JOURNAL OF ALGEBRAIC STATISTICS
Volume 13, No. 1, 2022, p. 846 - 849
https://publishoa.com
ISSN: 1309-3452

Critical Analysis on Financial Reengineering Through Optimum Capital Structure for MSMES in India

Dr. Ratikanta Ray,

Dr. D. Y. Patil Institute of Management and Entrepreneur Development, Pune, Maharashtra, E mail-ratikantaray22@gmail.com

ABSTRACT

Financial Engineering is the design, development and implementation of innovative financial approach towards the growth of the organisation. The financial engineering is aimed at enhancing financial performance through techniques of finance optimisation and finance modelling. The noted finance optimisation technique is optimum capital structure decision making through financial leverage. Financial leverage is mainly consisting of debt equity mix in right proportion through financial reengineering so as to reduce weightage average cost of capital and enhance price earnings ratio there by increase the market price per share and market capitalisation. The present research has focussed on attainment of optimum capital structure for MSMEs of India through appropriate mix of debt and equity in view of apple-to-apple basis,

Keywords: Financial Engineering, Capital Structure, Financial Leverage, WACC, P/E Ratio, MSMEs

Introduction

The MSME-Micro, Small and Medium Enterprises, a branch of the Government of India, is the apex body for the formulation and administration of rules, regulations and laws relating to micro, small and medium enterprises in India. Prior to the enactment of the central government's Micro, Small and Medium Enterprises Development Act, 2006 (MSMED Act), India identified these enterprises as small-scale industries (SSIs). The concept was similar. Post the MSMED Act, small-scale industries were classified into micro, small and medium enterprises (MSMEs) based on capital investment as stated in Government Gazette. With effect from 1 July 2020, micro, small and medium enterprises were defined with the changes made in the following three respects – (i) it added an additional classification criterion, i.e., annual turnover, (ii) it increased the limits, and (iii) it removed the distinction between manufacturing and service-based enterprises. The MSMEs are the backbone of the Indian manufacturing sector and have become very important for economic growth in the nation. It is valued that the MSMEs accounts for almost 90 % of the industrial units and 40% of value addition in the manufacturing sector. MSME"s plays a vital role in the growth of GDP in the economy as it makes employment opportunities at low capital cost. Micro, small and medium enterprises (MSMEs) are an indispensable part of the Indian economy. In terms of Gross Value Added (GVA) and Gross Domestic Product (GDP), MSMEs accounted for about 33% and 31% of India's GVA and GDP, respectively, in the year 2021-22. Unlike large enterprises that are concentrated in the metros, MSMEs are spread across smaller and larger rural as well as urban centres of India. They are also the biggest source of employment, especially in rural India, and contribute to the rural development and industrialisation. MSMEs also act as a great social bridge as smaller enterprises are owned by socially backward classes and women than are larger enterprises. For these reasons and more, the India government has always promoted the growth and development of MSMEs through policy initiatives, technology up gradation, and via other means. Consequently, MSMEs have also grown in multi-folds in the past decades in terms of the number of enterprises in operation and the collective revenue of the sector.

Rationale and Significance of Research Study

Capital structure formulation is one of the crucial decisions taken by the finance manager of a company as these decisions determine the overall cost of capital and, eventually, the market value of the firm. Capital structure has to be decided whenever a firm starts its operations or needs additional funds to finance its new projects. The finance manager has to compare the various merits and demerits of multiple sources of long-term finance and then select the one which helps in achieving the optimal capital mix or one that minimizes the overall cost of capital. The determinants of the capital structure provide a significant indication which a firm has to consider before deciding on its capital structure. Ultimately, the financial perspective of every firm is to maximize its market value and minimize its cost of

JOURNAL OF ALGEBRAIC STATISTICS
Volume 13, No. 1, 2022, p. 846 - 849
https://publishoa.com
ISSN: 1309-3452

capital, while deciding on its capital structure. The capital structure mainly consists of debt, common stock, and preferred stock used to finance the various long-term projects of the firm. In other words, the capital structure is primarily a combination of debt and equity. Equity holders are the owners and have a long-term commitment to the firm, whereas debt holders are creditors and have no long-term obligation to the firm as they are more interested in the timely repayment of their principal. Capital structure decision poses a lot of challenges to firms. Determining an appropriate mix of equity and debt is one of the most strategic decisions public interest entities are confronted with. A wrong financing decision has the tendency of stalling the fortunes of any business. Therefore, if managers are to achieve the goal of wealth maximization, conscious steps must be taken in the right direction and at the right time to identify those factors that must be taken into cognizance in determining appropriate financing mix. It is upon this premise that this conceptual piece is designed to guide the top echelons of corporate managers in capital structure decisions. The paper explores a vast body of literature in articulating critical issues in capital structure decision.

Literature Review

There are relatively few empirical studies exploring the perception of owner-managers in finance even though they actually play a vital role in SMEs' financing decisions. Alternatively, most of the prior studies in capital structure determinants obtained information from secondary sources of panel data. This study, therefore, investigates empirically the financing patterns of SMEs using data gathered from SME owners. With reference to the existing studies on capital structure of SMEs in India and Maharashtra there does not appear to be any empirical work investigating the impact of environment, managerial attitudes, culture, and network ties on SMEs' financing in India, which has led to this current research, with the aim to fill the gap. Several challenges affect the growth of MSMEs, however. One of these is the limited academic studies into the financial performance of MSMEs in terms of capital structure and the determinants that affect the capital structure, probably due to the unavailability of adequate data.

Objectives of Study

The specific objectives of the study are:

1. To develop a theoretical framework for the determinants of capital structure.

2. To investigate the influence of owner-manager characteristics, firm characteristics, management performance and external factors on capital structure.

5. To examine the attainment of optimum capita structure of MSMEs under study

Research Methodology

The present research is mainly descriptive and explorative nature. For data analysis and research conclusion both primary data and secondary data are to be collected. Primary data will be collected by the researcher from the managers and owners of selected MSMEs. The requisite data will be collected from the published sources like MSMEs website Government of India, MSMEs websites located in Pune, Maharashtra and in India, Websites of FICCI, NASSCOM, CII, CMIE and Ministry of Corporate affairs etc.

Scope of Research

The present research study has examined the capital structure determinants of MSMEs both in the manufacturing and in the service sector of India. The MSMEs are considered as unique due to its huge tangibility and seasonality.

Research Analysis and Discussion

Capital structure is the combination of debt and equity that funds an organization's strategic plan. The "right" capital structure supports strategic financial goals, while optimizing flexibility and minimizing cost. Capital structure management can be approached by answering the question, what is the appropriate amount, mix, structure, and cost of debt and equity to support the organization's strategic financial goals through financial engineering? The proper and strategic management of capital structure ensures access to the capital needed to fund future growth and enhance financial performance. The key benefits of effective capital structure management are increased capital access, added flexibility, and lower overall cost of capital. "Organized properly in an organization of any size, a capital structure can be easily adjusted to meet changes in interest rates and the changing shape of interest rate yield curves," notes Kenneth Kaufman, managing partner of Kaufman Hall. Unfortunately, there is no magic proportion of debt that a company can take on. The debt equity relationship varies according to industries involved, a company's line of business and its stage of development.

The dynamics created in the current and competitive business environment, demands that a firm must continuously develop innovative solutions and product lines in order to satisfy the constantly changing needs and desires of customers, hence maximize its set objectives in terms of sales volume, market share and profitability. Reengineering eventually helps the culture in the organization to evolve from an insular one to one that accepts change and knows how to deal with it. A MSME needs an optimal capital structure to enable it maximize its market value while minimizing its cost of capital. It is known that too much debt increases the financial risk to shareholders hence affecting the return on equity that they require. Financial re-engineering enables a firm to maintain a well-organized capital structure so as to keep it afloat in the changing economic times. Higher performance and continuing efforts in innovations boosts organizational learning and improves the quality and speed of the operations. Therefore, innovation a Theoretically, the financial manager should plan an optimum capital structure for his company. The optimum capital structure is obtained when the market value per share is maximum. There is significant variation among industries and, among MSMEs within an industry in terms of capital structure.

Findings of the research

This study has made several important contributions to the existing studies of capital structure. The main contributions of the study are:

i. Unlike previous studies which mainly focus on the firm characteristics, this study has developed a conceptual model of capital structure determinants by integrating factors related to owner-managers, firms, culture, and environment.

ii. This present research has investigated the issue of capital structure among different MSMEs.

iii. This study has duly incorporated methodological triangulation that may mitigate the problem of the difficulties in accessing financial data of MSMEs in Maharashtra.

iv. This study is the first study that has investigated the direct association between determinants of capital structure and firm performance and the mediating role of the capital structure for the aforementioned associations.

v. This study has provided meaningful insight into the financing preferences of the entrepreneurs with relevant implementations to academics and business practitioners and advisors (e.g. financial providers or policymakers).

Conclusion

Indian MSMEs employ a substantial amount of debt in their “Capital structure” in terms of the debt-equity ratio as well as total debt to total assets ratio. The dependence of the Indian corporate sector on debt as a source of finance has over the year inclined particularly since the mid-nineties. The corporate enterprises in India seem to prefer long-term borrowings over short-term borrowing. Over the years they seem to have substituted short-term debt for long-term debt. As a result of debt-dominated “Capital structure”, the Indian corporate are exposed to a very high degree of total risk as reflected in high degree of operating leverage and financial leverage and consequently are subject to a high cost of financial distress which includes a broad spectrum of problem ranging from relatively minor liquidity shortages to extreme cases of bankruptcy.

Bibliography

1. Adhegaonkar V and Indi R M (2012), “Determinants of Capital Structure: A Case of Indian Chemical Industry”, International Journal of Marketing and Technology, Vol. 2,No. 10, pp. 130-136.

2. Akhtar S (2005), “The Determinants of Capital Structure for Australian Multinational and Domestic Corporations”, Australian Journal of Management, Vol. 30, No. 2,pp. 321-341.

3. Baltagi B (2008), Econometric Analysis of Panel Data, John Wiley & Sons, Hobo-ken.

4. Bayrakdaroglu A, Ege I and Yazici N (2013), “A Panel Data Analysis of Capital Structure Determinants: Empirical Results from Turkish Capital Market”, International Journal of Economics and Finance, Vol. 5, No. 4, pp. 131-140.

5. Bhaduri S N (2002), “Determinants of Capital Structure Choice: A Study of the Indian Corporate Sector”, Applied Financial Economics, Vol. 12, No. 9, pp. 655-665.

6. Bhayani S J (2006), “Leverage and Its Impact on Shareholders’ Return: A Study of Indian Cement Industry”, International Journal of Management Science, Vol. 2, No. 1, pp. 31-42.

7. Bhole L M and Mahakud J (2004), “Trends and Determinants of Corporate Capital Structure in India: A Panel Data Analysis”, Finance India, Vol. 18, No. 2, pp. 37-55.8. Chen J and Strange R (2005), “The Determinants of Capital Structure: Evidence from Chinese Listed Companies”, Economics of Planning, Vol. 38, No. 1, p. 11.

9. Cook D and Tang T (2010), “Macroeconomic Conditions and Capital Structure Adjustment Speed”, Journal of Corporate Finance, Vol. 16, No. 1, pp. 73-87.

10. Cortez M A and Susanto S (2012), “The Determinants of Corporate Capital Structure:

Evidence from Japanese Manufacturing Companies", Journal of International Business Research, Vol. 11, No. 3, pp. 121-134.

11. De Wet J H H (2006), "Determining the Optimal Capital Structure: A Practical Contemporary Approach", Meditari Accountancy Research, Vol. 14, No. 2, pp. 1-16.

12. Donaldson L (1985), "Organization Design and the Life Cycles of Products", Journal of Management Studies, Vol. 22, No. 1, pp. 25-37.

13. Fama E and French K (2002), "Testing Trade-Off and Pecking Order Predictions About Dividends and Debt", The Review of Financial Studies, Vol. 15, No. 1, pp. 1-33.

14. Graham J R and Harvey C (2001), "The Theory and Practice of Corporate Finance: Evidence from the Field", Journal of Financial Economics, Vol. 60, Nos. 2&3, pp. 187-243.

15. Harris M and Raviv A (1991), "The Theory of Capital Structure", The Journal of Finance, Vol. 46, No. 1, pp. 297-315.