Three Essays on Corporate Cash Holdings: Evidence from India

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Extended Abstract

Increasing corporate cash balances have been a growing concern for investors and policymakers in the past two decades (Bates et al., 2009, 2018; Opler et al., 1999). The rising trend of cash as a significant percentage of the assets on the balance sheet is not just limited to the developed economies but also a phenomenon in emerging economies (Kusnadi et al., 2015; Pathak & Ranajee, 2019; Tripathi, 2020). This dissertation attempts to study the impact of ownership structure on corporate cash holdings in India.

The first essay explores the relationship between controlling shareholder ownership and cash flow sensitivity of cash holdings (CFSC). CFSC is defined as the propensity of firms to save cash from cash flows. This activity reflects the management's view about their financial strength and the likelihood of financial constraints (Almeida et al., 2014). Using a sample constituting 3,802 publicly traded Indian firms, over the period 2001 – 2019, the empirical analysis finds that controlling shareholders positively affect CFSC. I argue that controlling shareholders avoid accessing any form of external capital that may threaten the dispersion of their socio-economic wealth (Wei et al., 2020; Gómez-Mejía et al., 2007). Controlling shareholders also fear the dilution of their existing stakes if the firm prefers raising equity. Further, increasing debt leads to increased monitoring of the controlling shareholders by lenders. Therefore, the trade-off between the desire to maintain control, manage bankruptcy costs and preserve socio-economic wealth affects the controlling shareholders' choice of increasing cash holdings from the cash flows. Further, I also find that CFSC, due to controlling shareholder ownership, is lesser in the business group affiliates. In additional analyses, I also examine the drivers of CFSC by controlling shareholders and address the endogeneity concerns.

In the second essay, I examine – a) whether institutional ownership leads to effective use of cash holdings and enhances the value of cash holdings and b) whether the financial constraints influence the relationship between institutional investors and the value of cash holdings. Higher institutional ownership improves the corporate governance metrics by reducing information asymmetry, increasing accountability of the controlling shareholders and curbing expropriation of resources. Institutional investors also increase the dividend payments (Jacob & Lukose, 2018), thus reducing the free cash flows under control of the insiders. Therefore, I propose that

cash in the firms under the monitoring of institutional investors will be less likely to be misused, thereby valuing the cash at premium. Using an unbalanced panel data from 2001-2019 with 3,827 unique firms, I find that there exists a positive relationship between institutional ownership and the value of cash holdings. Next, I observe that the positive relationship between institutional ownership and value of cash holdings is more pronounced in financially less constrained firms. I conjecture that in firms facing external financing constraints, cash holdings are inherently valuable. But in financially less constrained firms, monitoring by institutional investors enhance the value of cash holdings, by reducing the financial mismanagement. The results are robust to different proxies of financial constraints and alternative specifications.

The third essay examines a) whether earnings quality affects the level of cash holdings and b) if the monitoring by institutional investors affects the relationship between earnings quality and cash holdings. Earnings quality, i.e., the quality of accounting information, is a non-diversifiable risk factor (Easley & O'hara, 2004) that affects the cost of debt and equity (Francis et al., 2005), thereby the firm's capital structure and financing decisions. Lower earnings quality exacerbates the information asymmetry between internal and external stakeholders, and affects dependence on external capital markets adversely. Using a sample of 2,421 firms from 2000-2019, I find that the firms with lower earnings quality increase cash. Monitoring by institutional investors further affects this relationship. Importantly, I find that institutional investors are efficient only when they hold a minimum of 10% equity in the firms. According to Companies Act 2013, only equity holders who hold 10% or more holding can call for an extraordinary general body meeting (Section 100) or appeal to the National Company Law Tribunal (NCLT) against oppression and mismanagement (Section 213). Institutional investors can effectively demand greater transparency or exercise meaningful oversight only when they hold greater than or equal to 10% equity. Finally, I summarise and interlink the findings of three essays, discussing the contributions, limitations, and directions to future research.

Keywords: Cash holdings, Controlling Shareholder ownership, Cash flow Sensitivity of Cash, Institutional Ownership, Earnings Quality

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