Dynamic capital structure adjustments and business group affiliations: Indian evidence

Biswajit Ghose¹
Kailash Chandra Kabra²

Abstract:

This study examines the asymmetries in capital structure adjustment speed depending on firms’ affiliation to business groups. Using partial adjustment framework on a dataset of 2001 listed Indian non-financial firms over the period of 2005-2013, it finds that Indian firms annually adjust about 37% of their deviation from target leverage. Groups firms, in general, adjust their leverage ratio slower than the stand-alone firms, suggesting lesser net benefits of adjustment for the former than the latter. The results are persistent irrespective of firms’ extent of deviation from their target leverage. However, the net benefits of adjustment and consequently the adjustment speed for both the groups of firms, irrespective of their extent of deviation from target leverage, seem to be alike when they are over-levered and lower for group firms than the stand-alone firms when they are under-levered. These findings indicate that both group and stand-alone firms face identical threats when they are over-levered whereas, group firms possibly have alternative arrangements to reduce the owner-manager agency conflicts and tax liability when they are under-levered. These findings are expected to prove helpful for financial managers in designing their capital structure based on ownership structure, and the nature and extent of deviation from the target leverage.

Keywords: Target Capital Structure, Adjustment Speed, Business Group Affiliation, Over-levered.

¹ Department of Management, Mizoram University, Aizawl, Mizoram, India
² Department of Commerce, North-Eastern Hill University, Shillong, Meghalaya, India

Corresponding Author:
Biswajit Ghose. Department of Management, Mizoram University, Aizawl, Mizoram, India,
Email id- biswajitghose84@gmail.com