

Cash Holdings in Pakistani Firm's

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Abstract

Unbalanced panel of 363 Pakistani public listed firms is used to analyze factors affecting cash of the firm. We came to know that larger firms having more networking capital hold more cash. Results also suggest that cash holding of a year is also depending upon cash holding of previous year.

Keywords: Cash Holdings, Pakistani Firms, Cash, Financial Leverage, Random Effect Model.

Introduction

Cash holding can be traced to (KEYNES, 1936) who made it known that there are two major advantages that can be seen in the holding cash. (Miller & Orr, 1966) argued on the subject of the most favorable plane of cash assets. This most favorable plane of cash assets has a representation of domination for money by solid put it to somebody with the intention of nearby are economies of balance in cash administration. This would guide superior organizations to embrace smaller amount cash than less important organizations. Moreover, it is disputed with the purpose of the fees bring upon yourself in get hold of money from side to side sponge are not correlated with the element of the finance, representative that such cost are a preset quantity. (Peterson & Rajan, 2003). (Opler, Stulz, & Williamson, 1999) Looking at the determinants and inference of cash assets in the middle of widely traded US organizations in the period of 1971–94. They discover that organizations with tough enlargement chances, senior commerce danger, and lesser dimension grasp additional money than additional organizations. Organizations that contain the maximum right of entry to resources marketplace, for example huge organizations and persons with recognition ratings, in addition to; far above the ground levered organizations have a propensity to grasp fewer cash.

Upholding a suitable height of liquidity is significant intended for any firm because cash is required to carry out day to day activities, to pay off its debts as well as to take advantage of any opportunity in the market. Cash holding firms trying to maintain an appropriate level of liquidity

that is seen within an organization it has been discovered that it is a fundamental towards a smooth running of any organization. Managers in companies have been seen to have a tendency to hold a huge proportion of their cash and cash equivalents so that there would be a reinvestment on the other bodily resources, the expenditure to the stockholders and to compose by convincing that the money is kept in our organization. (Almeida, Campello, & Weisbach, 2002). The level of the cash that an organization in the Pakistani context is mainly characterized by the cash flow management, dividend payments, working capital requirements, policies regarding capital structure, asset management and investments . It has been noted that organizations that have a great investment opportunities or offer in the capital markets and a higher credit rating would have a lesser level of their cash balances when it is compared to the non-cash assets than the organizations that have low level of investment opportunities.

Evidence has shown that organizations that have a high credit rating have accumulated amount of cash balances (Opler, Stulz, & Williamson, 1999),and the negating the organization's static trade off model where those with the top management that always on the move to improve their shareholders reserves. According to (Bates, Kahle, & Stulz, 2009), the key reason for holding cash have been the defensive reason, the matter reason, the organization reason and tax reason. The cause at the back the growth of the transaction motive was to bring down the liquidating assets cost than holding cash when there is urgency. The precautionary motive has to deal with the organization's need to hold extra cash in Pakistan in the case of any unforeseen situation that would require the use of capital outlay (KEYNES, 1936). The main reason that is

seen behind the tax motive development was that the companies with high tax would be able to pay (Foley, 2007). A lot of organizations may not have cash when it is time to pay for their tax. This is the reason why a lot of organizations in the end would want to liquidate their own assets which is what is called the agency motive.

There are policies that involves capital structure, working capital requirements, cash flow organization, bonus expenditure, speculation and asset organization typify the height of money a organizations maintain (Opler, Stulz, & Williamson, 1999). The reason for determining the cash holdings and its development with the following theories; Jensen's Free Cash Flow speculation, the Tradeoff representation and the Myers' Pecking Order Theory, e.g. (Opler, Stulz, & Williamson, 1999), (Ozkan & Ozkan, 2004), and (Ferreira & Vilela, 2004).

The significance of cash holdings can be seen in three motives which are ; the transactions motives which is involved in keeping cash in order to meet the routine requirement of a business like payment of employees. The precautionary motive that is done to be able to meet a need that comes unexpected and then the speculative motive which have to be done so that the business can have an advantage of any offer that may come to it at unexpected time.

The aim of this reading is to examine the present literature on cash holdings by examining the contact of cash reserves with firms in Pakistan. This study has been produced to examine the variables of cash holdings such as Total cash/assets, Effective tax rate, Growth opportunities, financing deficit, dividend payments, Length of cash conversion cycle, financial leverage and net working capital. This study evaluates the impact of all these measures on profitability and performance of firms in Pakistan.

Literature Review

In view of the fact that present are what we describe considerable permanent expenses of receiving finance exterior in addition to the economies of level of money organization that is seen in the public and private organizations (Dittmar, Mahrt-Smith, & Servaes, 2003), the bigger organizations are required to obtain their business in a cheaper and easier method. as well as this, hoisting of the cash by the associations

promoting their non-core possessions in the era of the organization's monetary difficulty (Lang, 1995) should be very simple for the diversified organizations and the big corporations tends to become more diversified in their organizations (Rajan & Zingales, 1995). From this illustrated relationships, this model would be able to predict the lower cash holdings in large private organizations.

An organization that exhibits a very high cash amount, that could led to it been used for the reduction of debts or for buying banks shares, the chances of charge of cash assets will raise as the organization's tax rate elevates (Opler, Stulz, & Williamson, 1999). It should be noted that the higher rates in tax could keep in touch to senior tax protects from arrears and senior chance expenses for investment additional cash and money owing with the intention of being a smaller amount. We as a result are expecting that confidential associations with superior effectual tax rates grasp subordinate cash equilibrium.

(Afza & Adnan, 2007) Had studied the corporate cash holdings in some selected organizations in Pakistan from 1985- 2005. The research studied different factors like the dividend payments, the growth opportunities, the organization's dimension, the cash course doubt, the remaining working wealth and the influence. The consequence of these factors was taken care of by the support of the Jensen's free cash flow conjecture, trade-off Model and the pecking establish theory. The relation that is seen between the size, profitability and cash conversion cycle was understudied (Attari & Raza, 2012).

The additional representative alternative of cash is bank appearance of praise (Demiroglu & James, 2011) or individuals in progress possessions that can with no trouble be distorted into cash. Receivables, for instance, can be without difficulty cashed out from beginning to end factoring in diminutive organizations or by securitization procedure in better ones. Net operational assets (network of cash) can as a result be well thought-out as a cash alternate (Opler, Stulz, & Williamson, 1999) both in the public and secret organizations. It goes after those confidential organizations with a senior net operational principal are hypothetical to have subordinate cash sense of balance. In addition, prior studies have also reported that cash represents substitute of credit for the firms

(Demiroglu & James, 2011). This is because receivables can easily be cashed in small firms to meet financial obligations. Therefore, net operational assets can be unspecified as a significant alternate for money in public and private firms (Opler, Stulz, & Williamson, 1999). In this way, confidential organizations are additional probable to encompass far above the ground percentage of net working capital which can reduce cash balances.

(Pinkowitz & Williamson, 2001) took a research study on the effect of cash holding pattern and the bank power in some Japanese organizations for a specific period around 1974-1995, then the German organizations intended for the stage 1984-1994 and American associations for 1971-1994. The fractious country investigate examination is what has showed that organizations in Japanese that tends to grasp additional money than their German or American complement do. Despite the fact that the cash investment method may be alike crossways American and German association, the OLS weakening investigation exposed in addition that the Japanese money equilibrium are considerably prejudiced by the control authority of the banks.

The readings by means of the information with the intention of the heavy cash holdings that can be seen and have a higher rents that are taken out by a number of store throughout the age when they have to take pleasure in that a amount of authority in country's business lend systems. Also, data were collected from more than 11, 000 organization (as well as 30 from Pakistan) as of 45 states for the year 1998 and in a job a shareholders' privileges directory urbanized by (Lopez de Silanes, La Porta, Shleifer, & Vishny, 1998). The research results have revealed that some organizations in countries with a lower shareholder protection that can be up to twice as a lot of money as compact in a number of state with far above the ground shareholder defense. In the container of deprived saver defense that is observe, the thing that decide a business cash investment, for example asset chance and asymmetric in sequence turn out to be less significant.

The plane of association cash assets in addition to their determinants have really helped in understanding the topic. However, it is only few

of these researches that are analyzed in developing countries like Pakistan while major of the researches are done in developed countries. In 1998-2005, an investigation of cash holdings for 205 non-financial Pakistani firms was carried out. It was discovered with the purpose of that in attendance is a association that is observed connecting the cash assets of these organizations and the different organizational characteristics like the voting rights & policies, size of firm, corporate governance, and board structure. These widely held researches on these organizations showed that cash assets are exaggerated by influence, speculation chance, net operational resources, and organizations size. Cash ratios become high if the organization's cash flow growth opportunities and riskiness are also high. Organizations that have low corporate governance hold high height of money assets. The monetary psychoanalyst and the managers have to be very specific when it comes to the functionality of cash determining systems.

There are several researches that have been undertaken on the economy markets that are developed and lately on emerging markets samples, which have struggle to respond the query with theory,

Why do organizations grasp money and what establish its quantity by means of the hypothetical representation of the exchange representation?

Free cash flow theory (Jensen, Agency costs of free cash flow, corporate finance, and takeovers, 1986), (Myers, Determinants of corporate borrowing, 1977), the pecking order model (Myers & Majluf, Corporate financing and investment decisions when firms have information that investors do not have, 1984) and By making the a good number of exchange speculation on the container of imprisonment of money, what reported after the researches was that in attendance was an most favorable money height that would consequence from the weight of the costs and the marginal benefits. The cash investments produce the compensation and expenses and are very important in the economics of the enlargement chances of the association. The reimbursement of investment money is it helps to act as a safety buffer that would help associations to keep away from the expenses of elevate exterior burial or close a business obtainable belongings and which permits organizations to money their enlargement chances. Pecking order theory (Myers & Majluf, Corporate financing and

investment decisions when firms have information that investors do not have, 1984) offers explanation on the determinants of cash,

Enlargement chances are not important, perhaps for the reason that of a far above the ground optimistic association with the money shortfall changeable. As this previous changeable there a important unenthusiastic symbol in the weakening, it possibly will contain transposed this lack of enthusiasm to the enlargement chances changeable creation it be unable to find fraction of the predictable optimistic power (Bigelli & Sanchez-Vidal, 2012).

According to the pecking arrange hypothesis, there is neither a most advantageous money owing for the corporation nor an most favorable height of cash assets. It go behind that at what time internal money are not an adequate amount, corporation will hoist debt and influence. The organization's cash course is consequently characteristically agreed to as an descriptive variable, despite the fact that with dissimilar meaning (Opler, Stulz, & Williamson, 1999); (Ozkan & Ozkan, 2004). It has been considered that the organization's business discrepancy possibly will be a additionally complete unpredictable at the same time as it not just accept the organization's cash route but it procedures the accurate quantity of the firm's every year outside economics (Shyam-Sunder & C Myers, 1999). An organization's funding scarcity would then show the approach moreover to a lessening of cash possessions or to an augment in liability, or in cooperation. for that reason it has been anticipated that confidential organizations with senior economics deficit have subordinate cash assets and superior debt altitudes (Bigelli & Sanchez-Vidal, 2012). Pecking order theory put it to somebody with the intention of present is neither most favorable debt nor most favorable point of cash assets for the organizations. This theory reveals that internal funds of organizations are not adequate for the firms to meet financial obligations rather they need to raise debt which increases leverage level of the organizations (Opler, Stulz, & Williamson, 1999); (Ozkan & Ozkan, 2004). In this regard, the authors have reported that the financial deficit of firms can include cash flow measures (Shyam-Sunder & C Myers, 1999).

Monetary influence is deliberate by fiscal debt in excess of total possessions. As far as the monetary individuality of miniature firms is worried, they

come into view to contain a considerably superior investment deficit, a longer money change sequence, a subordinate monetary influence, a subordinate quantity of depository liability on entirety debt, a subordinate quantity of network working assets and subordinate expenses of R&D (Bigelli & Sanchez-Vidal, 2012). The subordinate monetary influence and bank money owing possibly will be owing to the advanced riskiness and inferior praise merit of diminutive organizations at the same time as the longer cash change cycle possibly will be owing to their subordinate constricting authority in payables and receivables' conditions of payment, compared with the largest secret firms.

When confidential organizations need to get hold of cash and encompass complicatedness in elevate more liability, moreover for the reason that they are fiscally inhibited or for the reason that they are previously too leveraged, they possibly will attempt to amplify retain salary by hurtful dividend expenditure (Bigelli & Sanchez-Vidal, 2012). Monetarily embarrassed confidential organizations should for that reason try to get hold of their money requirements by unkind up dividends (Fazzari & Hubbard, 1988). In the majority of the confidential organizations in attendance is only one depositor, over and over again the originator or the beginning family (Corbetta & Montemerlo, 1999); (Brav, 2009). An organization's wealth and individual riches are over and over again apparent as an entire, in particular in minute organizations (Ang, 1991). It go after that the option to disburse out dividends depends more often than not on the organization's needs for keep hold of cash to business new savings or to countenance a money shortfall, at what time it is not payable to make use of a number of tax compensation. US community corporation, as an alternative, entrust themselves to normal surplus expenditure in arrange to decrease administrative organization expenses, as they will additional often contain to go back to principal marketplace for lifting new principal, with a resulting additional truthful and well-organized keep an eye on (Easterbrook, 1984). Such promise does not set apart confidential corporation as in the majority luggage there is no possession-manage division and executive be inclined to agree with possessor. Associated by means of the on top of hypothesis, (Brav, 2009) discover that communal compact do not adjust their dividends a great deal in answer to

revolutionize in their presentation at the same time as dividend payments in secret organizations are a great deal more responsive to their in service presentation.

on top of the similar procession of way of thinking, the distance end to end of the hard cash change series will decide the organization's aptitude to make money from continuing processes: the shorter the distance end to end the senior the incidence of cash age group (Bigelli & Sanchez-Vidal, 2012). As (Opler, Stulz, & Williamson, 1999) put it to somebody, if a corporation administer to have a shorter money alteration sequence its motivation have a less important require of money sense of balance and this be supposed to grasp together for community and confidential firms. It has been predictable that confidential organizations with shorter money adaptation sequence show signs of subordinate money equilibrium. As predictable on top of, organization point of view possibly will lend a hand in giving details about the cash property of scheduled organizations but cannot be practical to confidential organizations. in actual fact, administrators of scheduled corporations may have a preference to grasp supplementary money moreover since they are risk-disinclined or for the reason that money lend a hand in the expenditure of privilege or the funding of surplus savings, as the free-cash-flow hypothesis put it to somebody (Jensen, Agency costs of free cash flow, corporate finance, and takeovers, 1986). on the other hand, in regulate to contain organization expenses of evenhandedness as a money determinant, possession and have power over be supposed to be alienated (Jensen & Meckling, Theory of the firm: Managerial behavior, agency costs and ownership structure, 1976), at the same time as it is over and over again the container for US scheduled companionships and is not to be expected to be the container for confidential corporations, where possession is completely determined in one particular investor or a relations or a confidential evenhandedness shareholder. Organization reasons will for that reason not exist integrated in our set of cash determinants.

According to (Acharya, Almeida, & Campello, 2007), money can be examined as "unenthusiastic debt" merely in the nonattendance of monetary frictions or in unnatural firm by means of low prevarication requirements. in actual fact, only monetarily unnatural organizations with near to the ground prevarication requirements (low

association among cash run and speculation opening) be inclined to make use of surplus cash run to decrease money owing and demonstrate a feeble cash flow compassion of cash, i.e. a near to the ground tendency to put aside money elsewhere of money flows of firms.

On the other side, just the information on US community firm's ropes these influence and a figure of of the variables used to calculate monetary constraint (connection score or profitable paper score) would not be appropriate to confidential organizations. Above and beyond, the height of monetary constriction that distinguishes confidential organizations is not uncomplicated to decide. In actual fact, on the single hand over, confidential firm be supposed to have additional harsh monetary restraint than scheduled firm, life form less important in dimension and have no straight right of admittance to capital marketplace. Alternatively, confidential organizations characteristically have immediately single or a small number of shareholders be in the right place to the beginning family (Brav, 2009) and be able to with no trouble get bank-debt if promise by the relations. This possession bind may alternate the intra-group associations which diminish liquidity requirements for Belgian scheduled organizations in production collection (Deloof, 2003). Bank debt can pin point of truth engage in recreation a most important position in formative the quantity of cash property in secretive organizations. in actual fact, in arrange to supervise little private borrowers, banks be inclined to get together non-public in sequence, and this possibly will diminish the far above the ground in sequence asymmetry that distinguish them (Fama, 1985). Second thing is that organization's acknowledgment merit possibly will be improved by recognized relations with depository (James, 1987); (Mikkelson & Partch, 1986) and this possibly will additionally decrease financial restriction.

More monetary suppleness might also gain from the renegotiation of depository give somebody a loan of upon mellowness (Chemmanur & Fulghieri, 1994). It pursues that liability make available by bank give somebody a loan of is hypothetical to diminish financial restraint in confidential organizations and dish up as a money alternate. The universal understanding that cash can be well thought-out as "unenthusiastic debt" be supposed to as a result grasp and confidential organizations with senior point of bank money

owing are predictable to contain inferior cash sense of balance.

In termination there is most favorable cash point. It is worn as a shock absorber among keep hold of income and asset wants. Under this assumption, the cash plane would presently be the result of the investment and speculation decision. Subject new equities are unusually expensive for organizations for the reason that of in sequence asymmetries. As a consequence, organizations finance their savings first and foremost with interior money, at that moment with money owing and as a final point

with equities. As a consequence, when equipped cash run are far above the ground, organizations make use of them to economics new commercial scheme, to reimburse debts, to disburse bonus and in conclusion to build up money. The Free Cash Flow Theory (Jensen, Agency costs of free cash flow, corporate finance, and takeovers, 1986) give explanations that administrators have an inducement to save money to add to the quantity of possessions beneath their be in charge of and to increase optional power in excess of the solid speculation pronouncement

Methodology

To investigate cash holdings in Pakistani firms we used balance sheet analysis data from state bank of Pakistan. Those years without data are not included in the examination so we get panel which is unbalanced of 363 firms from 2007 to 2011 of period. The variables utilized in the examination are as follows.

Cash Lag= Previous year Cash

Size= Ln of Assets

Growth opportunity= (Current year Sales – Previous year Sales)/ Previous Sales

Effective tax rate= Tax Expense / Net Profit before tax

Dividend dummy

Total Cash/ Assets

Length of cash conversion cycle= Inventory turnover in days + Receivables turnover in days – Payable turn over in days.

Financial leverage= Non-current liabilities / Total Assets

Networking Capital/ Assets

Equation:

$$\text{Cash} = \alpha + \beta_1 \text{cash lag} + \beta_2 \text{size} + \beta_3 \text{growth opportunities} + \beta_4 \text{effective tax rate} \\ + \beta_5 \text{dividend dummy} + \beta_6 (\text{total cash/assets}) + \beta_7 \text{length of cash conversion cycle} \\ + \beta_8 \text{financial leverage} + \beta_9 (\text{net workingcapital/assets})$$

Random effect model is applied to gauge the effect of these variables like cash lag, size, growth opportunities, effective tax rate, dividend dummy, total cash/ assets, length of cash conversion cycle, financial leverage and networking capital/ assets on cash holdings. The results are shown on table 1.

Result of Random effect model

Cash	Coef.	Std. Err.	z -stats	P-Value
Cash Lag	.4616711	.0182394	25.31	0.000
Size	249093.9	27842.02	8.95	0.000
Growth opportunities	31.00524	3268.063	0.01	0.992
Effective tax rate	611.9589	2429.446	0.25	0.801
Dividend Dummy	63032.95	64453.28	0.98	0.328
Total Cash/ Assets	9287447	489370.8	18.98	0.000
Length of cash conversion cycle	.4267245	1.037957	0.41	0.681
Financial leverage	219258.6	174690.5	1.26	0.209
Networking capital/ Assets	-378866.9	99520.61	-3.81	0.000
constant	-3837851	406207.4	-9.45	0.000

We found that current year cash holding is affected by the cash holdings of previous year. Which means that if a firm holds cash in the previous year it will also grasp cash in the coming years. From our size variable we observe that the large firms use more cash as compared to the firms which are smaller in size the reason may be that the larger firms may be less growth opportunities. The variable Total Cash/ Assets which measure the proportion of total assets is also found to be significant. Similarly the proportion of networking capital/total assets is also found significant. Rest of the variables that is growth opportunities, dividend, effective tax rate, length of cash conversion cycle and financial leverage don't have affect on cash holdings in context of Pakistan.

Conclusion

The study concludes that the companies with large size holds more cash than smaller size. Also those Pakistani firms which are habitual in holding cash in the year which is previous also carry cash in the current year. The study also found that growth opportunities, effective tax rate, dividend, length of cash conversion cycle and financial leverage don't affect the cash holding in Pakistani firms.

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