of time the changes in capital structure affected the profitability of a company.As per the concept of financial leverage as the use of debt in capital structure increases the returns to the shareholders in the form of either net profit or EPS increase on account of the fact that the interest on loan is tax deductible and therefore the equity shareholders gain more returns on same investment.However for this to happen it is essential that the returns on the investment should be higher than the cost of debt.The data in regard to the financial leverage,operating leverage,EBIT & NP is tabulated below :

TABLE 6 . 1 showing everage,EBIT & Net profit

YEAR	1989	1990	1991	1992	1993	1994	1995	1996
F.Leverage	3.03	1.57	1.50	1.64	1.64	1.80	1.94	2.01
O.leverage	2.14	1.66	1.47	1.64	1.54	1.60	1.69	1.65
EBIT %	14.00	32.81	41.35	43.24	52.75	42.50	21.93	24.09
EBIT (Rs. in lacs)	33.50	69.88	106.75	125.84	221.66	232.18	266.13	370.36
NP (Rs. in lacs)	11.03	39.34	62.52	33.34	79.45	72.39	130.17	148.10

i) The financial leverage at 3.03 in 1989 was very high due to interest of Rs.22.47 lacs in EBIT of Rs.33.50. As a result at this level if any debt were to be added to the capital structure @ 8 % & if the company were to earn return on the investment in excess of 8 % the shareholders would gain by equal amount in the form of increased earnings i.e. profit after tax.The financial leverage came down over the period to 2.01 in 1996 meaning that the share of interest in the EBIT also came down.All other things remaining the same this would result in lesser returns to the shareholders since they would have a lesser advantage of trading on equity.The reason for lower ratio of financial leverage was that the company followed policy of ploughing back the profits & financing the expansion instead of raising the debt funds.The reduction in financial leverage was accompanied by decline in the EBIT ratio which both acted to reduce the earnings of the shareholders.Had the same financial leverage & the same EBIT ratio achieved the EPS would have been quite higher than the one achieved in 1995 & 1996.This can be explained by the following example :

Financial Leverage	3.03
EBIT %	42.50 %
Sales	1988.03
Revised EBIT	844.91
Less : Interest	566.10
PBT	278.81
Less : Tax @ 40 %	111.52
NP	167.29

Though the company still showed satisfactory profits they could have been higher had the EBIT percentage maintained at the 1994 level.However even though Financial leverage declined in earlier years it was more than compensated by tremendous increase in the EBIT percentage.The net profit however declined in 1992 & 1994 even though the EBIT percentage improved because of higher tax provisions.

Thus the financial leverage alongwith the EBIT affect the earnings available to the shareholders.

ii) The operating leverage was quite low during the above period which goes to show that the fixed costs in the total cost of the company formed a small percentage.This position is considered advantageous to any company since it indicates that any fluctuation in the sales will not cause heavy fluctuation in the EBIT.In fact where a company has low operating leverage it should be accompanied by a high financial leverage.The company however followed low operating leverage with low financial leverage.This combination indicates prudence and cautiousness on the part of the management but it also points out to loss of opportunities due to not raising of funds through debt.

iii)The net profit & its percentage over the period was as under :

TABLE 6 . 2 showing Net Profit & Net Profit Ratio

YEAR	1989	1990	1991	1992	1993	1994	1995	1996
NP	11.03	39.34	62.52	33.34	79.45	72.39	130.17	148.10
NP RATIO	4.24	8.55	10.98	4.35	7.22	6.12	8.06	7.45

The net profit had been growing on the whole except in 1992,1994 & 1996 the reasons being higher tax provisions in 1992 & increasing expenses particularly sales & administrative & slow growth of sales in 1996.The net profit kept its pace throughout the period on the whole in line with the EBIT.

Thus it can be definitely concluded that the changes in the capital structure do bring abount changes in the profitability of a company.The company under study made good use of debt funds in its capital structure and this was reflected in the growth in profitability & EPS.The falling financial leverage ratio indicates that the company had been prudent in its debt raising programme.The reserves of the company increased considerably in 1995 & 1996 thereby the debt equity ratio also came down.This ploughing back coincided with the falling fixed assets ratio.This resulted in comparatively lower profits.Had the fixed assets ratio improved the EPS would have jumped since the benefit of trading on equity would have been available to the fullest extent.

4.COUNTERING BUSINESS RISKS :

The company is in a position to raise further loans due to the comfortable & sound position of owned funds.This lends flexibility to the capital structure.However the fact that the company decided to lower the Debt Equity Ratio may point out the perception of the management regarding the future risks.It might be that the management expects the competition to intensify in the near future or it might expect a long period of recession in the economy.Similarly the likely entry of foreign companies in its industry would weaken its position in the market & thereby reduce its sales.A company in such a condition would adopt prudent & cautious policies in order to minimise the above risks of business environment which to a large extent are unavoidable.A company can only minimise the impact of such risks.As a part of the strategy to counter such business risks the company may decide to rely more on own funds rather than raise further loans.Though this will reduce the returns to the shareholders the management would be able to reduce its financial risks & thereby the profitability of the company can be maintained.This is because the business risks normally translate in reduced turnover & increased expenses.Similarly high operating leverage shows the vulnerability of a company to business risks since it measures the fluctuation in sales in relation to the EBIT.Therefore companies having high opearting leverage should not go in for high financial leverage.In such a condition it would be advisable to reduce the interest costs which are by nature fixed & which form a significant part of total sales of a growing company.In fact as stated above the raising of loans is a double edged sword.Where the business risks increase the financial leverage will expose the company to a lot of risks chief among them the insolvency of a company.

It is true that the changes in capital structure will not eliminate or reduce the business risks themselves since they are unavoidable to a large extent.However the adverse effects of business risks can definitely be minimised by substituting debt by owned funds in the capital structure.

Thus based on the study of the various accounting information & accounting ratios the following conclusions can be drawn :

1. The company under study made good use of debt funds in its capital structure.The changes in capital structure of the company resulted in increased profitability as evidenced by growing EPS, increasing dividend,bonus etc.

2. As a result the benefits of financial leverage accrued to the company to a large extent.As stated

above the company had not been able to reap the benefits of financial leverage to the fullest extent for the reasons already mentioned.

3. The company had low operating leverage which should have been accompanied by a high financial leverage to maximise the returns to the shareholders. Even though the shareholders of the company have considerably gained over the period the falling financial leverage has prevented the maximisation of their interests.

4. The company had been following a prudent & cautious policy in the later period beginning from 1995. The financial management of the company was also satisfactory as the ratio analysis shows.

5. The perception of the company regarding the future business risks was reflected in the capital structure of the company as evidenced by fall in the financial leverage and debt equity ratio. This evidenced the desire of the company to counter the future business risks.

6. The theories of capital structure cannot be applied to the company because of their inherent limitations.

6 . 5. LIMITATIONS OF THE STUDY :

The above conclusions should be read alongwith the following limitations :

i) The conclusions were derived by studying the actual data as published in the annual accounts of the company.The data was not compared with the projections of the company for the above period.

ii) The division of expenses into fixed and variable was made as per the trend shown over the years & was not derived scientifically or by actually scrutinising the books of the company.

iii) This study was intended to see whether generally there is a relationship between changes in capital structure of a company & its profitability over a certain period.This was because efficient management is the factor that affects the profitability the most.Therefore no mathematical equations for the above changes can be laid down nor can these conclusions be applied to each & every company in toto.

iv) The subject of operating,financial leverage & cost of capital is subject to many assumptions which apply to the results of this study.

6 . 6 . SUGGESTIONS :

Based on the conclusions and the limitations of this study the following suggestions are made :

1. There is further scope for improving the returns to the shareholders by way of increasing the financial leverage.As stated above the company had low operating leverage which reduces the degree of fluctuations in EBIT due to fluctuations in sales.Therefore the returns to the shareholders can be increased by relying on more debt i.e. by trading on equity to a larger exent.
2. As stated above the fixed assets turnover ratio fell in the 1995 & 1996.This shows that the expansion made by the company did not result in higher sales.As a result the returns to the shareholders also fell.Therefore there is scope for increasing the sales of the company.
3. The debt equity ratio also fell in the years 1995 & 1996.The ratio was very low in 1995 & 1996.The company can raise further debt for expansion and should balance the low operating leverage with high financial leverage.

4. The interest coverage ratio in 1995 & 1996 was 2.29 & 2.28 respectively. Considering the fact that the tax liability was to be repaid out of EBIT this ratio was quite low. The norm for this ratio is between 4 to 5. Therefore the company should take measures to increase this ratio by properly managing the tax liability.

5. The company has not raised funds in the foreign currency during the period of study. With the liberalisations of the provisions of the FERA the fund raising in foreign currency has become easier. These funds prove to be cheap even after considering the cost of forward premium. The company can profitably avail of these funds & can increase the returns to the shareholders.