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# Financial liberalisation and Capital structuring decisions of corporate firms: Evidence from India

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## HIGHLIGHTS

- The impact financial liberalisation on leverage and debt maturity is negative.
- Debt specialisation increased following the liberalisation.
- The effect is more pronounced for priority firms compared to non priority firms.
- We use a reform index to measure financial liberalisation.
- Reforms index captures the gradual nature of implementation of financial reforms.

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## ABSTRACT

We examine the impact of financial reforms on corporate financing decisions of Indian firms using the fixed effects panel estimator. The impact on the leverage and debt maturity ratio is negative while a positive effect is observed on debt specialisation. The impact is greater for priority firms compared to non-priority firms.

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## 1. Introduction

At some time in history, most countries followed regulated financial systems which included one or more of the following forms: administered interest rates, directed credit schemes, subsidised loans, capital controls and credit ceiling. Verma (1998) observed that a "financial repression state[1]" affects the efficient allocation of resources and interferes with lending and investment decision making which results in distorted credit allocation (Blundell-Wignall and Browne, 1991). These distortions/imperfections at the macro level would then affect corporate financing decisions at the organisational (firm) level. The adopted financial reforms generally aim at correcting these distortions by influencing structural aspects such as size, efficiency and competitiveness of financial markets, which in turn determine the firm's policies on (a) capital structure (sources of capital); (b) debt maturity structure (type of debt capital), and (c) debt specialisation (number of sources of debt capital) that they want to use.

It is therefore important to empirically examine how financial reforms change corporate financing decisions at the firm level. This kind of empirical examination assumes greater importance in the context of financial reforms being undertaken by many developing countries. The initiation of Indian financial liberalisation in the early 1990s provides the best setting for the examination of these

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[1] Heavily regulated financial systems.

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