EFFECTS OF CASH HOLDINGS ON CORPORATE PERFORMANCE AND VALUE: EVIDENCE FROM INDIAN COMPANIES

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Abstract

This paper analyse the factors that influence corporate cash holdings and examines the motivations for holding cash using data from a broad sample of BSE listed companies during 2006 to 2016. Most business hold cash to meet operating needs, safeguard from financial crisis or to take advantage of investment opportunities. In this paper,the author looked at the extent of cash holdings at publicly traded companies and some of the motives of cash accumulations. The empirical analysis conducted on the effects of cash holdings on corporate performance and values to investigate whether companies holding large cash are tending to improve their return on asset and corporate values. It implied that corporates accumulated cash due to economic uncertainty and rising profitability. Corporates holding large cash have a positive effect on performance and value if the investment opportunities are large to achieve better return on asset.

Keywords: Cash Holdings; Corporate Finance; Corporate Performance; Corporate Values

Introduction

Most of the Indian companies hold cash in a secured or low risk investment. The motivation of holdings cash is different from one company from another company. Some hold cash for smooth operational activity, and some hold cash for an investment opportunities. In an uncertain economy, a company would not have to hold cash. There is no optimal cash level, and a firm could wait and immediately raise outside funds whenever internal funds are insufficient to fund projects. If cash

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flows are unexpectedly low, a firm can raise external funds at fair prices to keep operating and to invest in positive net present value projects. Assuming that there are no liquidity premium and no negative tax effects if a firm borrows money and accumulates liquidity, shareholders' wealth remains unchanged.Management that maximizes shareholder wealth should set company's cashholdings at a level such that the marginal benefit of cash holdings equals themarginal cost of those holdings.There are two main benefits from holding liquid assets. First,the companies saves transaction costs to raise funds and does not have to liquidateassets to make payments. Second, the companies can use the liquid assets to finance itsactivities and investments if other sources of funding are not available or areexcessively costly. This paper examine simple dynamic effect of cash holdings on corporate performance and value.

Theoretical Motives and Empirical Hypothesis

Holding cash is irrelevant in a perfect capital market. If cash flows turns out to be unexpectedly low, companies has to raise funds to keep operating and to invest. Since there is no liquidity premium in the market, holding of liquid assets have no opportunity cost. Hence, companies may borrow funds to invest in liquid asset without any changes in shareholders wealth.

In the presence of agency costs of managerial discretion, management may hold cash to pursue its objectives at shareholder expense. First, management may hold excess cash simply because it is risk averse. More entrenched management would, therefore, be more likely to hold excess cash because it can avoid market discipline. Hence, one would expect firms with anti-takeover amendments to be more likely to hold excess cash. Second, management may accumulate cash to have more flexibility to pursue its objectives. Cash is like free cash flow. Cash allows management to make investments that the capital markets would not be willing to finance. In this sense, cash is not negative debt for management. While management can spend the cash whenever it wants to, it may not be able to raise debt whenever it wants to. By enabling management to avoid the discipline of capital markets, investing in cash can, therefore, have an adverse elect on firm value.

Hypothesis H1a: Cash holdings are positively related to firm size.

Larger firms were presumably more successful. Hence, they have been able to accumulate higher cash reserves. Managers of large firms have more discretionary power to hold excess cash without fearing a potential takeover. An alternative hypothesis is:

Hypothesis H1b: Cash holdings are negatively related to firm size.

Hypothesis H2a: Cash holdings are positively related to profitability.

Hypothesis H2b: Cash holdings are negatively related to profitability.

Hypothesis H3a: Cash holdings are positively related to growth opportunities.

Hypothesis H3b: Cash holdings are negatively related to growth opportunities.

Data and variables

To investigate the hypothesis on the determinants of cash holdings, a sample of companies listed in BSE taken for the empirical test by using CMIE - Prowessdx database. Descriptive statistics on key variables for the sample of the company's financial year from 2006 – 2016, sample of Indian companies publicly traded.The author exclude financial companies because their business involves inventories of marketable securities that included in cash, and because of their need to meet statutory capital requirements.Real Size has defined as the natural logarithm of assets. Cash balance to current asset representing the percentage of cash to current asset. N denotes the company's year observations. Negative figure in the cash flows is the outflow of cash. The author, present regressions predicting cash and the persistence of cash holdings using the entire dataset.

Variable	**Mean**	**25^{th} percentile**	**Median**	**75^{th} percentile**	**N**
Cash / Total Asset	0.09509	0.02492	0.0574	0.12442	593
Real Size	12.13386	11.15298	11.98668	13.32453	593
Net Working	0.08955	-0.02650	0.08413	0.19715	593

Capital / Asset					
Cash Balance / Current Asset	28.15769	9.5854	21.3555	41.6694	593
Debt / Equity	4.07819	0.06565	0.5275	1.23745	593
Cash Flow - Operating	40440.59	4302.6	15764.2	44983.15	593
Cash Flow – Investing	-39367.36	-46327.40	-11285.35	-2699.07	593
Cash Flow - Financing	1706.87	-9356.57	-1218.55	6589.27	593

The data also taken from cash flow statement of companies and analysed in operating, investing and financing segment of activities.

The dependent variable in the study is Cash and Asset is the independent variable in the regression model. Cash measured as cash and cash equivalent to total assets. Cash equivalents are short term, highly liquid investments that are easy to convert into cash and that carry an insignificant risk of loss in value.

Regression Statistics	
Multiple R	0.0286
R Square	0.0008
Adjusted R Square	-0.0009
Standard Error	0.1065
Observations	593.0000

ANOVA

	Df	*SS*	*MS*	*F*	*Significance F*
Regression	1.0000	0.0055	0.0055	0.4836	0.4871
Residual	591.0000	6.7017	0.0113		
Total	592.0000	6.7072			

	Coefficients	*Std. Er*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*
Intercept	0.0693	0.0373	1.8569	0.0638	-0.0040	0.1426
Size	0.0021	0.0031	0.6954	0.4871	-0.0039	0.0081

Results: The first result is that there is a negative relationship between the size of the companies and cash holdings (Hypothesis H1b). This observation is consistent with the proposition that it is relatively cheaper for larger firms to raise external funds. Then we find mixed evidence for the hypothesis of a positive relationship between cash holdings and profitability (Hypothesis H2a). The author estimate the model with operating cash flow instead of operating profit and document a significantly positive relationship. Growth opportunities are estimated to be insignificant by taking investing activities by the companies. This result is at odds with the theoretical predictions laid out in hypotheses H3a/b, suggesting either a positive or negative relationship.

Corporate cash holding and firm value:

Thus, the study analyses the relation between deviations from optimal cash holdings and firm value. If a nonlinear cash-value relationship exists in the study, where an optimal point which maximizes firm value exists, deviations from this optimal cash level will probably reduce firm value.Increase in excess cash leads to an increase in capital expenditure, acquisition spending, and pay-outs to shareholders. The above observation suggests that there is substantial persistence in excess cash.

Conclusion

The aim of this paper was to test the effect of cash holding on firm value. The paper studies a sample of85BSE listedcompanies with panel data from 2006 to2016. The study first empirically tests for theholding of cash level that maximizesfirm value by establishing hypothesis. The research observe significant influences from various company specific variables on cash holdings, and our findings support several hypotheses derived from theory. The research analysescompanies create more cash reserves out of their operations and less from financing, which they spend little on capital expenditures and other payments like debt repayment.The availability of internal fundsis beneficial inundertaking projects without raising external capitalat high transaction costs.Corporate cash holdingsmay reduce cash flow uncertainty, whereas the freecash flow theoryargues that the free cash flow impliesagency cost of managerial discretion and opportunitycost.

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