

Relationship between Promoters Shareholding and the Financial Leverage of Listed BSE Firms in India

Bhawana Jain

Amrita School of Business, Coimbatore

Amrita VishwaVidyapeetham

Amrita University India

Goutham M

Amrita School of Business, Coimbatore

Amrita VishwaVidyapeetham

Amrita University India gautib4u@gmail.com

Abstract— Firms with higher percentage of shares held by promoters are considered as family firms and form a large proportion of business operations all over the world. Financial decisions made by such firms differ from the financial decisions of non-family firms. There are various factors that are involved in financial decision making. This study uses the random effect model analysis of the impact of promoters' shareholding on the financial leverage of firms. The results show that there is a negative significant relationship between promoters' shareholding percentage and leverage (Debt-Equity ratio) and a significant but negative relation between the stock return and size of the firm. The yearly data has been collected from CMIE prowwess for the period 2003-2016 for BSE 500 Index firms

Keywords— family firms, promoters shareholding, financial leverage

I. INTRODUCTION

Family firms play an important role not only in the growth of the company but also in growth of an economy (Barontini and Caprio, Faccio and Lang, 2002 and Marck et al., 2005). Financial decisions impact the availability of sources for investment and have a long term impact on the growth and profitability of the firm. Factors influencing the financial decisions of a firm are varied, ownership and control, being one of the most important. A firm can raise the capital in two ways; one is through debt financing that involves issuing bonds or taking loans and other is through equity financing. Now days, there is change in the financing pattern of firms with major contributors like private equity firms and high net worth individuals coming into picture. The focus of this paper is to find out the relationship between the Promoters' equity ownership and financial leverage of the non-financial firms listed on the BSE 500 Index.

Financial leverage can act as the medium to reduce the cash flow of the firms (Jensen, 1986; Farinha, 2003). It can even act as an instrument for solving problems between company management and shareholders for the company, since this can be monitored by creditors (Agarwal and Knoeber, 1996). One of the important decisions that should be made by the firms is

the proportion of debt and equity. The decision impacts risk that is faced by the firm. Higher the debt taken by the company there will be chances of bankruptcy in the time of poor performance. This study finds out the relationship between promoter shareholding and financial leverage (debt to equity) of the non-financial listed firms in India.

The promoters' ownership is defined as the total percentage of equity shares owned the promoters or family members, defined as the promoters group. And a firm is a family firm if majority shares are held by the promoters or promoters group.

II. LITERATURE REVIEW

Many researchers have studied the financial decisions of family firms. Croci, Doukas and Gonenc (2011) find that family firms mostly prefer debt finance to raise the capital than equity because they don't want to lose control. Family firms don't prefer to raise capital by means of equity (Andres, 2011; Croci, Doukas and Gonenc, 2011). They rather, prefer to reinvest the profit than to raise debt for growth. They choose internal funds rather than external funds (Rafel and Alfredo, 2015; Romano, Tanewski and Symyrnios, 2001). When compared to internal funds, the external funds are riskier and may result in bankruptcy (Andres, 2011; Santos, Moreira and Vieira, 2013)

The maturity of debt differs for family and non-family firms. Family firms prefer long term maturity of debt while non-family firms prefer short term maturity of debt (Doukas and Gonenc, 2011). Chen, Dasgupta and Yu (2014) observe that transparency of the family firms increases the maturity time period of the firms and reduces the leverage ratio of firms. Various other factors which are all influencing the financial decisions of the firms. Bouzgarrou and Louhichi (2013) find out that the decisions made by family firms were to have control of the firm. Basu and Sen (2015) studied that financial decisions was to made out insiders ownership. The family norms, attitude, behavioral control these are all other factors

which influence the financial decisions of the family firms by Koropp, Grichnik, Stanley and Kellermanns (2014).

Vincent, Eddy and Ann (2012) studied whether the difference in the generation gap of the firms and this can be finding by measuring age of the firm and how it affects the capital structure and growth of family firms. They also find out second and third generation family have low debt level than first generation families. Bjuggren, Duggal and Giang (2012) for the swedish family firms studied the relationship of insiders ownership and capital structure of the firms. And they find out there is no relationship between the two. The difference between the single class share firms and dual class share firms is that the former has more of equity financing and the later has not have much of change in capital structure but they have more period for the maturity of debt (Thomas O'Connor And Thomas Flavin,2013). Jensen (1986) found that by distributing cash to shareholders the conflict between the inside and external shareholders can be reduced. There is very little studies found on the relation between family-owned firms and dividend pay-outs, this was found from the Columbian firms (González et al. (2014)). Wen et al., (2002) found that there is negative relation between the board composition and leverage of the firms in China.

Du and Dai (2005) examined from the east Asian firms and found that firms with controlled like family firms will choose higher debt and this was from the years 1994-96.

Family firms involvement in the business will be global and with differential characteristics for different countries. The firms longer term approach and decisions help the family firms to be successful according to (Bertrand and Schoar, 2006).

III. DATA DESCRIPTION AND METHODOLOGY

The sample consists of 454 listed non-financial firms from BSE 500 Index for the 14-year period of 2003 to 2016. The data was collected from CMIE-Prowess. The definition of the variables and its expected relationship with financial leverage are shown below.

VARIABLES MEASUREMENT

There are various variable used for the study purpose and they are as follows

Dependent Variable

Financial Leverage is calculated by total debt to equity ratio (total debt divided by common equity).

Independent Variable

Promoters of the firms' shareholding equity percentage

Control Variables

Dividend Payout Ratio

Dividend payout Ratio is measured by Dividend amount paid to the Net Income of the firm

Firm size

Firm size is calculated by natural logarithm of total assets of the firm. Small sized firms will mostly rely on equity financing while large sized firms rely more on debt financing.

Age

Age is calculated as the difference between the year 2016 and the year of establishment of the firm.

Collateral

The ratio of the tangible assets to total assets is to find out the collateral of the firm. The higher collateral helps the firm to raise debt capital.

ROA

The variable is used to measure the firm's PBDITA (Profitability before Depreciation, Interest, Taxes and Amortization) over total assets. Higher performance will reflect the company to have more cash flows to reduce the external source of funds.

Cash Holding

The ratio of cash and bank balance to the total assets to measure the cash holding of the firm. The higher the cash will be helpful for the firm to avoid issuing new securities.

Methodology

To find out the determinants of financial leverage, fixed effects and random effects model was employed. grtle was used for the analysis.

The following is the general model used for the study

$$Y = \beta_0 + \beta_i X_i + \mu_i \quad (1)$$

Where Y is the dependent variable, X_i $i= 1$ to N is the independent variable and μ_i is the error term.

This study uses Random Effect model used for the regression analysis.

$$\text{Leverage} = \alpha + \beta_1 \text{Promoter's Shareholding Percentage} + \beta_2 \text{Dividend Payout} + \beta_3 \text{Size} + \beta_4 \text{Age} + \beta_5 \text{Collateral} + \beta_6 \text{ROA} + \beta_7 \text{Cash Holdings} + \lambda_t + \mu_i$$

IV. RESULTS

The above mentioned model 1 is estimated using random effects model. The results of the estimation are tabulated in table IV. Hausman test was conducted to identify the better

model and random effects model has been identified as the better model. Random effect model is the better model.

Independent variable	Coefficients
Const	0.280401
PromotersInSharesheld	-0.586253
ROA	-4.38789**
Cashholding	6.16447
Collateral	-1.02322
PayoutRatio	-0.233599
FirmSize	1.06463***
FirmAge	-0.447716
dt_2	-0.0579902
dt_3	-0.18414
dt_4	-0.136989
dt_5	3.14337**
dt_6	0.00615885
dt_7	-0.0335494
dt_8	1.69044
dt_9	0.305351
dt_10	0.0443865
dt_11	1.89838
dt_12	0.243021
dt_13	-0.0566191
dt_14	-0.134569

***p<0.01, **p<0.05, *p<0.10

As we look at the table, the promoters share percentage negatively related with debt to equity ratio. The higher the promoters share of equity increases and there is decrease in the debt to equity ratio. The profitability that is ROA is at the level of significance of 5% and negatively related with Leverage. The Firm is positively related and at the level of significance of 1%. Payout ratio and Collateral are all negatively having impact with the leverage. Cash available in the firm is positive with respect to Leverage.

V. CONCLUSION

As the Promoters share percentage increases the financial leverage of the firm gets decreases, which means that company would prefer equity financing rather than debt financing when the promoters share percent increases. So the higher the promoters percentage the less the leverage of the firm is. By looking at the profitability, it has negative relations with leverage. When the company profitability gets increases the leverage of the equity position is stronger for the firms.

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