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FINANCIAL LEVERAGE AND CAPITAL STRUCTURE PLANNING IN SMALL-SCALE INDUSTRIES

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ABSTRACT

Capital structure refers to the mix of long-term sources of funds and equity share capital/owners' capital including reserves and surplus. Capital structure is key to the objective of profit maximization, ensures the minimum cost of capital and the maximum rate of return to equity holders. The main objectives of this study are to examine: (i) whether in small firms while employing financial leverage its effects are considered or not, (ii) What considerations they recognize in determining the financing plan, and (iii) Whether they plan their capital structure or not. For the said purpose we have collected data through questionnaire from 400 small-scale units in Haryana. After analysis we found that in most of small-scale industries while employing financial leverage its effects are not considered, while taking financial decisions non-financial factors play an important role, cost of debt is considered only by big units of the sector and capital structure is also planned only by the same units.

KEYWORDS

Cost of Debt, Capital Structure Planning, Debt-Equity Ratio, Financial Leverage, Theories of Capital Structure.

INTRODUCTION

Financial leverage results from the presence of fixed financial charges in the firm's income stream. These fixed charges do not vary with the earnings before interest and taxes (EBIT) or operating profits. They have to be paid regardless of the amount of EBIT available to pay them. After paying them, the operating profits (EBIT) belong to the owners. Financial leverage is concerned with the effects of changes in EBIT on the earnings available to equity-holders. It is defined as the ability of a firm to use fixed financial charges to magnify the effects of changes in EBIT on the firm's earnings per share. In other words, financial leverage involves the use of funds obtained at a fixed cost in the hope of increasing the return to the shareholders.

There are two types of leverage – 'Operating' and 'Financial'. The leverage associated with investment (asset acquisition) activities is referred to as operating leverage, while leverage associated with financing activities is called financial leverage. While basically we are concerned with the financial leverage for purposes of financing decision of a firm.

The investment projects of a firm can be financed either by increasing the owners' claims or the creditors' claims. The owners' claim increases when the firm raises funds by issuing common shares or by retaining the earnings; the creditors' claims increase by borrowing. The various means used to raise funds represent the financial structure of an enterprise. Traditionally, short-term borrowings are excluded from the list of methods of financing the firm's capital budgeting decisions, and therefore, the long-term claims are said to form the capital structure of the enterprise. The term capital structure is used to represent the proportionate relationship between debt and equity.

REVIEW OF LITERATURE

In practice, financial management literature does not provide specified methodology for designing a small firm's optimal capital structure. Theoretical and empirical research suggests that financial planners should plan optimal capital structure. A number of research studies have been conducted regarding the choice of debt equity mix in the total capitalization of a firm in the International as well as Indian context. These studies have revealed the following:

INTERNATIONAL CONTEXT

In 1958 Modigliani and Merton Miller (hereafter called M-M) were the first to present a formal model on the relationship between the leverage, cost of capital and the value of the firm. They maintained that under a given set of assumptions, the capital structure and its composition has no effect on the value of the firm. MM model shows that the financial leverage does not matter and the cost of capital and the value are independent of the capital structure. When corporate taxes are taken into account, the value of a firm increases linearly with debt-equity ratio because of interest payments being tax exempted. M-M's work has been at the centre stage of the financial research till date. Their models have been criticized, supported, and extended over the last 55 years.

David Durand (1963) criticized the model on the ground that the assumptions used by M-M are unrealistic. Solomon (1963) argued that the cost of debt does not always remain constant. When the leverage level exceeds the accepted level, the probability of default in interest payments increases thus raising the cost of debt.

Stiglitz (1969, 1974) proved the validity of the M-M model under relaxed assumptions whereas Smith (1972), Krause and Litzenberger (1973), Baron (1974, 1975), and Scott (1976, 1977), supported the M-M model, but only under the conditions of risk free debt and costless bankruptcy. When bankruptcy has positive costs, there exists an optimal capital structure which is a trade-off between tax advantage of debt and bankruptcy costs.

This trade-off theory was challenged by Miller (1977). He argued that bankruptcy and agency costs are too small to offset the tax advantage of debt. But when personal taxes are taken into account, this advantage is completely offset by the disadvantage of personal tax. Thus, in equilibrium, the value of a firm is independent of its capital structure, even when the market is imperfect.

But Miller's model was rejected by De Angelo and Masulis (1980). They argued that even if bankruptcy, agency and related costs are ignored, introduction of non-tax debt shields is enough for a firm to have an optimal capital structure. And even if these costs are taken into account, an optimal capital structure exists, irrespective of availability of non-debt tax shields.

Masulis (1980, 1983), Brennen and Schwartz (1978) and Jensen and Meckling (1976) also advocated the existence of an optimal capital structure in an imperfect market, while using different mechanisms.

Empirical work by Bradley, Jarrell and Kim (1984), Long and Malitz (1985) and Titman and Wessells (1985) largely supports bankruptcy costs or agency costs as partial determinants of leverage and of optimal capital structure. DeAngelo and demonstrated that with the presence of corporate tax shield substitutes for debt, each firm will have a "unique interior optimum leverage decision with or without leverage related costs".

The findings of Allen N Berger (Oct.2002) are consistent with the agency costs hypothesis- i.e. higher leverage or a lower equity capital ratio is associated with higher profit efficiency, all else equal. He also concluded that under the efficiency risk hypothesis, the expected high earnings from greater profit efficiency substitute for equity capital in protecting the firm from the expected costs of bankruptcy or financial distress, whereas under the franchise-value hypothesis, firms try to protect the expected income stream from high profit efficiency by holding additional equity capital.

Ferri and Jones (1979) found that the industry-class was linked to a firm's leverage, but not in a direct manner than what has been suggested in other researches. Harris, Rodney, Roenfeldt and Cooley (1983) stated that financial leverage clienteles play an important role in the determination of the capital structure. Richard Kolondy and Diane Rizzule Suher (1985) indicated that no relationship is shown between shareholders return and the company's pre-issue degree of financial leverage.

Chungchang (1992) found that the leverage can be used as an instrument to transfer wealth between investors and employees. The transfer can go in either direction. Hull (2002) found that the industry debt to equity norms are significantly more negative than returns for the firms moving closer to these norms. Rajan and Zingales (2002) found that the extent to which firms are levered is fairly similar across the G-7 countries, with only United Kingdom and Germany being relatively less levered. Nissim and Penman (2003) stated that the financial statement analysis distinguishes leverage in financing activities from leverage in operations.

INDIAN CONTEXT

As per a study conducted by Sharma. M. L. (1986) on the financial appraisal of Industrial corporations in India, concluded that there could not be a uniform capital structure which will suit the requirements of all the companies. Capital structure has to be tailored to suit the needs of every individual company. However, it is possible to frame a model capital structure for a group of companies having similar characteristics.

Another study conducted by B. R. Choyal (1986) concluded that the funded debt constituted the major source of financing the total assets employed in three of the corporations under study. All five state level warehousing corporations under study adopted a conservative policy of financing by keeping the debt-equity ratio below the norm of 1:1. The management also relied more on borrowed funds to finance the fixed assets in these corporations.

According to the study conducted by Prasanna Chandra (1975), a significant relationship existed between the share price and the variables like return, risk, growth size, leverage, etc. Thus, leverage or the debt-equity mix in the capital structure is also one of the factors affecting the value of a share of a firm.

The earlier studies conducted by Bhatt (1990) and Pandey (1984) revealed that corporate managers generally prefer borrowings to owned funds because of the advantage of the lower cost and no dilution of existing management control over the company. However, in a recent study conducted by Babu and Jain (1998) it has been found that the corporate firms in India are now showing an almost equal preference for debt and equity in designing their capital structure. Freedom in paying dividend and ease in raising money are the reasons cited for equity preference. However, due to increasing competition, returns have become uncertain. Hence, companies would not prefer debt over equity though debt is a cheaper source of finance because of tax advantage.

Sharma and Rao (1969) tested the M-M model using cross-sectional analysis for engineering companies, wherein the value of a firm was found to be independent of its capital structure after allowing for tax advantage. But the results could not be generalized as the sample was homogenous. The other work by Pandey (1992) observed that the M-M theory is not fully valid under Indian conditions. He concluded that, initially, cost of capital and value of a firm are independent of the capital structure changes, but they rise after a certain level.

OBJECTIVE OF THE STUDY

The main objective of the study is to examine the important factors considered by small-scale industries while taking financing decisions and planning of capital structure and use of capital structure theories.

SCOPE OF THE STUDY

The present study deals with the small-scale industries in Haryana. It was not possible to cover all the states in India due to time and financial constraints. However, we believe that the findings of the study would have equal applicability for the enterprises in other States also, since there is much similarity among the small industries with respect to size, structure, operation and management.

DATA REQUIREMENT

The present study is based on primary data. The data have been collected through questionnaire, interviews and observations. The primary data are the main base of the study. For this purpose we have undertaken intensive case studies of 400 selected small-scale industries. While selecting these units we have taken enough care to see that these are representative of all type of industries and all districts in Haryana. For the said purpose we have divided all the industries into six categories such as Garments, Auto-parts, Electronics, Metal Products, Rubber and Plastics, and Others (Table 1).

TABLE 1.0: SAMPLE SIZE

Name of the Industry	sample
1. Garments	80
2. Auto-parts	40
3. Electronics	60
4. Metal Products	78
5. Rubber and Plastics	56
6. Others (Machinery parts, Paper products, Chemical products, etc.)	86
Total	400

FINANCIAL LEVERAGE IN SMALL-SCALE INDUSTRIES

The effect of financial leverage on the return to equity shareholders depends upon the relationship between earnings before interest and taxes on the one hand and the amount of interest charges and fixed preference dividend on the other. Financial leverage also involves the financial risk i.e., the risk of failure to cover the fixed financial costs of the company. When the rate of earnings is less than the rate of interest or preference dividend, the use of debt can result into loss to the equity share-holders. Debt is like fat which is good for a healthy person but dangerous for a person with high blood pressure. While using it, the debt absorbing and debt repaying capacity of the company must be kept in view. Thus, financial leverage has the potential of increasing as well as reducing the return to equity shareholders.

TABLE 1.1: EFFECTS OF FINANCIAL LEVERAGE IN THE DESIGNING OF CAPITAL STRUCTURE CONSIDERED BY SMALL-SCALE INDUSTRIES IN HARYANA

Name of Industry	Yes		No		Total
	No.	%	No.	%	No.
1. Garments	8	10.0	72	90.0	80
2. Auto-parts	7	17.5	33	82.5	40
3. Electronics	6	10.0	54	90.0	60
4. Metal Products	5	6.4	73	93.6	78
5. Rubber & Plastics	7	12.5	49	87.5	56
6. Others	10	11.6	76	88.4	86
Total	43	10.8	357	89.2	400

In small firms all the decisions are taken by the owners. And most of the businesses are owned or managed by such persons who are not having any formal education of commerce/business. So, most of the owners/and management do not know the meaning of the term "financial leverage" and its effect on the return to equity shareholders in small-scale industries. As per the information collected regarding the effects of financial leverage in designing the capital structure are considered or not, 89.2 per cent small-scale units gave their answer in negative. There are various reasons for not considering its effects. Most important among them is the limited choice between Debt and Equity. In small-scale industries equity capital is in scarcity. When finance is required the only choice is debt. So, effects of financial leverage are not considered in most of the small-scale industries.

On the other hand, the Small-scale industries which are considering the effects of debt capital on return on equity include those big units of small sector which have an option among equity or debt. And in these industries help of experts is taken, before taking financing decision, to study the options available in detail. Table 1.1 shows that only 10.8 per cent industries in small sector in Haryana are considering the effects of financial leverage. Among them the highest percentage is in Auto-parts industry, 17.5 per cent followed by Rubber and Plastics industry 12.5 per cent, Others industry 11.6 per cent, Garments and Electronics industries, 10.0 per cent each and Metal Products industry 6.4 per cent.

CONSIDERATIONS IN FINANCING DECISION USED IN SMALL-SCALE INDUSTRIES

Determining the relative importance of the various financial problems faced by a small-scale industry would be both difficult and subjective; however, the cost and availability of long-term funds would have to be considered of prime import. Raising permanent capital for the expansion of an enterprise is not accomplished with ease, particularly for the small sector industry. In general, the small firm is thought to incur higher cost for its funds as well as a greater limitation - in terms of the diversity of sources. There are various considerations that must be recognized in determining which financing plan should be accepted by the company.

- (i) **TRADING ON THE EQUITY.**
- (ii) **DEBT-EQUITY RATIO.**
- (iii) **THE ABILITY TO COVER FIXED FINANCING CHARGES.**
- (iv) **NON-FINANCIAL INFLUENCES OF THE FINANCIAL MIX.**

TABLE 1.2: CONSIDERATION IN FINANCING DECISIONS IN SMALL-SCALE INDUSTRIES IN HARYANA

Name of Industry	Trading on Equity		Debt-Equity Ratio		Interest Coverage Ratio		Non-Financial Factors		Total No.
	No.	%	No.	%	No.	%	No.	%	
1. Garments	4	5.0	5	6.3	10	12.5	61	76.2	80
2. Auto-parts	4	10.0	6	15.0	7	17.5	23	57.5	40
3. Electronics	5	8.3	6	10.0	10	16.7	39	65.0	60
4. Metal Products	2	2.6	5	6.4	6	07.7	65	83.3	78
5. Rubber & Plastics	3	5.4	3	5.4	6	10.7	44	78.5	56
6. Others	4	4.6	6	7.0	7	08.1	69	80.3	86
Total	22	5.5	31	7.8	46	11.5	301	75.2	400

Table 1.2 shows that in small-scale industries 75.2 per cent units consider non-financial factors for taking financing decisions. And important considerations, such as Trading on equity, Debt-equity ratio and Interest coverage ratio are considered only by 5.5 per cent, 7.8 per cent, and 11.5 per cent units respectively in small-scale industries. These factors are considered in financing decisions mostly by those industries which have an option between Equity and Debt as a source of financing, and are mostly large units. The other reason of considering them is having team of experts in management.

As said above in 75.2 per cent units in small sector, financing decisions are taken by considering non-financial factors, the main reasons of it are non availability of equity and preserve control. The maximum number of units in this category are from Metal Products industry 83.3 per cent followed by Others industry 80.3 per cent, Rubber and Plastics industry 78.5 per cent, Garments industry 76.2 per cent, Electronics industry 65 per cent, and least in Auto-parts industry 57.5 per cent units.

Interest coverage ratio is also very important tool in taking a financing decision, which is also not being paid much attention by small-scale industries. Only 11.5 per cent units are using it for financing decisions. In this category the leading one is Auto-parts industry, where 17.5 per cent units are considering interest coverage ratio for selecting the source of finance, followed by Electronics industry 16.7 per cent, Garments industry 12.5 per cent, Rubber and Plastics industry 10.7 per cent, Others industry 8.1 per cent and Metal Products industry 7.7 per cent units. Trade on Equity and Debt-Equity Ratios are also important factors for financing decisions. Debt-Equity Ratio is maximum considered by 15 per cent units in Auto-parts industry followed by Electronics industry 10 per cent, Others industry 7 per cent, Metal Products 6.4 per cent, Garments industry 6.3 per cent, and least by Rubber and Plastics industry just 5.4 per cent units. Trade on Equity factor is also maximum considered by Auto-parts industry, where 10 per cent units are using it for financing decision followed by Electronics industry 8.3 per cent, Rubber and Plastics industry 5.4 per cent, Garments industry 5 per cent, Others industry 4.6 per cent, and least in Metal Products industry 2.6 per cent units.

CAPITAL STRUCTURE PLANNING IN SMALL-SCALE INDUSTRIES

Capital structure refers to the mix of long-term sources of funds such as debentures, long-term debt, preference share capital and equity share capital including reserves and surpluses (i.e. retained earnings). Some companies do not plan their capital structure, and it develops as a result of the financial decisions taken by the financial manager without any formal planning. These companies may prosper in the short-run, but ultimately they may face considerable difficulties in raising funds to finance their activities. With unplanned capital structure, these companies may also fail to economize the use of their funds. Consequently, it is being increasingly realized that a company should plan its capital structure to maximize the use of funds and to adopt more easily the changing conditions.

It was pointed out that although the use of debt will, in most cases, cause the rate of return on equity capital to increase, it also increases the financial risk of the firm. That is, the use of debt increases the possibility of insolvency as well as variability in the earnings available to equity. A large majority of small industries are perfectly capable of assuming a certain amount of risk and should be interested in employing a level of debt commensurate with their ability to assume risk. If this level is exceeded, it is generally believed that the value of the firm will be adversely affected and the firm may actually experience insolvency. A paradox exists in small industries since in many cases the major source of funds is debt oriented, yet many small businesses cannot afford debt because they cannot stand risk. For this reason all owners and managers should be extremely careful when determining their capital structure.

TABLE 1.3: CAPITAL STRUCTURE PLANNING IN SMALL-SCALE INDUSTRIES IN HARYANA

Name of Industry	Yes		No		Total No.
	No.	%	No.	%	
1. Garments	8	10.0	72	90.0	80
2. Auto-parts	10	25.0	30	75.0	40
3. Electronics	15	25.0	45	75.0	60
4. Metal Products	10	12.8	68	87.2	78
5. Rubber & Plastics	8	14.3	48	85.7	56
6. Others	12	14.0	74	86.0	86
Total	63	15.7	337	84.3	400

In small-scale industries in Haryana as shown by Table 1.3 just only 15.7 per cent industries are planning their capital structure. The maximum number is 25 per cent in Auto-parts and Electronics industries followed by 14.3 per cent in Rubber and Plastics industry, 14 per cent in Others industry, 12.8 per cent in Metal

Products industry, and least is 10 per cent units in Garments industry, which plan their capital structure. Capital structure is planned only in large units of small scale sector particularly having a company form of organization. On the other hand 84.3 per cent units are not planning their capital structure at all. Maximum number of such units is in Garments industry 90 per cent, closely followed by Metal Products 87.2 per cent, Others industry 86 per cent, Rubber and Plastics industry 85.7 per cent, Auto-parts and Electronics industries 75 per cent each. Majority of these units are managed by persons having no knowledge of capital structure planning and who cannot afford the services of experts or do not have much choice among debt and equity to finance the future projects. These are the main reasons of not planning capital structure in small units. Small units depend on debts capital for their financial requirements.

CONSIDERATION OF COST OF DEBT IN SMALL-SCALE INDUSTRIES

The cost of capital is a very important aspect of financial management and many financial managers of middle-sized and large firms use it as the basis for accepting or rejecting investment projects. But to the managers of small firms due to its difficulty in computation this concept is less important. Nevertheless, it should be remembered that the debt is cheaper than equity capital not only because of the relative absence of risk from the view point of the investor when compared to equity capital but also because interest charges are tax deductible. The effective cost of debt capital is reduced by the amount of the firm’s tax rate.

TABLE 1.4: BASIS OF SELECTING DEBT OR EQUITY IN SMALL-SCALE INDUSTRIES IN HARYANA

Name of Industry	Cost of Debt		Non-Financial Reasons		Total No.
	No.	%	No.	%	
1. Garments	8	10.0	72	90.0	80
2. Auto-parts	10	25.0	30	75.0	40
3. Electronics	15	25.0	45	75.0	60
4. Metal Products	10	12.8	68	87.2	78
5. Rubber & Plastics	8	14.3	48	65.7	56
6. Others	12	14.0	74	86.0	86
Total	63	15.7	337	84.3	400

As shown in Table 1.4, in small-scale industries in Haryana only 15.7 per cent industries are calculating cost of debt while taking a loan. It has been pointed out that cost of capital cannot be calculated in small and middle-sized firms with any degree of confidence. That’s why, in such a less number of small-scale industries, this very important factor is used in selecting between debt and equity for financing. In this category the maximum percentage, 25 per cent, belongs to Auto-parts and Electronics industries, followed by Others industry 14 per cent, Rubber & Plastics industry 14.3 per cent, Metal Products 12.8 per cent, and the least in Garments industry 10 per cent. Only, those industries, which are planning their capital structure with the help of experts, calculate cost of capital. Due to this only big units are calculating cost of capital. In Auto-parts & Electronics industries large units are more in comparison to Garments industry and Metal Products industry so their percentage is more in using this factor. The other reason may be the choice among debt or equity.

THEORIES OF CAPITAL STRUCTURE USED IN SMALL-SCALE INDUSTRIES

There have been several major contributors to a theory of capital structure. Basically, there are two opposite schools. One is so-called traditional theory states that, up to a certain point, debt added to the capital structure will cause the market value of the firm to rise and the cost of capital to decline; however, after the optimum point has been reached, any additional debt will cause the market value to decrease and the cost of capital to increase. The second approach states that the cost of capital is unaffected by the amount of debt employed. One of the foremost advocates of the traditional approach is Ezra Solomon; the latter approach is defended by Modigliani and Miller.

As far as small scale industries are concerned all the industries which are planning their capital structure adopt the traditional theory of capital structure advocated by Ezra Solomon. These industries believe that a judicious use of debt increase the value of the firm and reduce the cost of capital. The optimum capital structure is the point at which the value of a firm is the highest and the cost of capital the lowest.

DEBT-EQUITY RATIO IN SMALL-SCALE INDUSTRIES

The debt-equity ratio is determined to ascertain the soundness of the long-term financial position of the company. This ratio expresses a relationship between total liabilities (external equities) and the owner(s)’s equity (internal equities). It provides meaningful information for evaluating the relative position of creditors and owners. In other words, this ratio shows the relationship between different sources of company’s finance. It indicates the extent to which the firm depends upon outsiders for existence or survival. A higher debt-equity ratio indicates higher financial risk. The choice of debt-equity ratio depends on relative cost of debt as compared to equity. The existing debt-equity ratio influences the future debt raising capacity of a business. If debt-equity ratio is already high, it becomes difficult nor it is desirable to raise fresh debts.

TABLE 1.5: DEBT-EQUITY RATIO IN SMALL-SCALE INDUSTRIES IN HARYANA

Name of Industry	0%		Upto 40%		41-80%		81-120%		121-160%		161-200%		Above 200%		Total No.
	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%	
1. Garments	-	-	1	1.3	4	5.0	8	10.0	10	12.5	22	27.5	35	43.7	80
2. Auto-parts	-	-	-	-	-	-	4	10.0	06	15.0	12	30.0	18	45.0	40
3. Electronics	-	-	-	-	4	6.7	4	6.7	07	11.6	12	20.0	33	55.0	60
4. Metal Products	-	-	3	3.8	3	3.8	4	5.1	06	7.7	18	23.1	44	56.5	78
5. Rubber & Plastics	-	-	2	3.6	2	3.6	2	3.6	05	8.9	15	26.8	30	53.5	56
6. Others	-	-	3	3.5	3	4.6	6	7.0	10	11.6	21	24.4	42	48.9	86
Total	-	-	9	2.3	17	4.2	28	7.0	44	11.0	100	25.0	202	50.5	400

With the help of above table we can analyse the Debt-Equity ratios in various small-scale industries. Table 1.5 shows that 75.5 per cent industries in small sector are using external equities between 161 to 200 per cent or more of the owner(s)’s equities. Only one fourth industries in small-scale sector are using Debt capital less than 161 per cent of owner’s Equity. In this category the maximum percentage is in Garments industry 28.8 per cent, followed by Others industry 26.7 per cent, Auto-parts and Electronics industries 25 per cent, Metal Products industry 20.4 per cent, and least in Rubber and Plastics industry 19.7 per cent.

As far as the standard of Debt-Equity ratio is concerned in a capital rich country, the practice is to use as little debt as possible. A debt-equity ratio of 1:3 or 33.3 per cent is regarded as good – and a ratio of 1:1 or 100 per cent would indicate an extremely heavy and unsatisfactory debt situation. But in under developed countries such standards cannot be expected. It is not unusual to find companies having a Debt-Equity Ratio of 2:1 or even 3:1 in the case of joint stock companies in India. But in small-scale industries the debt equity ratio more than 2:1 or more than 200 per cent is not considered good.

Now we can conclude that in majority of the small scale industries (50.5%) are using more than 200 per cent external equities which show a large share of financing by creditors relative to the owner(s). In future, these firms may face problem in getting further loans from outsiders and even face problem in paying interest on such a huge amount of loans. In this category the minimum percentage is 43.7 per cent, in Garments industry. Otherwise 45 per cent in Auto-parts industry, 48.9 per cent in Others industry, 53.5 per cent in Rubber and Plastics industry, 55 per cent in Electronics industry, and maximum 56.5 per cent units in

Metal Products industry are using more than 200 per cent external equities in comparison to owner(s)'s equities. The main reason of such a high percentage of external equities is shortage of owners' funds.

CONCLUSION

In small-scale industries the owners' are not familiar with the term financial leverage. That's the reason while employing financial leverage its effects are considered only by one-tenth units. And these units have option among debt and equity capital. Financing decisions are taken in two-third industries on the basis of non-financial factors. Important considerations such as Trading on Equity, Debt-Equity ratio and Interest Coverage ratio are considered only by five to eleven per cent units. In majority of small-scale industries capital structure is not planned. Only fifteen per cent units plan their capital structure and considered cost of debt while selecting Debt or Equity as a source of finance. In the small-scale industries majority of the units are using more than twice external equities in comparison to owner's equities.

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