

IMPACT OF TRADE INVESTMENT ON FIRM VALUE AND SOLVENCY POSITION

Mr. Pankaj Sharma

Research Scholar, S. D. School of Commerce, Gujarat University.
sharmapankaj12011996@gmail.com

Dr. H. C. Sardar

Professor
S. D. School of Commerce, Gujarat University
sardarhc@gmail.com

Abstract

The corporates are becoming larger and giants by spreading their control, joint control, or influence in domestic and foreign firms through trade investment for the expansion of business. Therefore the main objective of this study is to know the impact of trade investment strategies on firm value and solvency position of corporates. To meet this objective the data has been collected from 34 BSE listed companies. These companies are selected from automobile, FMCG, pharmaceutical, telecom, and information technology industry based on market capitalization and availability of data. The data has been analyzed using fixed effect panel regression analysis in STATA software. The study concludes that the trade investment strategies have significant impact on firm value. Therefore it is suggested to the corporates that in making trade investment decisions or corporate restructuring decisions this should be considered.

Keywords: Firm Value, Solvency, Trade Investments, Subsidiaries, Associates, Joint Ventures

INTRODUCTION

Corporate restructuring is regarded as being crucial to ending all financial crises and improving a company's performance. The corporate competitive entity's management consults with a tax and economic professional for cooperation and guidance in the transaction transactions and negotiation.

Trade Investments

Trade investment means the investment in other entities securities or stakes for the business purpose.

Main three Trade Investment Strategies

1. Investments in entities to control the entity
2. Investments in entities to jointly control entities and the resources.
3. Investment in entities to have significant influence in operational and management decisions.

Corporate Consolidation

Corporate consolidation is the process of integrating multiple business divisions or corporations into a single, larger organisation. By removing irrelevant persons and processes, corporation consolidation is a legal strategy that is frequently used to increase operational efficiency. No matter how costly and difficult it may be in the short term, corporate consolidation often connected with mergers and acquisitions can produce long-term efficiency gains and a concentration of market share. The most extreme approach is to combine many businesses or business units into a completely new corporation. If one of the combined firms gets liquidated, this could be a costly venture. There are numerous and varied justifications for consolidation. They consist of, but are not restricted to:

1. Operative effectiveness
2. Removing rivalry for consumers and/or resources
3. Entering new markets and expanding existing ones

4. Inventive ideas and fresh goods
5. Financing alternatives at lower costs for larger companies
6. Shared activities
7. Increased income

Solvency

Solvency ratios are an important part of the financial analysis that determines how well a business has enough cash flow to meet its debt commitments as they become due. Leverage ratios and solvency ratios are synonyms. A low solvency ratio is thought to increase a risk of the firm of being unable to repay the debt and increase the likelihood that it will do so.

The solvency position is measured by debt-equity ratio. The formula for the same is as follows;

$$\text{Debt – Equity Ratio} = \frac{\text{Long Term Debts}}{\text{Shareholders Equity Funds}}$$

Firm Value

Value of a firm is an economic idea that depicts a company's worth. It is the value that a company has at a specific time. It is a sum of money that, one must pay to acquire or gain control of a corporate firm. A company's worth can be established using either book value or market value, similar to how it is with an asset. But usually speaking, it alludes to a company's market value. The firm value is measured by Tobin's Q ratio. The formula for the same is as follows.

$$\text{Firm Value} = \frac{\text{Market Capitalisation}}{\text{Total Assets}}$$

LITERATURE REVIEW

(Sharma, 2019) examined the trade investment strategies and their effects on Tata Motors' financial performance, it was discovered that the company's joint ventures and associates were producing respectable returns, and that its overall return on investment was double that of an investment made at cost, demonstrating sound investment practices. According to the study, while a company's long-term fundamental position is strong on its own and is also maintained by trade investments, its performance and operational efficiency fall short of expectations. As a result, the company made trade investments that will boost its overall performance and operational efficiency of the company during consolidation.

(Herrmann et al., 2003) explored if Japanese subsidiary earnings can provide additional insight beyond that provided by parent-only earnings in projecting consolidated earnings. They discovered that the persistence of subsidiary earnings is comparable to or greater than the persistence of parent-only earnings in explaining year-ahead consolidated earnings for each of the six primary earnings levels reported in Japan (sales, gross profit, operating income, current income, earnings before taxes, and net income). They also discovered that, for each of the six levels of profits analysed, subsidiary earnings add additional information to parent-only earnings that makes consolidated earnings more predictable. Additionally, they demonstrated that subsidiary earnings are typically useless for forecasting parent-only profitability. They also discovered that the utility of subsidiary earnings in predicting consolidated earnings is correlated with the ratio of subsidiary assets to consolidated assets, the persistence of subsidiary earnings, the degree to which firms are dominated by debt, and firm size.

(Lyles & Salk, 2007) empirically investigated the knowledge acquisition from foreign parents in international joint ventures in the Hungarian context. They analyse organisational traits, structural mechanisms, and environmental influences that affect the acquisition of knowledge from the foreign parent. They further found some evidence, but only for two-party joint ventures with Equal equity arrangements, that cultural disputes can hinder knowledge acquisition. Additionally, they investigated the connection between knowledge acquisition and several performance metrics for IJVs. The association between knowledge acquisition and performance was substantial for all performance metrics, and assessments of some performance dimensions were more significantly impacted by knowledge acquisition from the foreign parent and organisational features than others.

RESEARCH GAP

There are numerous studies have been conducted on measuring firm value and solvency position of corporates; measuring the performance of international subsidiaries, associates, and joint ventures. However, there is no study conducted on measuring the impact of trade investment strategies on firm value and solvency position of corporates.

RESEARCH METHODOLOGY

The main objective of this study is to know the impact of trade investment strategies on firm value and solvency position of corporates. To meet this objective a causal research design has been used and data is collected for five year (01-04-2015 to 31-03-2020) from the annual reports of respective company. The sample of 34 listed companies is selected from five industries such as automobile, telecom, FMCG, pharmaceutical, and information technology based on market capitalization and availability of data. For causal research the dependent variable is firm value and solvency while the independent variables are trade investment strategies. The collected data has been analyzed using fixed effect panel regression analysis in STATA software.

DATA ANALYSIS

Statistical Output 1: Descriptive Statistics for Trade Investment and Firm Value Variables

	N	Minimum	Maximum	Mean	Std. Deviation	Variance
TBQ	170	.0215	24.9656	4.047230	3.8654362	14.942
STROI	170	-1.5249	3.9334	.312523	.7356513	.541
ATROI	170	-.7683	5.6000	.158812	.5987289	.358
JTROI	170	-1.9073	3.0963	.066535	.4028931	.162
TTROI	170	-1.5249	3.9334	.340543	.7565601	.572

Statistical Output 2: Fixed Effect Regression for Trade Investments and Firm Value

Fixed-effects (within) regression	Number of obs	=	170
Group variable: CompanyID	Number of groups	=	34
R-sq: within = 0.0607	Obs per group: min	=	5
between = 0.0403	avg	=	5.0
overall = 0.0041	max	=	5
	F(4,132)	=	2.13
corr(u_i, Xb) = -0.1795	Prob > F	=	0.0802

TBQ	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]
STROI	2.697407	1.02765	2.62	0.010	.6646141 4.7302
ATROI	.6616504	.336992	1.96	0.052	-.0049532 1.328254
JTROI	.7402184	.3607975	2.05	0.042	.0265253 1.453912
TTROI	-2.701965	1.056018	-2.56	0.012	-4.790873 -.6130571
_cons	3.970036	.1307601	30.36	0.000	3.71138 4.228692
sigma_u	3.7601621				
sigma_e	1.3950151				
rho	.87901269	(fraction of	variance due	to u_i)	
F test that all u_i=0:	F(33, 132) =	31.69		Prob > F =	0.0000

The above statistical output 1 presents the descriptive statistics for the trade investments and firm value variables. The STROI (return from trade investment in subsidiaries), ATROI (return from trade investment in associates), JTROI (return from trade investment in joint ventures), and TTROI (return from total trade investments) are used as the indicators of trade investments while the Tobin's Q is used as the indicator of firm value. The statistical output 2 presents the results of fixed effect panel regression analysis. The hypothesis for this is as follows;

H₀: There is no significant impact of trade investment strategies on firm value.

H₁: There is a significant impact of trade investment strategies on firm value.

The p-value for the t-test on co-efficient of independent variables indicates that the STROI, JTROI, and TTROI have significant impact on firm value of selected companies. The co-efficient value indicates that the STROI and JTROI have positive impact on firm value but

the TTROI have negative impact on firm value. The within R-square value is 0.0607; this means that these independent variables explain only 6.07% variance in the dependent variable.

Statistical Output 3: Descriptive Statistics for Trade Investment and Solvency Position Variables

	N	Minimum	Maximum	Mean	Std. Deviation	Variance
STROI	170	-1.5249	3.9334	.312523	.7356513	.541
ATROI	170	-.7683	5.6000	.158812	.5987289	.358
JTROI	170	-1.9073	3.0963	.066535	.4028931	.162
TTROI	170	-1.5249	3.9334	.340543	.7565601	.572
DER	170	-13.62	21.98	.3446	2.09243	4.378

Statistical Output 4: Fixed Effect Regression for Trade Investments and Solvency Position

Fixed-effects (within) regression		Number of obs =	170
Group variable: CompanyID		Number of groups =	34
R-sq:	within = 0.0101	Obs per group:	min = 5
	between = 0.0153		avg = 5.0
	overall = 0.0117		max = 5
		F(4,132)	= 0.34
corr(u _i , X _b) =	-0.0115	Prob > F	= 0.8536

DER	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]
STROI	-1.595129	1.431594	-1.11	0.267	-4.426964 1.236705
ATROI	-.1588399	.4694555	-0.34	0.736	-1.087469 .7697894
JTROI	-.2717607	.5026183	-0.54	0.590	-1.265989 .722468
TTROI	1.574281	1.471113	1.07	0.287	-1.335726 4.484288
_cons	.3503272	.1821587	1.92	0.057	-.0100007 .7106551
sigma_u	1.1877915				
sigma_e	1.9433619				
rho	.27197061	(fraction of variance due to u _i)			
F test that all u _i =0:	F(33, 132) =	1.81	Prob > F =	0.0098	

The above statistical output 3 presents the descriptive statistics for the trade investments and solvency variables. The STROI (return from trade investment in subsidiaries), ATROI (return from trade investment in associates), JTROI (return from trade investment in joint ventures), and TTROI (return from total trade investments) are used as the indicators of trade investments while the debt-equity ratio is used as the indicator of solvency. The statistical output 4 presents the results of fixed effect panel regression analysis. The hypothesis for this is as follows;

H₀: There is no significant impact of trade investment strategies on solvency position.

H₁: There is a significant impact of trade investment strategies on solvency position.

The p-value for the t-test on co-efficient of independent variables indicates that the STROI, ATROI, JTROI, and TTROI do not have significant impact on solvency position of selected companies.

FUTURE SCOPE OF THE STUDY

Further study can be conducted by adding some control variables in the model for limiting the influence of confounding and other extraneous variables. This study can be further extended to know the impact of trade investment strategies on other financial and non-financial measures of performance.

MANAGERIAL IMPLICATION

This study found that trade investment strategies have significant impact on firm value of the corporate. Thus, this should be considered by the corporates before investing in any entity. This will be helpful to the corporate in making corporate restructuring of trade investments related decisions.

CONCLUSION

The main objective of this study is to know the impact of trade investment strategies on firm value and solvency position of corporates. To meet this objective panel regression analysis is performed to statistically test the proposed hypotheses. The study found that the trade investments in subsidiaries and joint ventures have significant and positive impact on firm value, but the total trade investments have negative impact on firm value. It is also found that there is no significant impact of trade investment strategies on solvency position of corporates. This study concludes that the trade investment strategies like investment in subsidiaries and joint ventures have significant impact on firm value. Therefore, it is suggested to the corporates that in making trade investment decisions or corporate restructuring decisions this should be considered.

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