Business cycle effect on leverage: A study of Indian non-financial firms

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Research Question

Business Cycle and Leverage:

How Business cycles effect firm leverage?

- Gertler and Gilchrist (1993) find it pro-cyclical for all firms
- Korajczyk and Levy (2003) find the variation based on firm's financial constraints

Pro-cyclical: For constrained firms

Counter-cyclical: For Unconstrained firms

This Paper:

- Document relationship in context of India

Results

For sample of listed, non-financial firms

- Increase in leverage during recession years
  - Only for unconstrained firms
  - No increase in leverage for unconstrained firms

- Methodology
  - Panel Data : Fixed Effect Model
  - Quantile Regressions
  - Financial Constraints: Top Quartile in Market-to-Book & Cash

Comments

- Contribution to Literature
- Methodological Issues
- Steps going forward

Contribution to Literature

- Halling, Yu and Zechner (2016) find counter-cyclical evidence for international sample
  - Do not find evidence for firm characteristics effecting speed of adjustment
  - Small drop in speed of adjustment in common law countries

- This Paper
  - Find firm characteristics i.e. Financial constraints affect speed of adjustment
  - Evidence in India-common law countries

Fit in Literature

- Why make it another paper testing the above hypothesis in India
  - India provides very different institutional setting compared to other common law countries
  - For example: Less developed bond market and reliance mostly on bank credit for debt is an important distinguishing factor.
  - Exploit variation in access to finance using various policies like priority sector lending, differential access to bank credit over different states

Methodological Issues

- Standard errors are clustered – not sure
- No result for constrained sample could be due to lack of statistical power
  - Try these tests in single specification
- Result/prediction on interactions not clear

Steps Forward

- Add more firms like non-listed firms
- Exploit the banking relationships more
  - Number of lenders play important role
- Access to finance measures like
  - Ljungqvist and Farre-Mensa (2016) provides different measures of financial constraints

THANK YOU