



Factors Influencing Capital Composition: Review Of Literature

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ABSTRACT

Capital management plays a crucial role in shaping the overall financial well-being and growth of a firm. Determinants of capital structure can vary depending on various factors and circumstances. However, some common determinants include: cost of capital, business risk, profitability and growth opportunities, tax considerations, market conditions etc. It's important to note that these determinants are not exhaustive, and each company's capital structure decisions are unique based on its specific circumstances and strategic objectives. In this study factors have been scanned from two perspectives, the first is economy level and the second is sector level. Therefore, reviews of literatures are related to the study conducted on both the overall economy and specific sectors. By conducting this comprehensive literature review, we aim to identify common factors influencing capital structure that have emerged from previous research. This will contribute to a deeper understanding of the factors determining capital combination decisions. It, also, provides valuable understandings for all the parties in the field of finance.

Key Words: Firm, Determinant of capital Structure, Economic level, Sector Level, Business Risk

JEL Code: G31, G32

1. Introduction

The Capital structure denotes the composition of a company's long-term financing sources, including debt, equity, and retained earnings. It is an important aspect of financial management, as the optimum combination of equity and debt capital can significantly impact a firm's financial health and performance (Mohanraj, 2011). The capital combination of an organization is substantially influenced by both interior (micro) and exterior (macro) factors. Outside factors include macro-economic variables such as government tax policies, inflation rates, and the overall condition of the capital market. Whereas micro variables, which are specific to individual firms. Also these play an important part in shaping the capital structure of an organization (Baral, 2004).

Several experiential research works have been done to explore theories of capital structure and classify the causes of capital combination in India as well as internationally. This paper intention is to arrange for a comprehensive review of literature of research conducted over the past eleven years in emerging and developed markets. The analysis of studies is conducted at the domestic (India) and international levels, comparing and contrasting numerous capital structure elements. These factors have been scanned from two perspectives: the first is economy level and the second is sector level. Therefore, reviews of literatures are related to the study conducted on both the overall economy and specific sectors.

2. Construction of the Paper

This work is alienated into four segments, where the introduction being the first. In Section two, we demonstrate an analysis of factors influencing capital structure based on international research work. Section

three focuses on the survey of literature on capital combination in the context of India. Finally, in section four, discussion and conclusion based on the findings of the literature reviews are provided.

By conducting this comprehensive literature review, we aim to identify common factors influencing capital structure that have emerged from previous research. This will contribute to a deeper understanding of the factors determining capital combination decisions. It, also, provides valuable understandings for all the parties in the field of finance.

3. International Evidence of Determinants of Capital Structure:

3.1. Economy Level

Research findings regarding factors influencing capital structure at the economy level propose that several reasons, for instance economic conditions, government policies, and market dynamics, can influence the financing decisions of firms operating within a specific economy. In this segment, reviews of conclusions of various international researchers regarding the leading factors of capital structure at the economic level are done. The duration of these studies is between 2010 and 2021.

Ramakrishnan (2012) concentrated on the critical effect of determinants on the capital design of Malaysian firms from 1996 to 2007. The review distinguished risk, non-charge obligation safeguard, size, and substantial quality as critical variables impacting the assurance of capital construction. Ogbulu and Kehinde (2012) assessed the effect of different determinants on the capital construction of 110 firms recorded on the Nigerian stock trade from 2000 to 2005. The investigation discovered that size essentially affected capital construction, while age had a negative and critical impact. Kędzior (2012) analyzed the variables affecting the capital design of 1,063 organizations in European Endorser states from January 1, 2005. The review uncovered that benefit, size, financial development, expansion rates, corporate personal expenses, the progress of the financial area and capital business sectors, and public lawful systems essentially affected deciding the capital design. Chandrasekharan (2012) broke down the factors of capital design in Nigerian firms during 2007-2011. The review distinguished size of firm, age of firm, development, benefit, and substantial quality as important factors of capital design in firms in Nigeria. Fauzi et al. (2013) concentrated on factors of capital design in 79 firms on the New Zealand stock trade between 2007 and 2011. The investigation discovered that substance, development, flagging, administrative proprietorship, and size of firm were critical variables for complete obligation. In a study on the determinants of capital design in organizations recorded in Oman from 2006 to 2011. The review uncovered that lower benefit was adversely connected with influence, while higher productivity in resource turnovers was emphatically connected with influence (Fernandez et al., 2013). Choi (2014) researched the major factors of capital construction in fifty firms in Korea from 2008 to 2012. The investigation discovered that productivity, substantial quality of resources, and size of firm had a critical positive relationship with influence, while learning experiences and duty safeguard substitutes had a huge negative relationship. In another study the concentration was on the factors of capital construction in 49 recorded organizations on the Karachi Stock Trade (KSE) from 2000 to 2010 in Pakistan. The investigation discovered that sans risk financing costs, benefit, firm size, liquidity, and substance of resources were huge influences of capital design (Zubairi and Farooq, 2014). In the study conducted on Libyan firms regarding the influences of capital combination between 2008 and 2013. The investigation discovered that excessive cost profit proportions and exorbitant loan fees diminished the expense of value finance, driving firms to pick value over obligation (Masoud, 2014). In a study on the main determinants of Portuguese SMEs' capital construction utilizing information from 12,857 SMEs from 2007 to 2010, the investigation discovered that liquidity, resource construction, and productivity were the main factors of Portuguese SMEs' capital design (Proenca et al., 2014). The investigation discovered, in a study on the influences of capital design in 144 recorded firms in the Stock Trade of Thailand from 2000 to 2011, that size of firm and benefit were huge influences on capital design (Thippayana (2014). Cekrezi (2015) dissected the influences of 69 non-recorded firms in Albania between 2008 and 2011. The investigation discovered that profit from resources, return on value, substantial quality, and liquidity were important factors of capital design, with huge effects on long haul obligation as well as momentary obligation. The investigation likewise discovered that size, hazard, adaptability, and non-obligation charge safeguards essentially affected long haul obligation.

3.2. Significant Influents of capital structure at sector level

This segment presents the influences of capital structure that have been investigated at the sectorial level in the international literature.

Name of the researchers and Year	Area	Determinants examined and Found significant
Prahalathan (2010)	Industrial sector	Positive significant Net Tangible Asset and Profitability, Size of firm and Non-debt tax protections
Khrawish and Khraiweh (2010)	Industrial companies	Size, Tangibility-significant positive, Inverse relation in Profitability and Leverage

Khamis and Baharuddin (2011)	Construction companies	Size of firm, Growth and Positive Assets Tangibility and Profitability
Ting and Lean (2011)	Government-linked companies	Positive Assets Tangibility and Profitability, Size of firm, Leverage -negative
Baharuddin et al. (2011)	Construction	Profitability-negatively significant with form size, Net assets tangibility and growth are positively significant
Bundala and Machogu (2012)	Non-financial companies	Net Assets Tangibility and Profitability are significant positive
Chhapra and Asim (2012)	Textile sector	Size, and Profitability –positive significant
Sabir and Malik (2012)	Oil and gas	Profitability with leverage -negative significant and Liquidness, Size of firm and Net asset tangibility-positive significant
Lim (2012)	Financial services	Profitability, Size of firm, Non-debt tax Protection, and Income instability
Cortez and Susanto (2012)	Manufacturing	Net Asset Tangibility, Non-debt tax protection, Profitability,
Zarebski and Dimovski (2012)	Real estate investment trusts	Size of the firm, Profitability, Net Asset Tangibility, Growth opportunities
Zabri (2012)	SME	Net Asset Tangibility, Non-debt tax protection, Liquidness
Vatavu (2012)	Manufacturing	Size of firm, Asset tangibility, Operating risk, and rate of inflation
Shah and Jam-e-Kausar (2012)	Leasing	Size of firm, Non-debt tax protection, Profitability, and Liquidity
Utami (2012)	Manufacturing	Asset Tangibility, Profitability and Growth
Ajanthan (2013)	Hotels and restaurant companies	Profitability-negative significant
Basseyy et al. (2013)	Agro-based firms	Asset structure, firms' age, export status and Owner's gender
Md. Yusuf et al. (2013)	Electric and electronics Company	Size and asset tangibility-significant positive relations liquidity-negative
Chechet et al. (2013)	Chemical and paints sector	Tangibility and profitability
Tornyeva (2013)	Insurance Firm	Size of the firm, Profitability and Growth
Kuhnhausen and Stieber (2014)	Non-financial companies	Size of the firm, Degree of Leverage, Industrial growth, Liquidity and Profitability
Kariuki and Kamau (2014)	Food and beverage manufacturing firms	Size of firm and Growth opportunities
Acaravci (2015)	Manufacturing sector	Size of firm, Growth prospects, Asset tangibility, and Profitability,
Kumar et al. (2017)	Manufacturing Sector	Net Asset tangibility, N-D tax shield and Liquidity
Rashid et al. (2020)	Manufacturing Sector	Equity and debt combination, Net Asset tangibility and Profitability
Wang et al., (2021)	Manufacturing Sector	Size of firm, Degree of leverage and Profitability
Karas & Reznakova, (2021)	Manufacturing Sector	Size of firm, Asset tangibility, level of risk, Rate of inflation, and Profitability

4. Indian Evidence of Determinants of Capital Structure:

4.1. Economy Level

Certainly, liquidity is an important determinant when considering a business organization's capital combination choices. Liquidity denotes to the ability of a company to execute its short-term obligations. It is, generally, measured as the ratio of current assets to current liabilities. The association between capital structure and liquidity has been studied by various researchers, and the findings have been mixed. Some studies, such as those conducted by Kaur et al. (2020), Rani et al. (2020), and Sharma & Paul (2015), have found a straight association between capital structure and liquidity. This proposes that firms with higher liquidity tend to have higher leverage. On the other hand, other authors, including Ahsan et al. (2016), Guner (2016), Kahya et al. (2020), and Milos (2015), have indicated a reverse association between capital structure and liquidity. This infers that firms with higher liquidity may have lower levels of leverage.

Capital management is an essential aspect of managing large enterprises. The capital structure plays a crucial role in shaping the overall financial well-being and growth of a firm (Tripathy et al., 2021). Various factors influence the composition of the capital structure, as well as business risk, corporate tax position, financial flexibility, managerial conservatism and aggression, and the ability to efficiently use foreign capital to increase profitability (Panda et al., 2021). Though, it is significant that most of the studies on Indian data do not emphasize the contribution of industry attributes in analysing the influence of a firm's external economic environment on its choice of debt financing. Previous studies by Chakraborty (2010), Handoo and Sharma

(2014), Chauhan (2017), as well as recent ones by Das et al. (2020), Farhan et al. (2020), and Chadha and Seth (2021) do not highlight this aspect.

4.2. Significant Influents of capital structure at sector level

This section presents the determinants of capital structure that have been investigated at the sectorial level in the Indian literature.

Name of the researchers and Year	Area	Determinants examined and Found significant
Mishra (2011)	Manufacturing PSU	Size of firm, Assets Tangibility, Growth and Profitability and tax shields.
Mohanraj (2011)	Manufacturing	Firm's size, Profitability, Liquidity and Leverage
Riyazahmed (2012)	Automobile	Dividend pay-out, Degree of leverage, and Risk of business
Ray (2013)	Cement	Tangibility, Tax shields, Size of the firm, firm's age, Profitability
Aggarwal and Singh (2014)	Consumer electronics sector	Profitability, Net Asset tangibility, and Growth opportunity
Poddar and Mittal (2014)	Steel companies	Size of the firm, Liquidity, Profitability, and Solvency
Sinha and Samanta (2014)	Cement companies	Tangibility, growth, Size of the firm and N-D Tax shields
Chauhan (2017)	Manufacturing Sector	Firm's size, Profitability, Liquidity and Degree of Leverage
Das et al. (2020)	Manufacturing Sector	Profitability, Net Asset tangibility, and Growth opportunity
Farhan et al. (2020)	Service Sector	Firm's size, Profitability, Liquidity and Degree of Leverage, N-D Tax shields
Panda et al. (2021)	Manufacturing Sector	Asset Tangibility, Profitability, Liquidity and Degree of Leverage, FDI

5. Discussion and Conclusions

The observed and experiential study conducted on capital composition has been prepared at both the economic and sector levels. The paper presents separate studies conducted in India and internationally, including sector-specific and economy-wide determining factor of capital composition. After reviewing the Indian and global literatures on elements influencing capital composition, the paper identifies several important determinants. These include business risk, cost of long-term debt, loan servicing capacity, dividend pay-out ratio, firm age, firm's size, growth prospects, liquidity, protections against non-debt tax, profitability, tangibility, and uniqueness. We settle by describing the major determining factors of capital structure which are discussed in various studies:

- Business risk, measured by standard deviation, is found to be allied with the costs of insolvency. A higher business risk causes the utilization of debt, while a lower business risk boosts it. The rate of corporate tax, measured as dividing provision for tax by PBT (profit before tax), is also identified as an important determinant.
- The cost of debt denotes to the rate of interest an organization bears on its long-term loans/debts. It is measured as returns either before or after-tax. It is often calculated as dividing interest before tax by long-term debt
- The corporate tax is charged by the government on a firm's profit. The rate of corporate tax is commonly considered as dividing tax provision by PBT (profit before tax).
- Debt servicing capacity, measured by pre- depreciation profit, divided by gross interest, indicates the firm's ability to manage the interest expenses.
- The dividend pay-out ratio, calculated as the DPS (dividend per share) divided by the EPS (earnings per share). It shows the capacity of a firm credit finances to its investments.
- Firm age is also a significant determinant, as new firms may face higher bankruptcy costs and therefore have limited access to debt. Firm size, measured by total sales, total assets, or market capitalization, affects bankruptcy risk.
- Growth opportunities influence a firm's leverage capacity and it contributes in the progress in the total assets. Also, it is indicated as excess of the market value of equity over book value.
- Liquidity, indicated by the short-term solvency ratios i.e. current ratio and quick ratio, is important for meeting debt service obligations. Depreciation or depletion is considered as non-debt tax shields. They can cause a reduction in tax liabilities and affect a firm's financing decisions.
- Profitability is considered as return on assets, and tangibility, ascertained as division of the net fixed tangible assets by the total assets, is also considered as influencer of capital combination. .

- Firms initially finance their investments from retained profits. If earnings retained are inadequate, external financing is sought. The dividend pay-out ratio is measured as dividing the DPS (dividend per share) by EPS (earnings per share).
- A Larger company, generally, have lower insolvency risk as compared to smaller firms. Firm's size is denoted as the natural logarithm of market capitalization or, total sales or, total assets. Firms having high growth chances undertake large projects/plans to escalate shareholder returns.
- Firms with huge tangible assets may cause greater leverage capacity, because the tangible assets may be utilised as guarantee for procurement of debt. The tangibility is denoted as net fixed assets divided by the total assets.
- Distinctiveness in assets is created by the R & D (research and development) department of a firm. Specialized aids of employees or workers and merchants contribute to uniqueness, enabling the source of exceptional products and services to consumers. To measure the uniqueness of a firm, the selling cost is divided by the sales.

These determinants provide insights into the factors that influence a firm's capital structure decisions. But it must be kept in mind that the significance of the determining factor discussed in the study may vary according to the conditions and situations of different industries and countries.

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