

**THE DETERMINANTS AND VALUE OF CASH HOLDINGS:
EVIDENCE FROM LISTED FIRMS IN INDIA**



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A Doctoral Dissertation Submitted in Partial Fulfillment of the Requirements
for the Fellow Programme in Management

Indian Institute of Management Indore

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March, 2015

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ABSTRACT

Cash is an important and highly liquid asset held by a business firm to meet its liquidity needs and other purposes. The extant literature reveals that there has been an emphasis on the determinants and marginal value of corporate cash holdings due to an increase in cash holdings of the listed firms across the developed and emerging countries. The present study investigates the determinants and marginal value of cash held by the listed firms, that is, a sample of S&P CNX 500 companies listed on the National Stock Exchange (NSE) during 2007–2012. In addition, the impact of global financial crisis on the level and the marginal value of cash held by the firms were also examined.

Both the static and dynamic panel data regression methods were applied to examine the determinants of corporate cash holdings. On the basis of the empirical results obtained from the static panel data model, a strong positive relationship was observed among cash holdings and cash flow, dividend payment, market to book ratio, net debt issuance, and net equity issuance of the firms, whereas, a strong negative relationship was observed among cash holdings and net working capital, leverage, capital expenditure, and research and development (R&D) expenditure.

The dynamic panel data model was used to address the dynamic nature of cash holdings, where the generalized method of moments (GMM) technique was employed for estimating the determinants and the speed of adjustment (SOA) of cash holdings with one-step and two-step estimators for the difference generalized method of moments (DIFF-GMM) and the system generalized method of moments (SYS-GMM). It was found that the coefficient of lagged cash ratio is significantly positive and below one, which supports the dynamic trade-off theory of cash holdings.

The SOA of corporate cash holding towards the target level of cash holding ranges from 54 to 79 percent across the SYS-GMM and DIFF-GMM, respectively. This implies that the firms adjust 54 to 79 percent of the gap between the actual and target level of cash holdings each year. In addition, this study found that the global financial crisis affects the cash holdings of the firms.

The present study employed Faulkender and Wang (2006) methodology for estimating the marginal value of cash holdings through panel data regression in comparison to the Ordinary Least Square (OLS) regression method applied in the extant literature. The excess stock returns were regressed over the change in cash holdings after controlling the firm-specific financial characteristics that included profitability, financial policy, and investment policy variables. An average firm has been found to have a marginal value of cash at Rs. 0.217, which is significantly lower than the marginal value of cash documented in literature. This study concludes that the marginal value of cash holdings increases with the level of cash holdings and decreases with an increase in the leverage. The global financial crisis does not affect the marginal value of cash held by the firms. The findings of the study show crucial implications that are beneficial for the managers and investors.

Keywords: corporate cash holdings; dynamic panel data; marginal value of cash; fixed effects model

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