Abstract

Three essays on corporate financial policies

In this thesis, I study the various aspects of financial decisions made by Indian corporates. In Essay 1 of the thesis, I investigate the sensitivity of corporate financial policies to current internal cash flow. Using Indian data, I document firms' channel more than 50% of current internal cash flow to retire debt. This higher 'debt-cash flow sensitivity' facilitates the firms to maintain investments in future by borrowing. In short-run, firms reduce dependency on external finance, increase investments and save cash. In the long run, firms enhance investments via borrowing and use of cash hoards. Unlike results based on developed markets, I find that firms respond symmetrically to positive and negative cash flow shocks by making changes in their borrowing.

In Essay 2, I examine the role of Economic Policy Uncertainty (EPU) on various corporate policies, viz. liquidity, investment, capital structure, and operating activities of public (listed) and private (unlisted) firms using data from the emerging Indian economy. I use the EPU news-based index of India developed by Baker et al. (2016) to proxy for the economic policy uncertainty (EPU). Using a sample of Indian firms between 2003-2019, I employ panel regression with firm-fixed effects to analyze the influence of EPU on different corporate policies by regressing the dependent variables (cash holdings, leverage, CAPEX) on EPU, accounting for appropriate controls. I find that owing to EPU, firms increase liquidity, reduce investment, and adjust leverage ratios. In addition, in line with the real options channel, I document that firms with high investment irreversibility significantly reduce their capital expenditures. My results also indicate that amid EPU, firms face increased borrowing and

operating costs. Finally, I explore the similarities and differences in policies between public and private firms in their response to EPU. I document that they differ in CAPEX, borrowing decisions, and financial assets sale. Unlike previous studies that focus on the impact of EPU on listed firms' decisions in the context of developed markets, I analyze the effect of EPU on the corporate policies of public and private firms in the context of an emerging economy. I provide some novel empirical findings based on the granular analyses of the impact of EPU on investment policies, borrowing mix, and operating activities.

In Essay 3, I analyze how strengthening creditor rights affects the capital structure of listed firms in an emerging country, India. The government of India enacted the Insolvency and Bankruptcy Code (IBC) in 2016 to revamp the existing 'fragmented' laws on bankruptcy characterized by inordinate delays that resulted in poor recoveries for creditors. IBC replaced the debtor-in-possession approach to a creditor-in-control regime, drafted a time-bound corporate insolvency resolution process, and reduced scope for the judicial intervention to make IBC more transparent and efficient. IBC is expected to impact the borrowing mix of firms with a concentrated ownership structure and high tangibility. My study could provide only weak evidence on the negative impact of strengthening creditor rights on borrowings made by listed firms. I do not find robust evidence to suggest that IBC impacts firms' capital structure with the current sample size based on panel regression estimates and difference-in-differences results. Only firms that were unconstrained before the reforms increased leverage after the passage of IBC. My findings provide a different insight compared to a few existing preliminary findings on IBC, which claim that firms benefitted after the passage of IBC.