Study of Established Financial Management Tools and Technique and Its Application in Financial Decision Making Of Companies (With Emphasis on Capital Structure)

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Abstract:
The research is an attempt to find the financial corporate practices followed in India and it tries to analyze whether various financial tools and techniques taught in business schools are actually followed and implemented in Corporate India. The research will help to understand the real scenario of its impacts in Mumbai Area. It will further help in understanding the financial practices implemented and used in Mumbai based industries and the extent up to which these are implemented in the selected Area. Given the problem such a response study will be an effort, Small though to understand the conformities or gaps between the theory and practice.

This will further help to
a) Enrich the further know how in text books
b) To eliminate outdated practises
c) To put theory and practise side by side and understand mutual relationship and reinforcement
There is perception that the theory is not followed while making major decisions so to understand the real scenario and practices followed in corporate this kind of research is necessary. The purpose of this research work is to suggest develop an effective system of corporate finance and methods and practises required to be modified and focussed upon by understanding its use and application in actual companies financial decision making.

Keywords: Capital structure, Weighted Average cost of capital, Cost of debt, market capitalisation

1) Objectives:
a) To identify corporate financial management practices in India with Focus on four areas Capital budgeting, capital structure, cost of capital, Dividend Policy.
b) To examine the practices of corporate finance used by practitioners vis-a-vis theory and finance tools taught in business schools and professional Institutes.
c) To assess the level of perceived awareness about tools and techniques of financial management.
d) To examine the pattern of managerial use of the financial management tools and techniques by the companies.
e) To suggest the practises, methods required to be modified and improved for better implementation in decision making of corporate finance.

The literature review capture at least 19 well researched papers, articles, book reviews along with important text from the year 1950 onwards. But out of these this review paper covers 7 papers selected based on the topics capital budgeting and capital structures. The research papers explored as part of literature review, along with the text shown is on Annexure1 lay the foundation for research study. Thus the topics explored are presented below. An attempt is being made to capture the gaps and tries to explore the areas required to be focussed on the further research. The research tries to attempt to cover and emphasis these areas and tries to address the problems studied through the literature review.

LR 1- Research Needs in corporate finance
LR2- Capital Structure
LR 3- Cost of capital
LR4- Sensitivity of cash flow
LR5-Mananger characteristic and Capital Structure
LR6 -Dividend Policy
LR7-- Multiobjective model of capital structure

LITERATURE REVIEW (LR)-I Research papers)  
A major aim of both theoretical and empirical financial research should be to aid the financial decision-maker. The primary purpose of this field research study is to ask practitioners directly about their perceptions of important, less-addressed problems in corporate finance in order to direct future financial research. The profile embraces those areas in corporate finance where additional research can be expected to contribute to more efficient managerial decision-making influence and effect of ownership concentration on operational decisions, New techniques for asset-liability management, Value of liquidity of cash, Impact of accounts receivable and payable policies, Seasonality impact on operational planning, the influence of tax laws on financial decision making, Awareness of regulators financial performance issues, Effects of financial statement restrictions, Effects of pension fund law, Management's role in at attempting to avoid hostile takeovers, How shareholder concentration affects firm value, are the interesting areas which needs to be studied in depth.

LITERATURE REVIEW (LR)-2  
How and When Do Firms Adjust Their Capital Structures toward Targets?-by Soku Byoun-- Journal of Finance • vol. Lxiii, no. 6 , 2008  
If firms adjust their capital structures toward targets, and if there are adverse selection costs associated with asymmetric information, how and when do firms adjust their capital structures? Paper suggest a financing needs-induced adjustment framework to examine the dynamic process by which firms adjust their capital structures. Researcher finds that most adjustments occur when firms have above-target (below-target) debt with a financial surplus (deficit). These results suggest that firms move toward the target capital structure when they face a financial deficit/surplus—but not in the manner hypothesized by the traditional pecking order theory. Previous studies expressed a need for a unified framework that incorporates elements of both pecking order and trade-off behaviour. In sum, the two competing theories, which have largely been evaluated in isolation from one another, can be viewed as complements. In order to address this issue, paper tries to combine the basic intuition of the pecking order theory. According to the pecking order theory, adverse selection costs are the dominant factor in capital structure decisions (Myers and Majluf (1984)). However, Frank and Goyal (2003), Fama and French (2002), and Barclay and Smith (2005) suggest that adverse selection costs are only one of many factors that firms take into account when making financing decisions—even when operating under the trade-off theory. The most apparent effect of adverse selection costs is a firm’s preference for internal funds. Accordingly, in the presence of adverse selection costs, firms may have target debt levels and still prefer internal funds over costly external ones. If the adverse election/transaction costs are higher for equity than for debt, firms with financial surpluses are more likely to reduce debt than equity in order to preserve the debt capacity for future financing needs and to avoid the higher costs of re-issuing equity.

LITERATURE REVIEW (LR)-3  
The paper assess how forms of disagreement among investors affect a firm’s cost of capital. Firms experience a lower cost of capital if investors perceive that other investors are ignoring relevant disclosures (perceived errors of omission), but a higher cost of capital if investors perceive that others are responding to irrelevant disclosures (perceived errors of commission). The impact of these two
sources of disagreement on the cost of capital is determined by the distribution of opinion and the nature of disclosure. For example, even though aggregated disclosures reveal less to investors, aggregated disclosures may decrease the cost of capital by eliminating disagreement associated with perceived errors of commission. These and additional results arise because the cost of capital is driven not only by investors’ uncertainty about the firm’s future, earnings performance, but also by investors’ uncertainty about the evolution of beliefs, which partly determines the path of prices.

LITERATURE REVIEW (LR)-4  
The paper tries to investigate the effects of manager characteristics on capital structure in a structural model. It implement the manager’s optimal contracts through financial securities that lead to a dynamic capital structure, which reflects the effects of taxes, bankruptcy costs, and manager-shareholder agency conflicts. Long-term debt declines with the manager’s ability, inside equity stake, and the firm’s long-term risk, but increases with its short-term risk. Short-term debt declines with the manager’s ability, increases with her equity ownership and declines with short-term risk. This paper theoretically and empirically analyzes the effects of managerial incentives and manager-specific characteristics on capital structure.

LITERATURE REVIEW (LR)-5  
The paper studies the sensitivity of levels of cash flow of the firm .It also identifies the characteristics’ of the cost of sources of funds ceteris paribus, a sensitivity of investment levels to cash flows indicates that the cost of internal finance is lower than that of external finance. The variation in the cost is attributed to “agency cost, agency conflicts, underinvestment incentives, or adverse selection. Moreover the paper highlights the managerial financial behaviour and says that many noninvestment uses of cash expand or contract investment potential and thus capture part of the investment effect of cash. Thus positive cash inflows may instead of motivating investment, be used for variety of noninvestment of uses of funds like reduction of leverage, increase in inventory and so on Hence the effective demand for investment does not always follow increase in cash .Again the paper highlights the diff bet constrained and unconstraint firm. Unconstraint firm which are debt free or enjoyed cash surplus may be in position to undertake add investment with or without external financing depending upon the amt of surfeit cash on the one hand and size of invest proposals on the other. In contrast constraint firms facing cash crunch may have limited scope for managing investments till they overcome the debt trap to ease the cash crunch. Investment may the follow.

LITERATURE REVIEW (LR)-6  
The interaction of corporate dividend policy and capital structure decisions under differential tax regimes by ufuck ince,James Owers Journal Economic Finance 2012  
The interaction of corporate dividend policy and capital structure decisions under differential tax regimes are studied in the paper .It develops a valuation model that integrates corporate capital structure and dividend payout policies. When the dividend tax rate exceeds the capital gains tax rate, dividend payout can partially offset value-enhancing effects of leverage. When the two rates are close, dividend payout loses its moderating influence. Almost half a century after the seminal MM contributions (Modigliani and Miller 1958; Miller, capital structure and dividend policy continue to be topics of great interest in the academic literature and for industry practitioners. In this paper researcher aims to contribute to the understanding of capital structure, dividend policy, and their interaction. In this paper a model is
developed in which firm value is determined simultaneously by dividend payout and financial leverage.

LITERATURE REVIEW (LR)-7
The paper highlights the practises of Indian and overseas businesses. The role of leverage in market capitalisation and EPS is studied. A quantitative approach using goal programming model is deployed to capture multiple goal posits before enterprise.
Capital structure decisions (CSDs) have become complicated in this exceeding competitive business environment. Theories and models of 1950s are unable to incorporate the demands faced by the decision maker. New models are needed to incorporate multiple objectives and constraints. Stakeholders are awfully demanding. Practitioners attempt to innovatively build the capital structures to meet the needs of all stakeholders. Off and on balance sheet exposure contributes to financial commitments. In the light of this background, the present study investigates the Indian corporates for their capital structure choices and builds a goal programming model for CSDs. The study has also explored the relationship of leverage ratio with market capitalization and earnings per share (EPS).
The gaps which are explored through the literature review covers some of the following areas and papers as follows

Lintners Path Breaking Analysis of Dividend Policy describes the current practice of corporate financial management. The results of that study are still quoted today and have deeply affected the way that dividend policy research is conducted. The theory and practice of corporate finance: Evidence from the field.
Perhaps the best-known field study in this area is John Lintner's (1956) pathbreaking Analysis of dividend policy. Many papers have been published on dividend policies. But there is need that to use these theories by academicians to develop new theories or potentially modify or abandon existing views.
The paper on "The Theory and Practice of Corporate Finance: Evidence From the Field" How CFOs really Practice Finance Ronald D. Watson, , Vol. 5, Financial Management Association International focused on capital budgeting, cost of capital and capital structure. The financial theories and tools of academia are slowly being adopted into financial theory, starting with the Nobel Prize-winning Franco Modigliani and Merton Miller papers in the 1950s, which asserts that companies choose their capital structure on the basis of a trade-off between the benefits of debt (the tax deductibility of interest payments) and the drawbacks of debt (higher interest payments). However, the surveyed CFOs considers "maintaining financial flexibility" — as the most important factor that is, keeping debt levels low in order to be ready for unforeseen opportunities.
There is a need to address some important issues in the literature through an examination of the effect of macroeconomic conditions on capital structure in the context of size of industries, Market Capitalisation and turnover with a focus on the Indian based Industries.

Many of the investments that small firms make cannot easily be evaluated using the discounted cash flow techniques recommended by capital budgeting theory. Many investments by small firms are not discretionary (a firm either makes a specific investment or it goes out of business), and future cash flows can be difficult to quantify. For example, if a firm is introducing a new product line, estimates of future cash flows can be imprecise (and market research studies required to obtain better cash flow estimates may not be cost effective).
When future cash flows cannot be easily estimated, discounted cash flow analysis may not provide a reliable estimate of a project's contribution to firm value, and it is not surprising that a firm might resort to gut feel to analyze the investment. For these reasons, small firms face capital budgeting challenges that differ from those faced by larger firms. Thus, it is possible that optimal capital
budgeting methods for large and small firms may differ. However, a fully integrated capital budgeting theory—identifying the conditions under which discounted cash flow analysis is appropriate—has yet to be developed. The question of how to better tailor the prescriptions of capital budgeting theory for small firms remains unanswered.

Bibliography

References:

Journals: