Capital Structure and its Restructuring in Public Enterprises

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Thesis Summary

Public enterprises have occupied the centre stage of our country's economic policy since independence. As a consequence, any study in the area of financial management of public enterprises becomes very relevant. One of the important aspects of financial management is the issue of debt to equity ratios. In this dissertation, we have looked at the issue of debt to equity ratios in public enterprises. For this two different definitions of DER, long term debt to equity ratio have been used. In total debt to equity ratio, we have considered the cash credit component also in addition to the long term debt as a part of debt.

Firstly we have looked at the experience of various other countries in this regard. We have found there was no other country which had a prescriptive norm like 1:1 for debt to equity ratios as in the case of India. It may be noted that due to nature of the ratio, the profitability of the enterprise could change the debt to equity ratio from the initial value of 1:1, unless conscious steps are taken to readjust the value to 1:1 at the end of each year.

It was found that the ratio of 1:1 did not hold good in case of central public enterprises. This was empirically established at 1% significant level. For further analysis, the enterprises were divided into four categories, oil companies, other profit making companies, accounting loss making companies and cash loss making companies. The need for this type of grouping has been explained in the text. It has been found that the relationship between business risk and debt to equity ratios, in the case of first three groups were as expected though the correlation itself was not significant.

capital employed, ratio of profit before tax to net worth, ratio of long term debt to net fixed assets, interest rates and ratio of gross profit to net sales. From these, the significant variables which explained the variations in debt to equity ratios were found out for five years, starting from 1986-87 to 1990-91, for each of these four groups of enterprises.

In the case of petroleum companies, the significant explanatory variables were, moving average of capital intensity, moving average of gross margin to capital employed , moving average of value added to capital employed, long term debt to net assets etc. However, during the earlier years, the interest rates also explained the variations significantly. In the case of profit making non-petroleum companies, the variables which explained the variations to a significant extent

been turned around successfully, while the other two are still making losses. From these cases, it is clearly established that mere capital restructuring is not enough to turn around perennially sick companies, but many other thins such as good leadership, an effective marketing set up etc. are needed. There are some enterprises which have been started knowing fully well that they will make losses. This may be due to the reasons of strategic importance or for protecting the interest of the labor (this applies mainly to taken over companies). In those cases, with the existing policy framework it is not possible to turn them around.