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Changing Distribution of Leverage and Formation of “Clubs” in Indian Corporate Firms during 1991-2021: A Nonparametric Approach

Speaker

Indrani Chakraborty
Director and Professor of Economics
Institute of Development Studies Kolkata



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Abstract:

This paper, jointly written by Prof. Indrani Chakraborty, Dr. Sukhdeep Singh, and Dr. Subrata Mukherjee, investigates the evolution of leverage ratio in Indian corporate firms over the 31-year period from 1991 to 2021 i.e. the entire post-reform period. It uses kernel density estimation techniques to analyse the distribution of leverage across firms in India. The paper finds that most of the estimated densities exhibit bimodal distribution while considering all firms. The existence of two separate ‘clubs’ has also been observed in all other categories of firms, viz., group-affiliated, stand-alone, good performing and bad-performing firms. The paper also shows that there exists intra-distribution dynamics and the persistence of leverage. To explain the reasons for the formation of two “clubs” in the distribution of leverage in post-reform India, it is argued that although the stock market was flourishing in India during the post-reform period, small firms did not have much access to that market due to higher informational asymmetries between insiders in these firms and the capital markets. Moreover, the paper observes that firms with a greater percentage of fixed assets to total assets have higher leverage because fixed assets can be used as collateral and hence taking debt would be less risky. Thus, two “clubs” with high and low leverage co-existed in the Indian corporate firms in the post-reform period, which is quite revealing. The findings raise questions about the conventional wisdom which states that the leverage of business group firms is different from that of the stand-alone firms and firms with high profitability should be less leveraged. Such findings arise from observing the conditional mean of leverage which is quite misleading. The observations reveal that these average effects mask the heterogeneous effects along the distribution of leverage. The findings have several policy implications for the managers of the companies and the regulators of the Indian stock markets.

Sd/-

Simantini Mukhopadhyay
Convenor, Seminar Committee, IDSK