CHAPTER – 6

SUMMARY AND CONCLUSION

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This chapter presents an overall summary of this empirical investigation including the concluding remarks. The chapter also tries to provide some important suggestions and recommendations which may be very crucial piece of information for the business entrepreneurs, corporate policymakers & managers and business analysts etc. The chapter ends with a description on the limitations of the present empirical investigations along with directions for further researches.

6.1 Summary of the Study

The various issues and aspects associated with the financing decision of a company like any other decision areas are certainty crucial and complex. The equity shares are the owners' fund where as the debt is the creditors fund and designing a judicious mix of these two sources of capital would likely to promote administration, sound management and thereby superior firm performance. The relationship is theoretically well accepted and empirically established. Again, ownership structure i.e. the pattern of distribution of equity ownership to different types of investors is supposed to have an important bearing on the success or failure of an enterprise. This is because equity investors are different in terms of objective of investment, expertise on investment nurturing and voting rights or control towards the action and decisions of management. It is true that, an individual investor with very small fraction of ownership in a firm along with less expertise would have more or less no influence on the decisions and functioning of the firm. On the other hand, large promoters and institutions having substantial ownership to the same firm with high expertise and specialized skill in nurturing investment and managing portfolio are expected to influence the firms' performance and efficiency by participating in the crucial decisions and ensuring well-directed functioning of the firm accordingly. Moreover, in India where family-owned and inherited businesses form a major segment of the corporate sector, the role and influence of large shareholders and giant promoters are of special importance and therefore research worthy.

Under this backdrop, the present study attempts to extend the existing set of literatures by providing some empirical insights into the impact of capital and ownership structure on the accounting and market performance of Indian manufacturing companies. A moderately balanced panel data consisting 91 manufacturing firms listed and regularly traded in the BSE 200 index of Bombay Stock Exchange of India is taken as the sample. To arrive at the results, the study adopts panel data regression analysis. Again, considering the dynamism of relationship and endogeneity problem, the study further adopts Arellano-Bond (1991) dynamic panel model which is based on Generalised Method of Moments (GMM) to arrive at robust results. Besides, guided by previous set of literatures on Indian context, the study also extend its analysis to check the non-linear effect especially of ownership concentration by largest shareholder on the performance of Indian manufacturing firms. Based on panel data regression analysis (including dynamic panel estimation) the study finds capital structure to be negatively related with the accounting and market performance of Indian manufacturing companies. Therefore, the postulation of agency theory of Jensen and Meckling (1976) that, increased debt acts as an internal instrument to discipline management and regulate managerial opportunistic behaviour which leads to increased firm performance, does not seem to be operational in Indian manufacturing sector. Rather, the findings of this study support the view of Myers

(1977) which disapproves the view of Jensen and Meckling (1976) and refers high debt as a potential source of conflict of interest between equity and debt holders as a result of default risk which brings another agency cost. According to him, it creates a problem called “underinvestment” or “debt overhang problem”. Therefore, debt may create over-restrictions on investments and ultimately unfavourably affect firm performance. The findings of the present study also endorse the previously documented evidences produced by Stulz, (1990), Krishnan and Moyer (1997), Kalcheva and Lins (2007), Dawar (2014), Pandey and Sahu (2019b) etc. and reinforce the view that threat of liquidation generates in firms due to high debt capital and its fixed payment obligations which ultimate discourage managers to take risky projects even though they may have earning potential. This under-utilization of funds arising out of fear of losses leads to lowering financial performance of Indian manufacturing sector.

The study confirms a significant and positive statistical relationship between domestic promoters’ ownership and the accounting performance of the sampled companies. However, the study does not evidence any significant statistical association between ownership by domestic promoters and market performance of Indian manufacturing companies. Besides, as the impact of domestic promoters on financial performance in case of Indian manufacturing companies is not found to be so strong, so the monitoring efforts as supposed to be undertaken by them seems to be marginal. The results, therefore, signify the need of Indian promoters to be vigilant and more serious on their role of monitoring and supervising management with the objective to resist opportunistic use of corporate resources and curtain type 1 or vertical agency problem. Moreover, the shareholding by foreign promoter is also found to positively influence the accounting and market performance of Indian manufacturing firms.

Therefore, our study in this regards goes in line with the findings of Pant and Pattanayak (2007), Manna et al. (2016), Mishra and Kapil (2017) which also endorse the positive impact of promoter ownership on firm performance.

So far as the findings regarding institutional ownership and firm performance is concerned, the study documents a significantly positive impact of institutional ownership on all the variables used to represent the accounting and market performance of the sampled firms for both the estimation techniques. In this regard, the study endorses the *efficient monitoring hypothesis* among the three hypotheses developed by Pound (1988). Therefore, in line with this hypothesis, our study sees the institutional shareholders in India as investment expert, efficient monitor and active participant towards business affairs. The study recognises their professional expertise, monitoring efficiency and investment nurturing capability. The institutional ownership is also proved to be a complementary to the internal governance mechanism of Indian manufacturing companies. Finally, the findings of the present study relating to the effect of institutional investors' shareholding and firm performance are aligned with the studies of McConnell and Servaes (1990), Douma et al. (2006), Sahut and Gharbib (2010), Striewe et al. (2013) etc.

Coming to context of ownership concentration, as the ownership gets concentrated among a circumscribed number of shareholders the expropriation effect is found to become more intense which adversely impacts financial performance of Indian manufacturing firms. However, taking largest owner as a variable for concentration and testing the quadratic relationship, the study finds a U-shaped relationship between ownership concentration by largest owner and accounting and market performance of such firms. The threshold is estimated to be around fifty percent which means the largest shareholders provide active monitoring and their interest is properly aligned with the interest of the firm as a whole when the shareholding touches and crosses a threshold of fifty percent, before which the expropriation effect becomes prominent due to expropriation effect arising out of misaligned interests. This finding can be aligned with the study findings of Kumar and Singh (2013) who establishes a threshold of forty percent of ownership for large promoter of Indian firms for aligning their interests with the firms. Moreover, in line with Altaf and Shah (2018) the findings of the present study also indicate towards expropriation and exploitation of minority shareholders by the large shareholders and the largest shareholder in Indian manufacturing firms. Although the expropriation effect is evidenced up to a certain threshold of ownership concentration but the opportunistic behaviour and exploitation of majority owners and largest owner cannot be completely denied in case of manufacturing sector in India. In other words, it is a matter of concern for the corporate stakeholders especially the minority shareholders that the expropriation effect co-exists with the monitoring effect in Indian manufacturing sector.

Inquiring into the root causes behind such expropriation in Indian firms we reach to some specific reasons as to why it is quite easy to abuse minority shareholders in India. Firstly, status of minority shareholders in India is largely different in compare to the developed economies' market like United States and United Kingdom. For instance, in USA, all major corporate decisions are initiated by the board itself and the majority shareholders hardly influence any of such corporate decisions of the board. The shareholders may change the course of the corporation only by replacing the board. Conversely, in India, a board follows the fundamental principle while taking the corporate decisions that the opinion of majority shall always prevail. Secondly, both the versions of Indian Companies Act i.e. of 1956 and 2013 have prescribed more or less similar criteria for minority shareholders to apply to the National

Company Law Tribunal or previously Company Law Board in case they feel oppressed. As per the provision of companies act, a member/shareholder having less that 10 percent of ownership in companies issued share capital can't alone seek redressal from the tribunal in case he/she feel oppressed. In such case, a minimum of hundred members or $1/10^{th}$ of total members whichever is lower, is required to apply to the tribunal. Most often than not, it becomes a cumbersome work for minority shareholders in India especially with less financial awareness and knowledge of legislation to comply with above stipulated criteria. Thirdly, the tribunal also shows reluctance to quickly interfere in internal corporate affairs with the caution that there may be unscrupulous shareholders who can take the undue advantage of the provisions through acting in pretext of investors' rights. Apart from these, there are a number of instances when courts in India act with the principle of non-interference and refuse to interfere in the management of a company. Finally, high cost, tedious & vexing legal procedure, less hope & instances of success and lack of education & legal awareness have also discouraged ordinary investors of India to initiate action against giant shareholders who are economically and politically enough powerful. Thus, the provisions on minority interest protection in India seem quite inaccessible and unrealistic for the common investors and it becomes quite easy for the majority shareholders to reap benefit of the legal flows or regulatory loopholes.

However, it is indeed a good sign that although after a certain threshold but a favourable impact is found to be exerted by the largest shareholder on the financial performance of the sampled companies. Therefore, ownership concentration by largest owner at high level is becoming a complementary force with the external institutional specifications and acting as an internal regulatory mechanism to dismantle the type I agency problem and improve firm performance.

6.2 Conclusion

The study finds capital structure and the various forms of ownership highly relevant and crucial towards the governance and performance of Indian manufacturing companies. The capital structure of Indian manufacturing companies is found to be very relevant to the accounting performance and shareholders' value creation. Interestingly, the postulation of agency theory, propounded long-before in the pioneering study of Jensen and Meckling (1976), that increased amount of debt can act as a disciplinary force to restrain managerial opportunism is not found to be true in case of Indian manufacturing companies. Rather, we see the opposite evidence that higher the degree of leverage lower is the financial performance. Besides, similar to capital structure the ownership structure and its concentration are also found to be very much significant for the corporate governance and performance of Indian manufacturing companies. Regarding ownership-performance relationship, the institutional type of ownership is seen to be the common influencing factor to all the measures of accounting and market-related performance. Besides, the ownership concentration as a whole and the largest shareholder are also found to have crucial bearing on the governance and performance of Indian manufacturing companies. Especially in case of largest shareholder, the study finds interesting evidence. The largest shareholders are found to exert two-fold impact on the internal governance of Indian manufacturing companies. At the lower level of concentration, they are found to pursue expropriating role whereas after a certain threshold their role within the businesses gets shifted to active monitoring. In this regard, the researcher in this study thinks, this may be due to the fact that, the interest of largest owners is initially misaligned with the interest of the shareholders fraternity as a whole but after a certain threshold of ownership the misalignment of interest is restored, the expropriation effect disappears and active monitoring effect begins to play.

To conclude, it is sensible to assume that the corporate entrepreneurs of Indian manufacturing sector those having a good grief over these factors are highly supposed to ensure a vibrant internal governance mechanism and effective regulatory framework which provide them a competitive advantage in terms of low agency problems, minimised internal conflicts, high operational efficiency and improved firm performance and market valuation.

6.3 Recommendations and Policy Implications

The study in context of Indian manufacturing firms, sharply questions the postulation that the use of debt capital can discipline managerial discretions and align the owners-mangers interests. The unfavourable impact of debt on agency cost and performance clearly points towards the need for alternative disciplinary mechanisms (internal or external) to address this crisis. As a part of internal governance, the ownership concentration i.e. the presence of large block-holders can be an effective tool of ensuring efficient monitoring of management in such firms. Besides, stricter external regulatory specificities are also recommended as a complementary to internal regulatory mechanism.

The study finds both an expropriation effect along with better monitoring by largest shareholder. Besides, effect of ownership concentration by the majority owners as a whole is found to be negative. Thus, the study based on its findings cannot completely rely the role of ownership concentration specially of majority shareholders as an internal governance mechanism in the Indian manufacturing firms and accordingly again suggests stricter external regulatory and institutional specificities as an alternative mechanism that could ensure better corporate governance and protection of minority shareholders interest as previously suggested by Kumar and Singh (2012), Hamid et al (2016), Altaf and Shah (2018). The study also recommends possible amendments in the corporate laws towards improving the legal status and redressal seeking power of the small investors in India.

In nutshell, the study bears an important message for the Indian manufacturing firms that, they should be much more reliant on efficient ownership structuring and external regulatory establishments rather than debt financing for the purpose of disciplining managerial opportunistic behaviour, regulating agency crisis and ensuring improved corporate performance.

6.4. Contribution of the Study

The output of this empirical research is highly expected to add incremental value in the domain of corporate finance and governance. The study successfully produces some fresh empirical insights relating to the effect of capital structure and ownership structure on the performance of manufacturing companies in context of India. The various findings of this research, especially the evidence of the two-fold effect of largest shareholder on the corporate governance and performance of Indian manufacturing companies are supposed to have crucial importance towards the scholar and academicians of this domain of knowledge and the corporate policymakers of manufacturing sector in Indian. The researcher also expects this study to further broaden the existing set of knowledge about this subject among the students of finance and economics, researchers in the domain of corporate governance and financial management and other concerned individuals.

6.5 Limitations and Future Research Directions

We must admit that the findings and thereby drawn inferences of this study are valid for Indian manufacturing companies. Besides, the findings, interferences and policy recommendations of the study are based on the concurrent political, economic & legal framework of India. Therefore, the validity of the study may lose with changing economic, political and legal environment of varied time periods. Hence, further studies on other sectors, markets or for different time periods may reveal varied results. Moreover, the study strongly recommends sector-specific inquiries and even cross-country investigations as future research avenues.