Corporate Capital Structure in India: Trends, Issues and Determinants

Abstract

This study examines the financing pattern of 891 manufacturing companies over the period from 1992-93 to 2007-08. It tests the theories of capital structure and determines the speed of adjustment to target capital structure. It also analyses the influence of macroeconomic condition on capital structure and role of business group affiliation in determining the capital structure. Results reveal that trade-off and pecking order theories of capital structure are not mutually exclusive to explain the financing pattern of Indian enterprises. Historical market to book ratio has been a better proxy for growth opportunity and it significantly affects the capital structure decisions. Stock return has a short-run impact on the determination of leverage ratios. Financial constraints and external financing costs play the significant role for determination of adjustment speed to target capital structure. It is the first study which tests the modified pecking order, market timing and inertia theories of capital structure, and examines the role of macroeconomic conditions and business group affiliation in determining capital structure and adjustment speed to target capital structure in India. The findings would help the corporate managers to devise the optimal financing policy for their companies in India.

Key words: *Target capital structure, adjustment speed, macroeconomic condition, trade-off, pecking order, historical market to book ratio, stock return, business group.*