CHAPTER – 7

S U M M A R Y A N D C O N C L U S I O N

In this chapter, we discuss the main findings of our study, its implications and avenues of future research.

7.1. Findings

The study addresses a set of very important questions,

- Do Indian firms consider a target leverage and adjust to reach optimal capital structure?
- Do the group affiliated firms derive the advantages available in the process of adjusting and reaching towards optimal capital structure, and in turn is it getting translated to achieve higher adjustment speed in reality?
- Further, does level of group diversification of the group affiliated firms improve the speed of adjustment for highly diversified firms?
- Do the macroeconomic conditions in which the firms are operating impact the speed of adjustment?
- Do the firm specific variables of the firm like profitability, size, status of listing and growth opportunities affect the speed of adjustment of capital structure in the firms?
- Is there any significant difference in the firm specific characters within group and within standalone firms on the speed of adjustment of capital structure of the firm?

The study investigated the above questions empirically with the data of non-financial non-government Indian firms both listed and unlisted for a period starting from 1989 to 2014.

The primary findings of our study are:

- We find strong evidence that firms in our sample consider a target leverage. This result of our study supports the trade-off theory of capital structure;;
- Firms in India make an attempt to reach the optimal capital structure by adjusting their leverage at every viable opportunity; this is similar to studies Flannery and Rangan (2006), Cook and Tang(2010)
- Further, the study also finds that the speed of adjustment of Indian firms is slower compared to most developed economies. This could be attributed to the developing features of our nascent economy. Flannery and Rangan, (2006), Cook and Tang (2010) and Getzmann et al, (2014)
- We find evidence that group affiliated firms have a significantly higher leverage adjustment speed compared to a standalone firm. This could be attributed to the internal capital available in the group and its members and also the group's reputation has an impact in reducing adjustment costs; our findings support Khanna and Palepu (2000), Mukherjee and Mahakud (2010) and Chakraborty (2013),
- Empirical evidence is found that the firms affiliated to groups which diversify into many sectors in the economy have a higher leverage adjustment speeds than firms affiliated less diversified groups; this supports the argument that diversified groups overcome market imperfections, like quality supplier, impact of reputation etc.; (Khanna and Rivkin (1999 and 2001), Manos et al. (2007)

- Our empirical analysis proves that macroeconomic conditions of the country have a significant and positive impact on the speed of adjustment of capital structure in the firms. i.e. Firms have a higher SOA during a good macroeconomic condition and low SOA during bad. This result holds merit in both developed as well as developing economy and supports studies like Cook and Tang (2010) and Mukherjee and Mahakud (2010)
- Our firm characteristic analysis had the following results:
    - **Impact of Profitability on SOA**
        - Our analysis shows that all firms with a higher profitability has a faster speed of adjustment compared to less profitable firm
        - The same result holds true for a high profitable group affiliated firm compared to less profitable group affiliated group firm.
        - For standalone firms too, high profitable firms has a faster SOA than less profitable firms

      Therefore, Profitable has a positive impact on the adjustment speed of firms. Indicating that firms with high cash flow have enough leg room to overcome adjustment costs and move faster towards their targets.
    - **Impact of Listing status on SOA**
        - Our analysis shows that all listed firms in the sample have a lower SOA than that of Unlisted firms
        - The same result holds true for both group affiliated and Standalone firms. i.e. SOA of a Listed group (standalone) firm is lower than that of unlisted group (standalone) firm

Therefore, status of listing of a firm has a negative impact on the adjustment speed of firms. This could be due to the intense regulations, higher transaction costs, higher scrutiny of decisions which listed firms go through and which impact the adjustment costs of the listed firms, which is not present for an unlisted firms. This result warrants further analysis to better understand the dynamics of financing decisions of a firm.

- **Impact of firm size on SOA**
    - Our analysis shows that for all firms in our sample, larger firms have a lower SOA than that of small size firms
    - The same result holds true for both group affiliated and Standalone firms. i.e. SOA of a large size group (standalone) firm is lower than that of small group (standalone) firm

Therefore, size of the firm has a negative impact on the adjustment speed of firms. This could be due to the higher scrutiny the firms go through of decisions which listed firms go through and which impact the adjustment costs of the listed firms, which is not present for an unlisted firms. This result warrants further analysis to better understand the dynamics of financing decisions of a firm.

- **Impact of growth opportunities on SOA**
    - Our analysis shows that for all firms in our sample, firms with higher growth opportunities have a higher SOA than the firms with lower growth opportunities

- The same result holds true for both group affiliated and Standalone firms. i.e. SOA of high growth opportunity firms is higher than that of low growth opportunity firms

Thus, growth opportunity of a firm has a positive impact on the SOA of the firm. This implies that a firm with higher growth opportunity attracts the interest of investors, thereby reducing their adjustment cost and increasing the adjustment speed

7.2. Implications

We had discussed, that majority of the studies so far in the area of Speed of Adjustment has majorly been in the US context or in the developed markets (Flannery and Rangan, 2006; Cook and Tang, 2010; Faulkender et al, 2012). India being emerging economy has a very different institutional set up than that of the western countries, in terms of inadequate disclosure norms, weak corporate governance and control, weak and evolving financial intermediaries, erratic product and labor markets (Khanna and Palepu, 2000). Therefore, studies conducted in the western or developed market may not hold true in the Indian context and it becomes imperative that these theories are tested in the Indian context rather than being generalized blindly.

Our study clearly shows that these institutional differences have a significant impact on the adjustment speeds of Indian firms.

- First, Indian firms do consider a target capital structure. They attempt at every viable opportunity to achieve this target. Further, the SOA of Indian firms is slower than that of the western counterparts. {33% for USA(Flannery and Rangan, 2006 and Cook and Tang, 2010); 59% for UK (Dang et.al, 2012)}

- Second, Institutional differences like Group affiliation have a significant impact on the leverage adjustment speed of firms and in turn on the value of the firm
- Third, level of group diversification has an impact on the leverage adjustment speed firms and thus the value of the firm
- Fourth, macroeconomic conditions have a significant impact on the adjustment speed of capital structure and hence on the value of the firm.

These outcomes have many theoretical implications on the literature in this area of research.

This study gives managers and shareholders substantial empirical evidence to review their institutional setups and take necessary action to have a favorable structure resulting in higher value of the firm.

In the wake of globalization of the Indian economy, it it imperative for the policy makers to create a uniform platform for competing firms coming from the developed world. This study makes an attempt to provide an empirical evidence to policy makers (whose objective is to provide an optimal business environment) for bridging the gap between the developed and developing economies; of any institutional differences which is providing an unfair advantage to a particular set of firms so that necessary policy changes could be made.

This study is a humble attempt to shed light on an area of literature which is not been elaborately studied. We hope this study motivates researchers to question and conduct analysis to answer many of the atypical characteristics of this field of research.

7.**3. Limitations of the study**

Though our study had made several contributions to the body of knowledge in this area of research, there are some limitations which we could not avoid.

- The residuals of our regression analysis are not normally distributed, which is very common in most the empirical works in finance and hence our results have to be interpreted by keeping this limitation in mind.
- The existing literature considers market leverage as the best indicator of debt levels of the firm. Since our objective was to study both listed and unlisted firms we had to use book leverage for our analysis;