

## CAPITAL STRUCTURE AND INVESTOR PERCEPTIONS

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### ABSTRACT

This research is an attempt to study the perception of investors in Oman towards capital structure decision of firms. More specifically, it tries to understand whether capital structure decisions matter to investors while taking their investment decisions in the case of Oman for equity stocks. Data was collected using a structured questionnaire from 350 respondents using stratified random sampling. Results provide clear evidence that only few investors believed in indicators like ownership structure and changes in their pattern can signal about the future price trends. Furthermore, the survey results also revealed that majority of investors rely on TV news for taking investment decisions. It was clear from the study that, though stock markets have been functioning in Oman for the last several years, there is a great need on specialized education or awareness programs on financial markets. The investors especially women were found as not well informed. This might have long term impact on capital markets, as better informed investors create efficient stock markets and help in better utilizing financial resources.

**KEYWORDS:** Capital Structure, Investor Perceptions

### INTRODUCTION

Past researches have been well evident that debt can act as a self-enforcing governance mechanism ie; issuing debt, strengthens the liquidity soas to meet the interest and principal obligations arising out of the debt liability. Thus, many researchers believe that debt mitigates the potential agency costs of free cash flow (Grossman and Hart, 1982; Jensen, 1986, 1993). On the other hand many researchers do not agree to the same and argue that most firms can easily meet interest payments and thus capacity of debt to act as a self-governance mechanism becomes less relevant especially when majority of the funds utilised comprise from internal sources or retained earnings (Allen and Gale, 2000).

Further, it is also important to note that whether capital structure decisions have an impact on investors decision especially while choosing among different equity schemes. Whether investors give preference to stocks with a higher portion of debt as benefits of trading on equity will be passed on to equity investors or investors are indifferent in terms of their choice for differences in capital structure. In the same line the paper explores the factors which influence the investment decision for investors and how the investors react with the changes in ownership pattern of Omani, Non Omani, Arab, Foreign and GCC Population in context of Oman.

The empirical study attempts to establish the important sources on which investors rely while taking investment decisions as well as how they associate the future earnings with the changes in ownership structure. This is an attempt to understand the investors preferences through a structured questionnaire circulated among 500 investors using a stratified random sampling.

## RESEARCH METHODS

The primary study was conducted using a structured questionnaire. The questionnaire was designed to take into account the important factors which influence capital structure. The questionnaire was designed by taking help of experts in the financial markets. After designing the questionnaire a pilot study was done and some of the questions in the instruments were modified so as to improve the quality of instrument.

The total numbers of respondents for the study were 350 and stratified random sampling method was adopted to select the samples out of the total population. The questions required the respondent to answer simple questions ranging from demographic profile, average duration of investments, other investment avenues where they invest etc. and then specific questions related to capital structure which were considered to influence investment decisions. The survey data was collected, tabulated and analyzed using SPSS and Microsoft Excel.

## RESULTS

Figure 1 4 shows the demographic profiles of the respondents. 69% of the total respondents were females and the remaining 31% were males. Further, the respondents were from the middle aged group i.e. 166 respondents were between 30-40 years of age and 51 respondents were in the age group of 40-50 years. (Figure 2)

Figure 3 represents the period of investments of our sample population. The results clearly point out that respondents were not short term or intra day investors but invested for a period more than 6 months. Figure 4 represents the responses of respondents regarding whether they were investing in other investment avenues also. Around 80% of the respondents also invested in other securities including mutual fund, debt, government bonds etc. Mutual funds were the most preferred investment followed by equity and debt.

After analyzing the general information about the investors we move to specific questions linked to investment buying behavior. The respondents were questioned about which factors they considered while buying a stock and were given the options like Annual Reports, News, Past Stock Market Return, Past price trends, Capital Structure. The respondents considered News to be the most important source of information and their buying and selling decisions were triggered by News and information from other media. Further, 21% of the respondents also considered capital structure of the firm while investing in a particular company. As per the response of the respondents capital structure was the second most important factor considered by the investors. After confirming the importance of capital structure we proceeded with specific questions of elements of capital structure like percentage shares held by different stakeholders, their perception for changes in level of debt, equity etc. When asked about the action of investors if a company in which they had invested raised more of debt what will be their reaction, 39% of the respondents intended to buy more of those stocks and about 36% will liquidate their positions and 20% responded that they will continue to hold the same position. The respondents were divided on the question as almost equal percentage of them considered it a negative news and considered liquidation as a option and on the other hand around 39% considered it a positive news therefore considered buying more of the same stock. In response to the questions regarding issuing fresh equity we found there is a general consensus among investors and consider it as a positive news and 68% of the respondents thought of buying more stocks. Also 23% of the respondents opted for liquidating their positions. In response to the question when company repays its debt, the respondents revealed selling their stock as the best option. Further, in case of buyback of shares the investors perceived it to be positive thereby indicating a preference of adding more to the quantity of stocks.

In case of ESOPS most of the respondents did not answered the question indicating less knowledge about ESOPS to the market participants. In case of response for issue of bonus shares, the investors again have consensus in favour of buying more or holding the same position.

The next portion of the instrument was designed to know the perception of investors towards ownership structure. The respondents were asked about their perception about prices, price volatility and dividend with the changes in ownership pattern of Omani, Non Omani, Arab, Foreign and GCC Population. In response of the last 6 questions which dealt with the issue of investors perception for changes in holding pattern of different stakeholder group, we found that majority of the respondents could not comment on the same issue. However, for increase in ownership of foreign population, majority of the respondents considered it a signal if price to increase in future.

The results provide important insights about the perception of Omani population regarding their investment decisions. The results provide clear evidence that though stock markets have been functioning in Oman for the last several years, there is a need to increase awareness about financial markets among the people. The investors especially women (as nearly 70 % of the respondents were women) are not well informed investors. Their investments decisions are based on news and other relevant information like financial reports, past data trends etc are not considered. Further, indicators like ownership structure etc can also provide insights about the financial health as generally some investors are generally more informed than the others in any market and changes in their pattern can provide signals about the future price trends. Furthermore, since investors rely on news as an important media, new companies can effectively use this media to raise new issue or fresh capital. Increase in awareness among the investors will have long term implications on the capital markets as better informed investors help in creating effect stock market thereby better utilization of financial resources leading to overall development of the country.

## CONCLUSIONS AND DISCUSSIONS

The primary survey was aimed at understanding the perception of investors in Oman towards capital structure decision of firms. We tried to understand whether capital structure decision matter to investors while taking investment decisions especially in case of Oman for equity stocks. As per the response of the respondents capital structure was the second most important factor considered by the investors before investing in a particular stock. When asked about the action of investors if a company in which they had invested raised more of debt, 36% of the respondents confirmed liquidating their positions. In response to the questions regarding issuing fresh equity we found there is a general consensus among investors and considers it as positive news and 68% of the respondents thought of buying more stocks. Further, many respondents could not answer many important questions providing clear evidence that though stock markets have been functioning in Oman for the last several years, there is a need to increase awareness about financial markets among the people. The investors especially women (as nearly 70 % of the respondents were women) are not well informed investors. Their investments decisions were based on news and other relevant information like financial reports, past data trends etc are not considered. Further, indicators like ownership structure etc can also provide insights about the financial health as generally some group of investors more informed than individual investors in developing financial markets and changes in their pattern can provide signals about the future price trends. Furthermore, since investors rely on news as an important media, new companies can effectively use this media to raise new issue or fresh capital. Increase in awareness among the investors will have long term implications on the capital markets as better informed investors help in creating effect stock market thereby better utilization of financial resources leading to overall development of the country.

Finally, the results provide important insights about the perception of Omani population regarding their investment decisions. The results provide clear evidence that though stock markets have been functioning in Oman for the last several years, there is a need to increase awareness about financial markets among the people. The investors especially women (as nearly 70 % of the respondents were women) are not well informed investors. Their investments decisions are based on news and other relevant information like financial reports, past data trends etc are not considered. Further, indicators like ownership structure etc can also provide insights about the financial health as generally some investors are generally more informed than the others in any market and changes in their pattern can provide signals about the future price trends. Furthermore, since investors rely on news as an important media, new companies can effectively use this media to raise new issue or fresh capital. Increase in awareness among the investors will have long term implications on the capital markets as better informed investors help in creating effect stock market thereby better utilization of financial resources leading to overall development of the country.

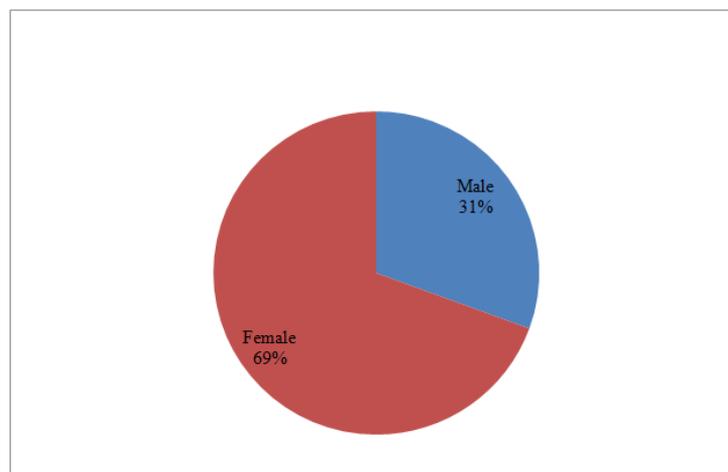
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## APPENDICES

*[Only for those Who Invest in Equity Stocks]*

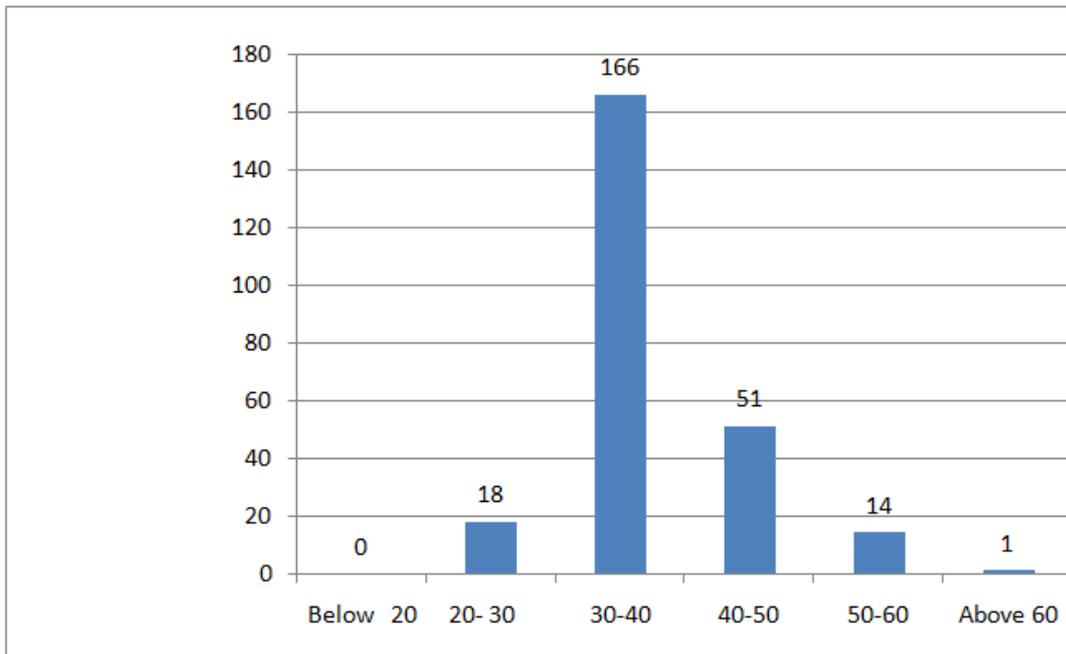
| Gender | Number of respondents |
|--------|-----------------------|
| Male   | 107                   |
| Female | 243                   |



**Figure 1: Respondents**

**Age**

|          |      |
|----------|------|
| Below 20 | 0    |
| 20- 30   | -18  |
| 30-40    | -166 |
| 40-50    | -51  |
| 50-60    | -14  |
| Above 60 | -1   |



**Figure 2**

**How Long do You Generally Invest**

**Number of Respondents**

|                      |     |
|----------------------|-----|
| Less than 3 months   | 19  |
| 3-6 months           | 27  |
| 6m - 1 year          | 108 |
| Greater than 1 year. | 96  |

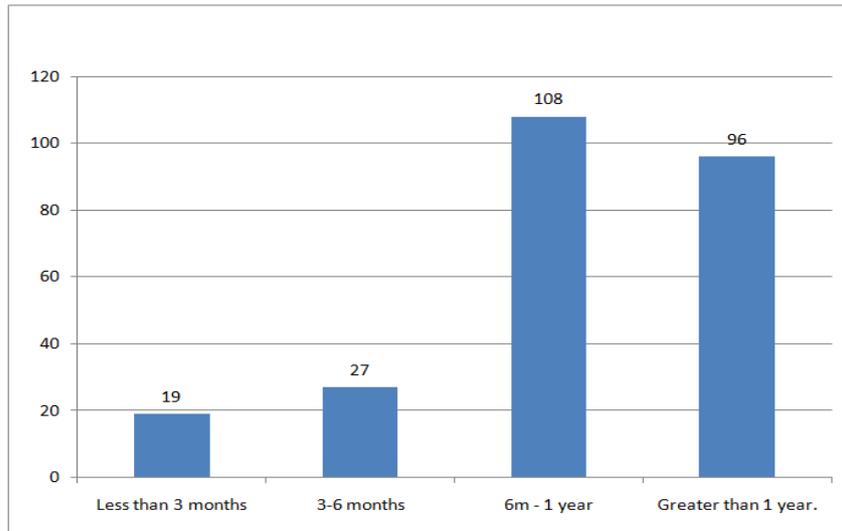


Figure 3: Period of Investment

**Do You Also Make Investments in Other Securities?**

Yes/No

Yes- 199

No- 45

Not answered 6

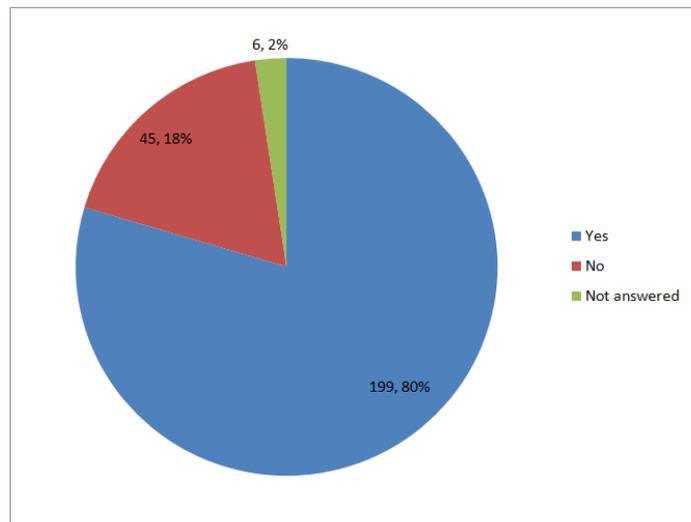


Figure 4

Where [Tick]

Equity 141

Debt 110

Bonds 91

Mutual Funds 197

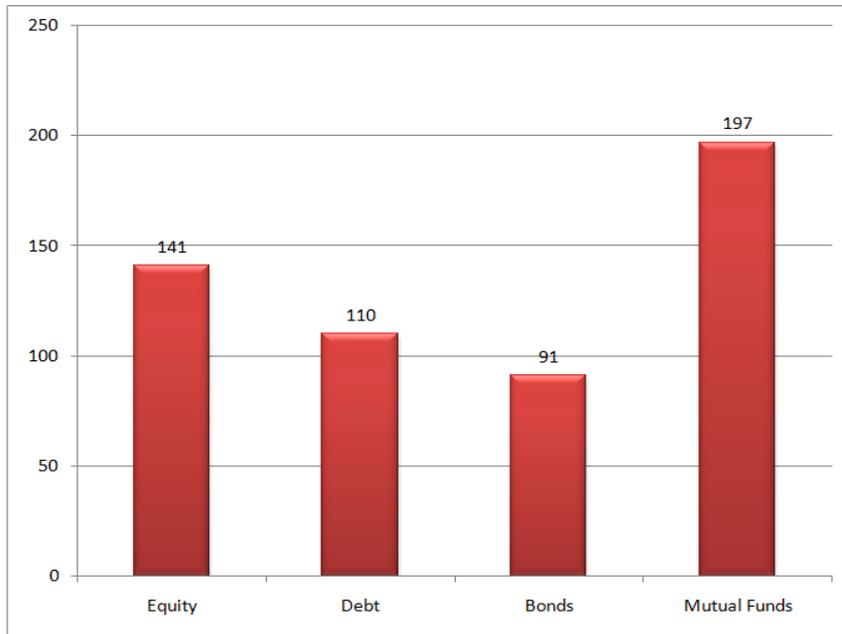


Figure 5

**How Long Have You been Investing in Stock Markets**

|                    |     |
|--------------------|-----|
| Less than 3 months | 21  |
| 3-6 months         | 68  |
| 6m - 1 year        | 12  |
| Above 1 year.      | 149 |

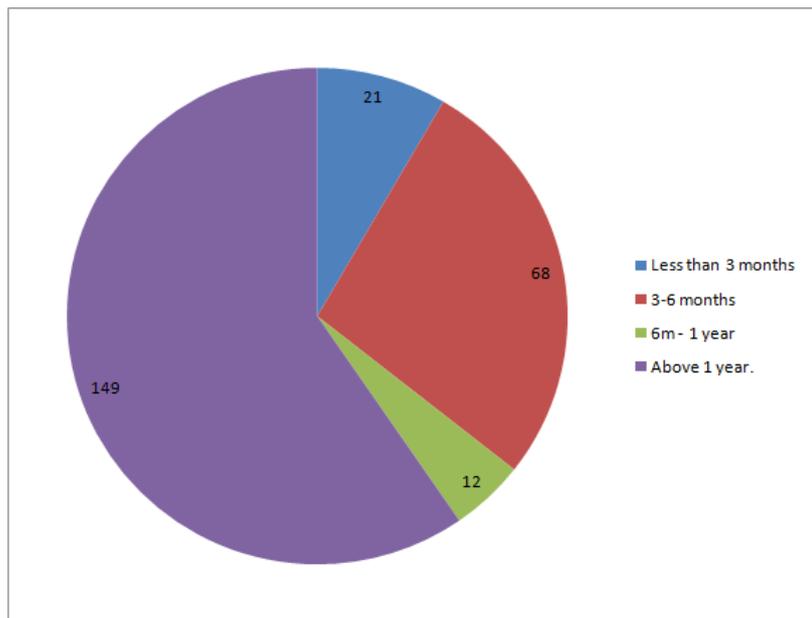
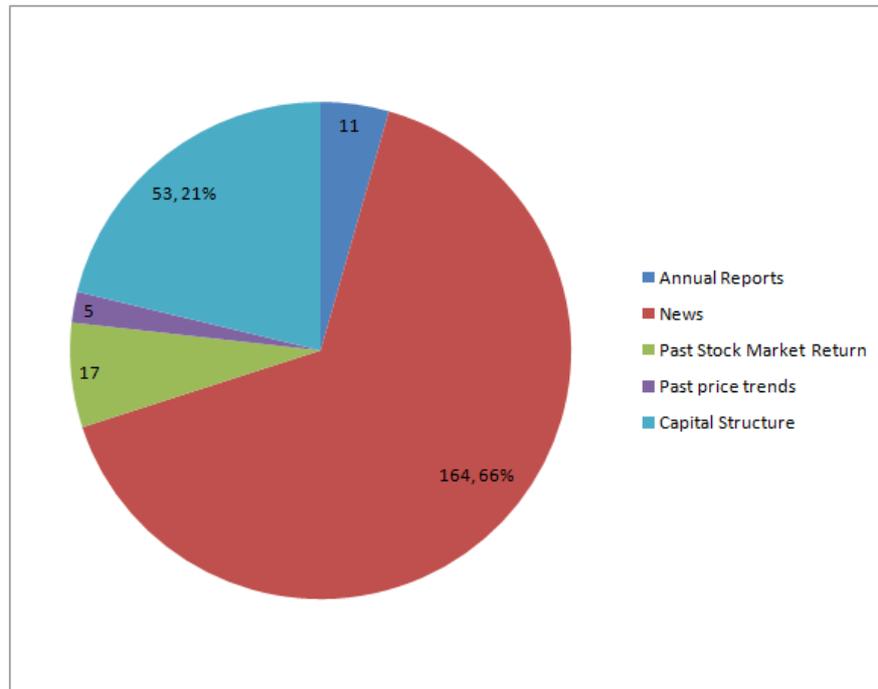


Figure 6

**Before buying any Stock which Information do you Collect About the Stock?**

|                          |     |
|--------------------------|-----|
| Annual Reports           | 11  |
| News                     | 164 |
| Past Stock Market Return | 17  |
| Past price trends        | 5   |
| Capital Structure        | 53  |
| Any Other                |     |



**Figure 7**

**Do you Think Capital Structure Decisions Influence Investors Decision Making while Buying Stocks?**

**If Yes, How?**

Answers favoring the point - Usage of more debt are better = 16

Answers that more equity shows better image- 149

Those who wrote, they don't know- 72

Not answered -13

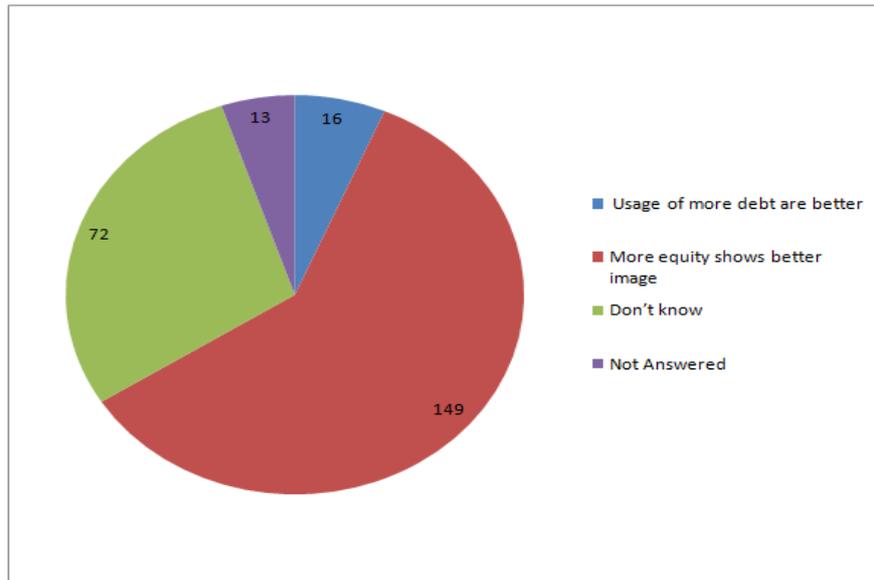


Figure 8

**If you have Bought Shares in Any Company and the Company Raises Fresh Debt, what will be Your Reaction?**

|  |    |
|--|----|
| Buy more of those stocks                                     | 96 |
| Liquidate my positions in those stocks                       | 91 |
| Hold the same positions                                      | 50 |
| Search for other relevant information like rate of debt etc. |    |
| NOT ANSWERED THIS QUESTION                                   | 13 |

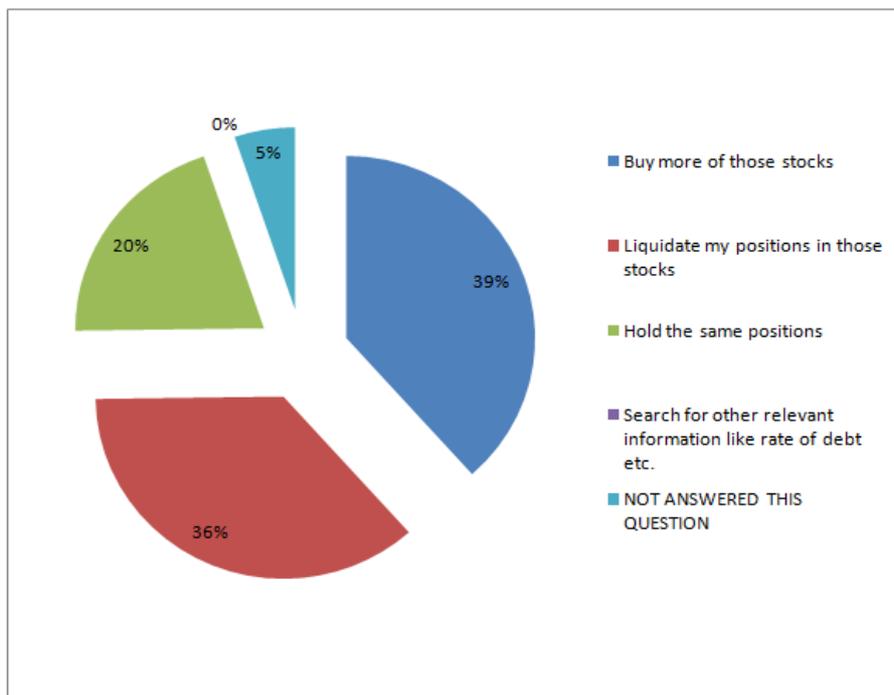
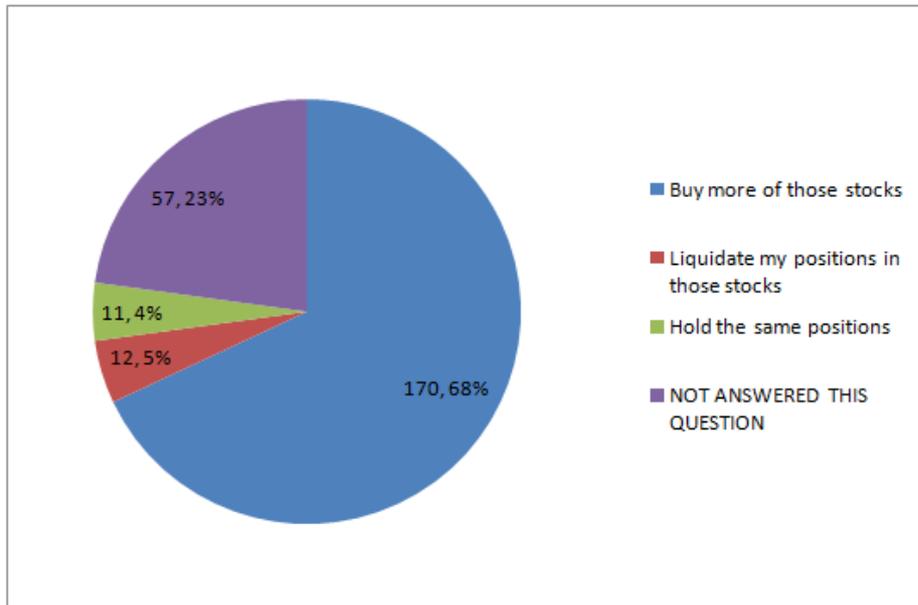


Figure 9

**If you have Bought Shares in Any Company and the Company Raises Fresh Equity, what will be your Reaction?**

|  |     |
|--|-----|
| Buy more of those stocks               | 170 |
| Liquidate my positions in those stocks | 12  |
| Hold the same positions                | 11  |
| NOT ANSWERED THIS QUESTION             | 57  |



**Figure 10**

**If you have Bought Shares in any Company and the Company Repays its Previous Debt, What will be your Reaction?**

|  |     |
|--|-----|
| Buy More of those stocks               | 34  |
| Liquidate my positions in those stocks | 187 |
| Hold the same positions                | 29  |

**If you have Bought Shares in any Company and the Company Buybacks its Shares from the Open Markets, what Will be Your Reaction?**

|  |     |
|--|-----|
| Buy More of those stocks               | 158 |
| Liquidate my positions in those stocks | 62  |
| Hold the same positions                | 29  |
| NOT ANSWERED THIS QUESTION             | 1   |

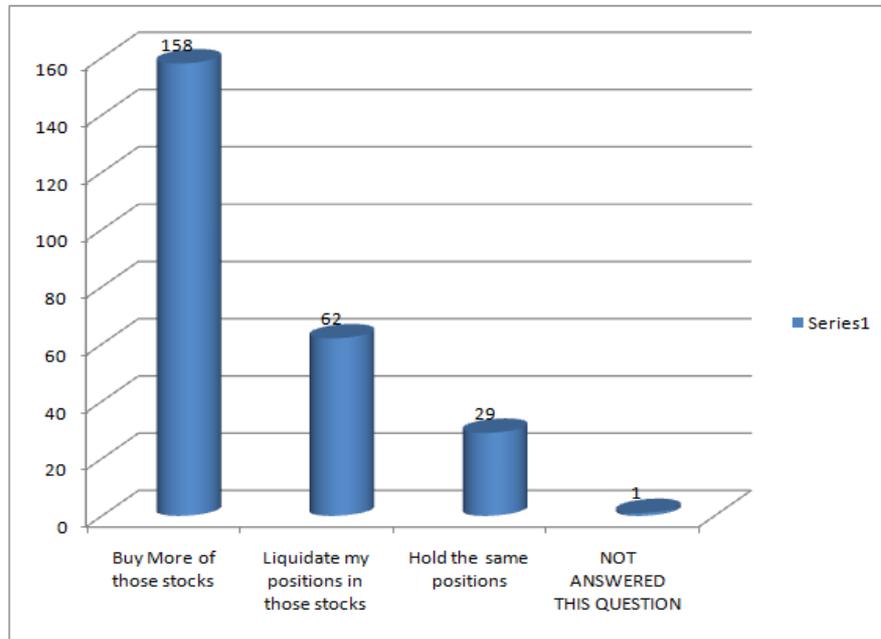


Figure 11

**If you have Bought Shares in Any Company and the Company Issues Shares to Management, Employees as Employees Stock Ownership Plan (ESOPS), what will be your Reaction?**

|  |     |
|--|-----|
| Buy More of those stocks               | 45  |
| Liquidate my positions in those stocks | 39  |
| Hold the same positions                | 51  |
| NOT ANSWERED                           | 115 |

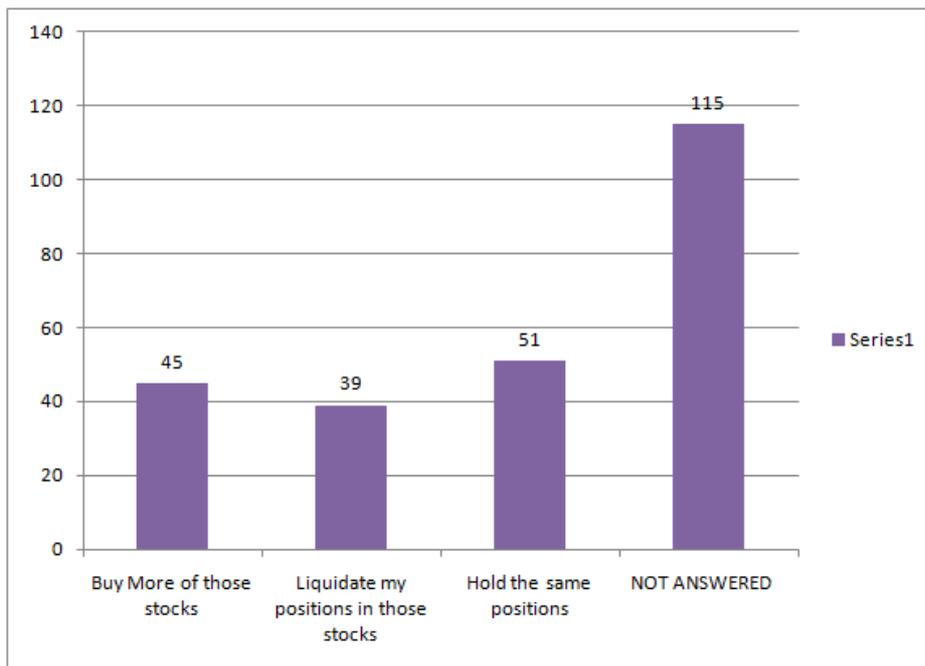
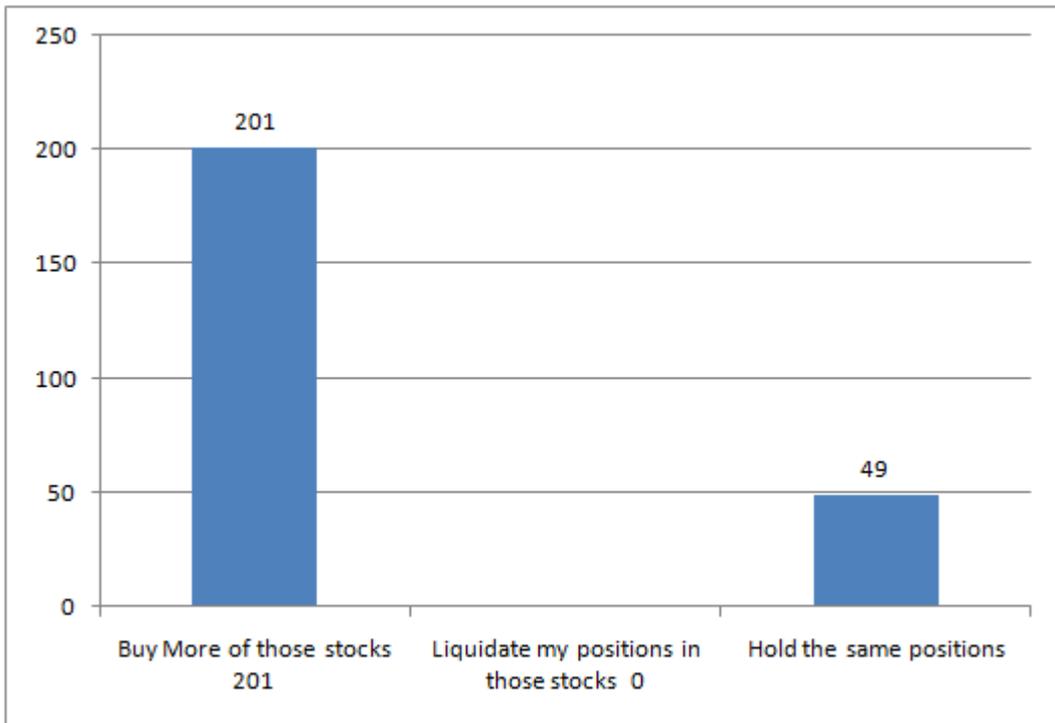


Figure 12

**If you have Bought Shares in any Company and the Company Issues Bonus Shares, what will be your Reaction?**

|  |     |
|--|-----|
| Buy More of those stocks               | 201 |
| Liquidate my positions in those stocks | 0   |
| Hold the same positions                | 49  |



**Figure 13**

**If the Percentage Shares held by OMANI population increase over the years in any stock, what will be your expectation from the stock?**

- Prices to decline 24
- Prices to Increase 18
- Volatility will increase 61
- Volatility will decline
- Dividends will Increase
- Dividends will decline
- Don't know 147

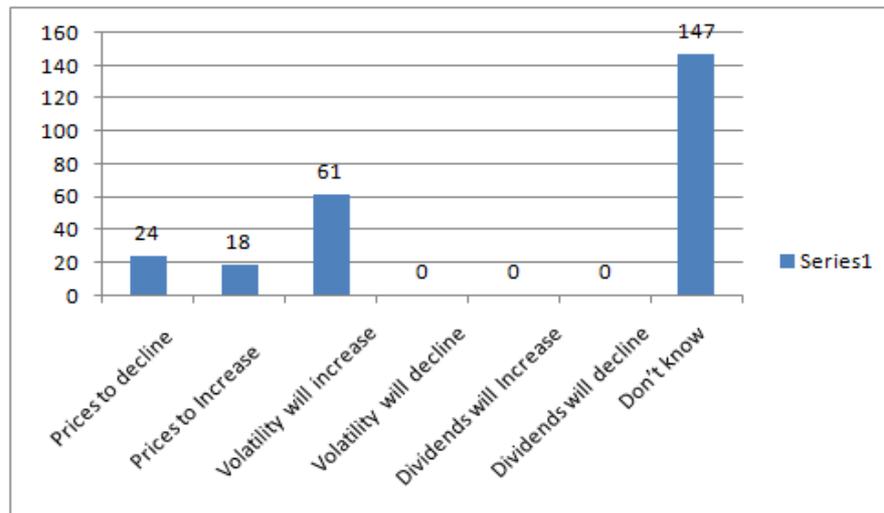


Figure 14

**If the Percentage Shares Held by NON OMANI Population Increase Over the Years in any Stock, what will be your Expectation from the Stock?**

- Prices to decline
- Prices to Increase
- Volatility will increase
- Volatility will decline
- Dividends will Increase
- Dividends will decline
- Don't know                      187
- NOT ANSWERED                      63

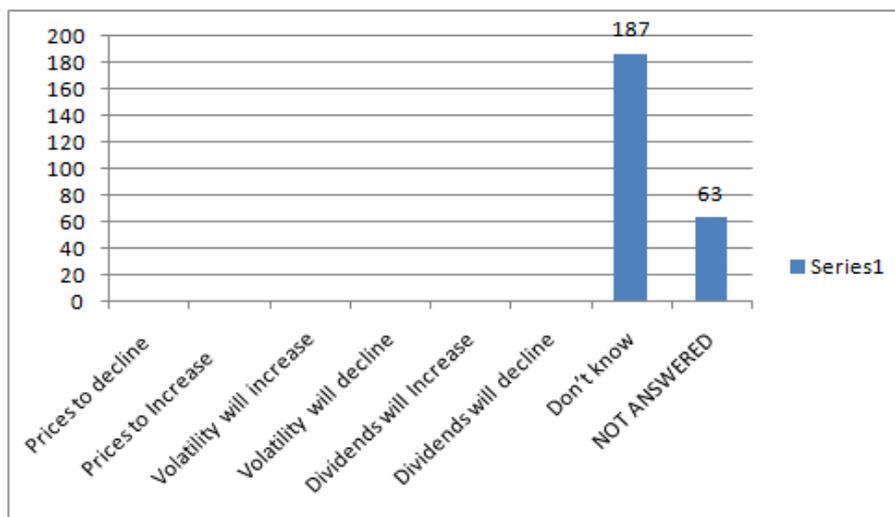


Figure 15

**If the Percentage Shares Held by ARAB Population Increase over the Years in Any Stock, what will be your Expectation from the Stock?**

- Prices to decline
- Prices to Increase 42
- Volatility will increase 59
- Volatility will decline 3
- Dividends will Increase
- Dividends will decline 7
- Don't know 140

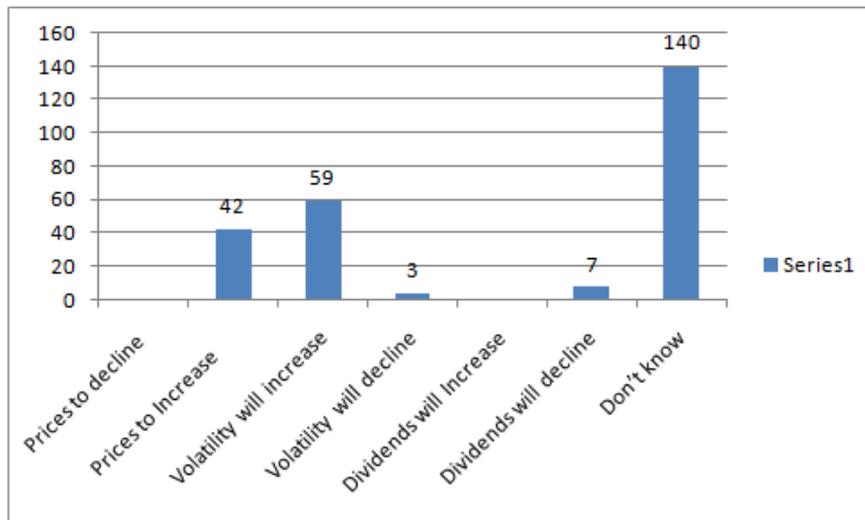


Figure 16

**If the Percentage Shares Held by GCC Population Increase over the Years in Any Stock, what will be your Expectation from the Stock?**

- Prices to decline
- Prices to Increase 81
- Volatility will increase 3
- Volatility will decline
- Dividends will Increase
- Dividends will decline
- Don't know 91
- NOT ANSWERED 86

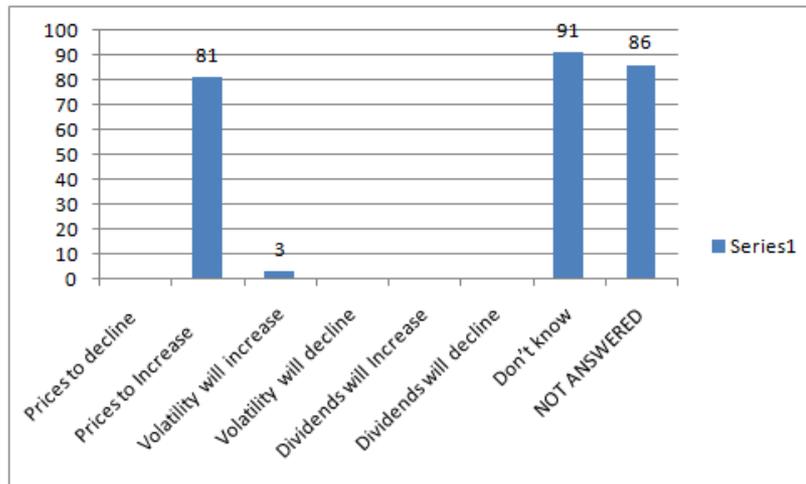


Figure 17

**If the Percentage Shares held by FOREIGN Population Increase Over the Years in Any Stock, what will be your Expectation from the Stock?**

- Prices to decline
- Prices to Increase 163
- Volatility will increase 57
- Volatility will decline
- Dividends will Increase 30
- Dividends will decline
- Don't know

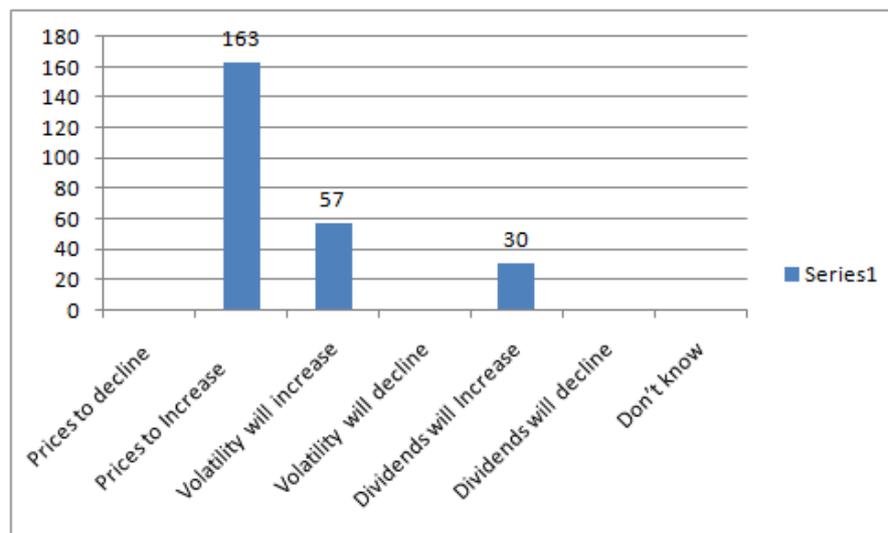


Figure 18

