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AN EMPIRICAL STUDY OF FIRM STRUCTURE AND PROFITABILITY RELATIONSHIP: THE CASE OF INDIAN AUTOMOBILE FIRMS

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ABSTRACT

The research paper focuses on the relationship between firm structure and profitability of Indian Automobile Companies. The analysis is concerned with the extent to which firm. Structure factors determining profitability. The study employed regression modal and the results demonstrated that firm size and growth are important determinants of profitability with positive impact whereas liquidity and leverage had a negative impact on profitability. Further, this study had found empirical evidence that past profitability, capital – output ratio and market share are also important determinants of profitability in the Indian Automobile Industry.

KEYWORDS

Determinants of Profitability, Factors affecting Profitability, Indian Automobile Industry, Leverage, Liquidity, Profitability and Size.

INTRODUCTION

The study of how and why firms attain profitability levels has been the main pre-occupation of Industrial organization economists for the last four decades. Many of the theoretical and empirical developments on the determination of corporate profitability emanate from traditional price theory and the Structure- Conduct-Performance (SCP) paradigm of the modern industrial organization literature. This latter framework was initiated by the Harvard economist **Bain (1956)**, utilizing much of the earlier work of **Clark (1940)** and **Mason (1949)**. Beyond Bain, over 20 years, a considerable research was undertaken examining the relationship between firm structure and profitability. In determining factors influencing performance diversity, literature dealing with such work suggests that industrial performance and performance differences among firms can be explained as arising from various characteristics; those which are industry specific (collusion hypothesis) and those which are firm-specific (Efficient market hypothesis). (**Capon, Farley & Hoenig, 1990**).

Industrial organization economists point to industry effects (i.e., concentration levels, industry growth) using the structure –conduct – performance model (SCP) as the main factor determining firm profitability. (**Demsetz, 1973; Peltzman, 1977; Scherer, 1980; Porter 1981**). On the other hand, the resource-based view (**Wernerfelt, 1984; Barney, 1991; Peteraf, 1993**) suggests that the explanation for the existence of more or less profitable firms within the same industry must be found in the internal factors of each company (for example, market share, firm size, skill level etc.). These firm-effect factors favour the achievement and maintenance of competitive advantages of each firm, which eventually lead to different profitability levels among firms belonging to the same industry (**Amato & Wilder, 1990**).

Many studies are found testing these competing hypotheses and the results concludes with general mixed opinions. In the market Structure-Conduct-Performance (SCP) literature, the most important hypotheses, appear to fall in to six categories (**Bothwell, Cooley and Hall, 1984**) which can be characterized as follows: seller's concentration may affect Profit-Monopoly power, conferred by high degrees of seller concentration, may cause high rates of return (**Bain, 1951**); High entry barriers may also affect profits positively (**Mann, 1966; Weiss, 1963; Comanor and Wilson, 1967; Qualls, 1979**); Absolute or relative firm size may also explain profits. (**Demsetz, 1973; Peltzman, 1977; Gale, 1972; Shepherd, 1972**); Risk differentials may be another variable affecting profitability differences (**Stigler, 1963; Fisher and Hall, 1967; Cootner and Holland, 1970**); Advertising Intensity also explaining profits (**Bloch, 1974**) and Growth also affects the profits (**Brozen's 1971**).

Actually profitability is a highly sensitive economic variable which is affected by a host of factors operating through a variety of ways. Some of them affect the product prices and quantities; some affect the cost of production while others make changes in capital stock, size, market share and growth of the firm. All such factors ultimately make the profitability of the firm to vary. It is difficult to build a theory of profitability which accounts for all such factors. Because of this difficulty, it is quite natural to analyze the variations in profitability by taking the partial approach, that is, to find the effect of certain major variables, ignoring the implications of other left out independent variables at a time. Hence, in this study the relationship between size, growth, liquidity, leverage, age, persistence of profitability, capital - output ratio, market share and profitability has been made.

SIZE AND PROFITABILITY

Economic Theory prescribes that increasing firm size allows for incremental advantages because the size of the firm enables it to raise the barriers of entry to potential entrants as well as leverage on the economies of scale to attain higher profitability. Key features of a large firm are its diverse capabilities, the abilities to exploit economies of scale and scope and the formalization of procedures. These characteristics allow larger firms to generate superior performance relative to smaller firms (**Penrose, 1959**). **Baumol (1959)** viewed that the larger firm may be in a position to earn a higher rate of return on its investment than the smaller firms because it has all options of a smaller firm open to it and in addition can undertake projects which are of large scale and are denied to smaller firms. On the other hand, larger firms can lead to increased co-ordination requirements, which in turn, make the managerial task more difficult leading to organizational inefficiencies and lower profit rates (**Downs, 1967**). Further, it has been suggested that increased size tends to be associated with higher bureaucratization (**Besanko et al., 2004; and Ahuja & Majumdar, 1998**). Another plausible argument to justify the possibility of a negative firm size-profitability relationship can be found in the concept of x-inefficiencies (**Leibenstein, 1976**).

A good number of researchers had investigated the relationship between firm size and profitability. Among the pioneering studies conducted in this field is attributed to **Hall and Weiss (1967)** showed that firm size exhibit a positive relationship with profitability. The results of **Marcus (1969)** study showed that firm size influences profitability in some, but not all industries. **Amato & Wilder (1985)** also conveyed that the relationship between firm size and profitability may be positive for some firm size ranges and negative for others. The studies by **Berk (1997), Michaelas et al., (1999), Hall et al., (2000), Cassar & Holmes (2003), Darko Tipuric (2002), Leledakis et al., (2004), Vijayakumar and Kathirvel (2003)** and **Renu Luthra and Mishra (2004)** showed the positive relationship between the firm size and profitability. On the other hand, studies by **Capon et al., (1990), Rajan and Zingales (2000), Goddard Tavakoli and Wilson (2005), Bala Ramasamy et al., (2005), Abdussalam Mahomoud Abu-Tapanjeh (2006), Kuldip Kaur (1998)** and **Abdul Rahaman Ammal (2003)** postulated negative relationship between firm size and profitability. Thus, from this theoretical background, the researcher advances the following hypothesis.

H₀: Firm size positively affects profitability.

GROWTH AND PROFITABILITY

The relationship between growth and profitability is of considerable interest both from theoretical and practical point of view. Basic economic theory, assuming inverted u-shape cost curves, implies that firms grow until they have reached the size where average variable cost is at minimum (**Besanko et al., 2004**). In that range, increased size would, ceteris paribus, be associated with improved profitability. By contrast, according to the strategy school theory not only static economies of scale in production, but experience curve effects pertaining to all aspects of the firm's operations can be the basis of cost advantages. This leads to a positive relationship between market share and profitability. However, even in the supportive literature it is observed that growth does not always enhance

profits. Growth beyond minimum efficient scale is associated with unknown or reversed effect on profitability, and pursuing growth in low growth markets or by increasing sales for products with low initial market share is no guaranteed recipe for financial success.

Marris (1964) was the first to develop a rigorous model to analyze the growth and profits of firms. According to Marris model, a firm's ability to shift the demand and supply functions (growth-profit frontier) depends on the environment in which it operates. According to **Greiner (1972)**, the relationship between company growth and profitability can be positive or negative. The empirical studies conducted by **Fenny and Rogers (1999)**, **Debashish Rai and Debashish Sur (2001)**, **Maninder S.Sarkaria and Shergil (2004)**, **Zeiton and Tian (2007)**, **Martin Hovey (2007)**, **Fulbag Singh and Monica Mogla (2008)** and **Ahmed Arif Karim Almazari (2009)** found evidence that growth had a positive impact on profitability. On the other hand, studies by **Hoy et al., (1992)**, **Kaen and Baumann (2003)**, **Abuzar and Ejelly (2004)**, **Long Chan and Xinlei Zhao (2005)** and **Eldos Mathew Punnoose (2008)** postulated negative relationship between growth and profitability. In summary, the empirical evidence on the relationship between growth and profitability is inconclusive. From the above reviews, the researcher concludes that most of the studies support the general notion that there is a positive relationship between growth and profitability. In order to test this general notion, the researcher postulates the following hypothesis.

H₀: Firms growth positively affects profitability.

LIQUIDITY AND PROFITABILITY

Promoters of Capital Theory share the axiom that profitability and liquidity comprise the salient albeit frequently conflicting goals of working capital management. The conflict arises because the maximization of firm's returns could seriously threaten the liquidity and on the other hand, the pursuit of liquidity has a tendency to dilute returns. The crucial part in managing its liquidity in day-to-day operations to ensure its smooth running and meets its obligations (**Eljelly, 2004**). Yet, this is not a simple task since managers must make sure that business operation is running in efficient and profitable manner. There are possibilities of mismatch of current assets and current liabilities during this process. If this happens and firm's manager cannot manage it properly then it will affect firm's profitability.

According to the existing literature on the relationship between liquidity and profitability, in a study by **Kamath (1989)** found liquidity affects profitability negatively. The other studies, **Deloof (2003)**, **Lazaridis and Tryfonidis (2006)**, **Eljelly (2004)**, **Raheman and Nasr (2007)**, **Garcia-Teruel and Martinez-Solano (2007)**, **Mathuva (2009)**, **Falope and Ajilore (2009)** and **Amarjit Gill, Nahum Biger and Neil Mathur (2010)** empirically examined the relationship between profitability and liquidity showed that there exists a significant and negative relationship between them. However, the study conducted by **Katerina Lyroudi and Lazaridis (2000)**, **Bardia (2004)** and **D.Sur, J. Biswas and Ganguly, P. (2001)** found that there was positive relationship between liquidity and profitability. From the above reviews, the researcher concludes the most of the studies support the general notion that there is a negative relationship between liquidity and profitability. In order to test this general notion, the researcher postulates the following hypothesis.

H₀: Firms liquidity negatively affects profitability.

LEVERAGES AND PROFITABILITY

The debate of optimal capital structure has been the focal point of the finance literature for previous several decades. According to Finance Theory, the capital structure do affects firm's cost of capital and consequently financial performance. The pioneering paper published in 1958 by Merton Miller and Franco Modigliani provides the conditions under which a firm's financing decisions do not affect its value. Due to the reflection on MM theorem, the issue of capital structure has generated unforeseen interest among financial researchers. The two most significant theories that aim to explain the relationship between capital structure and the market value of the firm are Pecking Order Theory (POT) and Static-Trade-off Theory (STT). The POT implies that profitable companies would usually not opt for debt financing for their new projects because of the availability of sizeable amounts of internal funds. However, as per STT, profitable companies would give preference to the use of debt financing in view of the attraction of tax shield benefit available on borrowed funds. Thus, STT predicts that there would be a direct relationship between profitability and leverage, while POT expects the opposite i.e., inverse relationship between them.

The available literature on leverages and profitability depicts a great deal of theoretical controversies. **Nikolaos P. Eriotis (2000)**, **Zhang et al., (2002)**, **Bevan and Danbolt (2004)**, **Tong and Green (2005)**, **Fraser et al., (2006)**, **Martin Hovey (2007)** and **Gabriela Michalea and Raluca Antal (2009)**, their findings suggest that firms follow a pecking order and also reported a negative relationship between profitability and leverage. On the other hand in accordance with trade-off theory in opposite relationship may be envisaged. Various researchers have analyzed different types of trade-offs between capital structure and corporate taxes (**Modigliani and Millar, 1963**), personal taxes (**De Angelo and Masulis, 1980**), Bankruptcy costs (**Titman 1984**), agency costs (**Myers, 1977**) and information asymmetry (**Myers and Majlof, 1984**). The stated rational is when firms are profitable they prefer debt to benefit from the tax shield. The underlying supposition dictates positive relationship between leverage and profitability. Thus, from this theoretical background, the researcher advances the following hypothesis:

H₀: There is a positive relationship between leverages and profitability.

AGE

Age of the firm can also be important determinant of profitability. Older the firm more may be the profitability of the firm, because experience and efficiency in the production process may decrease costs of production. So, it is expect positive relationship between age and profitability of the firm. However, in a situation of rapid technological progress, older firms may be less profitable as compared to the new ones, if they do not renovate their plants. With respect to the impact of age, one stream of research suggests that older firms are more experienced, have enjoyed the benefits of learning, are not prone to the liabilities of newness, and can, therefore, enjoy superior performance. (**Stinchcombe, 1965; Chittenden et al., 1996; Hall et al., 2000; Michaelas et al., 1999**). Another stream of research, however, suggests that older firms are prone to inertia, and the bureaucratic ossification that goes along with age; thus, they are unlikely to have the flexibility to make rapid adjustments to changing circumstances and are likely to lose out in the performance stakes to younger, and more agile, firms. (**Marshall, 1920**). Hence, theory is equivocal. Thus, according to this literature and in order to verify the same results for the Indian automobile firms, the researcher postulates the following hypothesis.

H₀: Firm age positively affects Profitability

PERSISTENCY OF PROFITABILITY

The hypothesis that the level of future profitability of a company will reflect its past profitability is one of appealing simplicity. It is also obvious potential value to the task of prediction. It is not, however, so satisfactory from an explanatory point of view, because it merely states that profitability is what it is and tends to remain what it is. Ideally, the economist would like to know why profitability is what it is. If he knows why it is what it is, then changes in profitability can be explained by changes in the factor which determine the level of profitability, any persistency of profitability can be explained by the persistency of these factors. This gives us a clue to the explanatory value of the relationship between past and future profitability.

The past performance of a firm acts as a guide to the future. It is true that the progress of a concern is determined not only by its past history, but by its future operations. However, the future cannot be analyzed; it is only on expectation, and any such expectation, would not be dependable unless based on the past experience. So, Past Profitability (P_{t-1}) may have the relevance as a determinant of current profitability. If profitability depends on the quality of the firm's management or on the monopoly power which the firm enjoys, or on both of these factors, one should expect to find some persistency in the profitability of firms over successive years (**Singh and Whittington, 1968**). Since, there is usually some continuity of good management and of monopoly power, so we expect that profitability in the previous year will determine the profitability in the current year. But, if profitability in the previous year is purely a chance phenomenon, then it may not affect the profitability in the current year. Thus, according to the above reviews and discussions, the researcher proposes the following hypothesis.

H₀: Past profitability positively affects profitability.

CAPITAL-OUTPUT RATIO

Capital-output ratio indicates the extent to which a firm is capital intensive in nature. Firms that are capital intensive in nature requiring large quantity of capital, may turn towards the cheapest source of finance have a tendency to show stable profits because these firms are less risky one and financial institutions can lead

more reliability to these firms's while lending money (Hurdle, 1974). But, Scherer (1970) found just the opposite results and said that capital intensive firms are more risky in nature, because, they may involve themselves in price cutting operations, thus making profitability more variable. According to Ferri and Jones (1980) also, future earnings of a firm will be more variable by the use of fixed assets. So, one can't expect a definite relationship between these two variables. Based on this argument, the researcher postulates the following hypothesis.

H₀: Capital-output ratio associates positively with profitability.

MARKET SHARE OF THE FIRM

Profitability of a firm also depends upon its market share i.e., the share of the particular firm in the total sales of that industry. Obviously, if the firm can increase its market share, it can expect more profitability as latter is a direction function of its sales i.e., if it can increase its sales in the market, it will have more profitability. Further, large market share in general is expected to yield high profitability, (i) by giving the firm a share based product differentiation advantages, (ii) by providing opportunities to this firm to operate in oligopolistic group for some joint strategies and increase in its bargaining power, and (iii) by allowing the firm to take advantages of economies of scale. Richard Mancke (1974), B.T Gale (1972), Shepherd (1972), Phillips (1972), Day (1973), Hurdle (1974) and Khalilzadeh Shirazi (1974) have affirmed the positive and significant relationship between profitability and market share. Thus, according to this literature, the researcher postulates the following hypothesis.

H₀: Market share positively affects profitability.

VARIABLES SPECIFICATIONS AND EMPIRICAL MODEL

In order to explain the profitability of the firms in Indian automobile industry, the various factors discussed above, have been taken together. This is achieved by developing a similar empirical framework used by Peter H. Grinyer and Peter Mc Kiernan (1991), Jim Nugent (1998), Sumit K. Majumdar (1997), Bala Ramasamy et al., (2005), Abdussalam Mahmoud Abu-Tapanjeh (2006) and Grace Tola Olutunla and Tomola Marshal Obamuyi (2008). The analysis of data employs the use of correlation and a multiple regression model that consists of factors associated with profitability of firms in Indian automobile industry.

The basic model consists of a multiple regression of profitability on a set of independent variables. The dependent variables of the regression model is return on assets (which is defined as, Gross profit as percentage on total assets) which relates the profitability to the asset base. This study investigates the effect of size, growth, liquidity, leverage, age, persistency of profitability, capital-output ratio and market share on firms' profitability. The current study use correlation analysis to identify the association between profitability and the independent variables, as well as regression analysis to estimate the causal relationship. The researcher considered the following regression model.

$$PR_{it} = \beta_0 + \beta_1 (\text{Size})_{it} + \beta_2 (\text{Growth})_{it} + \beta_3 (\text{Liquidity})_{it} + \beta_4 (\text{Leverage})_{it} + \beta_5 (\text{Age})_{it} + \beta_6 (\text{Past profitability})_{it} + \beta_7 (\text{Capital-output ratio})_{it} + \beta_8 (\text{Market share})_{it} + e_{it}$$

Where,

PR	–	Measures the firm profitability with gross profit as a percentage of total assets for the firm (i) in the year (t)
Size	–	Natural logarithm of firm's sales for firm (i) in the year (t)
Growth	–	Growth of firm's sales for firm (i) in the year (t)
Liquidity	–	Measures cash conversion cycle for the firm (i) in the year (t)
Leverage	–	Measures with debt to equity for firm (i) in the year (t)
Age	–	Natural logarithms of the firm's age for firm (i) in the year (t)
Past Profitability	–	One year lagged profitability for the firm (i) in the year (t)
Capital-output ratio	–	Measures the ratio of total capital to total sales for firm (i) in the year (t)
Market share	–	Measures the ratio of sales to total industry sales for firm (i) in the year (t)
β_0	–	Constant term for the firm (i) in the year (t)
β_1, β_2, \dots	–	Regression co-efficient
e	–	Disturbance term for the firm (i) in the year (t).

Table 1 below summarizes the definition, theoretical predicted signs and a-priori hypotheses were formulated, which were to be tested.

TABLE 1: PROXY VARIABLES DEFINITION AND PREDICTED RELATIONSHIPS

Proxy variables	Definitions	Predicted sign	a-priori hypotheses
Size	Natural logarithm of firm's sales	+/-	$P_1/\text{Size} > 0$
Growth	Growth of firm's sales	+/-	$P_1/\text{GS} > 0$
Liquidity	Cash conversion cycle	+/-	$P_1/\text{CCC} < 0$
Leverage	Debt to equity ratio	-	$P_1/\text{Lev} < 0$
Age	Age of firm from the starting year	+	$P_1/\text{Age} > 0$
Past profitability	One year lagged profitability	+	$P_1/\text{Past Profitability} > 0$
Capital-output ratio	Ratio of total capital to total sales	+/-	$P_1/\text{Capital output} < 0$
Market share	Ratio of sales to total industry sales	+	$P_1/\text{Market share} > 0$

ANALYSIS AND DISCUSSION

This section describes descriptive statistics summary, correlation, regression analysis and discussion of results.

DESCRIPTIVE STATISTICS AND ANALYSIS

Descriptive statistics includes the mean, standard deviation, minimum, and maximum, standard error of mean, kurtosis and skewness for the period 1996-2009. The data contains about 20 automobile firms for 216 firm-years observations. Table show that there are negative values at minimum values i.e., some firms have operated with losses during the study period.

Table 2 contains descriptive statistics of the variables used in this study. The table reveals that profit rate ranges between -189.39 per cent to 1638.92 per cent with mean of 22.29 per cent and a standard deviation 105.3. The same applies to growth, liquidity, leverage, past profitability capital-output ratio and market share, which show that the standard deviation is more than the mean. This implies that there is a high variations in the firm's mean. The table also reveals that profit rate, growth, leverage, age, past profitability, capital-output ratio and market share have a positive skewness, which indicates that the scores are clustered to the left at the low values. As for size and liquidity have a negative skewness indicating clustering of scores are at the high and as for the kurtosis statistic, all variables except for market share show a positive kurtosis suggesting that the distribution has peaked or clustered in the centre, with long thin tails.

CORRELATION ANALYSIS

A correlation analysis was performed to verify a possible association between and among the variables, in order to test whether there is any linear correlation between and among the variables. Collinearity explains the dependence of one variable to other. When variables are highly correlated they both express essentially the same information. Table 3 reports the Pearson correlation coefficients of all the variables employed in the study. Simple correlations among the variables that are reported in Table 3 are quite low. The largest reported value (-0.58) was between market share and size. In this respect, Kennedy (1985) suggests that correlation values below 0.80 do not pose a potential multicollinearity problem. Hence, the performance variables used in this study do not seem to pose a serious multicollinearity problem and this allows for standard interpretation of the regression coefficients.

DISCUSSION OF RESULTS

Using pooled regression technique, the study ran the regression of the profitability on the firm structure variables like size, growth, liquidity, leverages, age, past profitability, capital-output ratio and market share with aim to investigate whether these variables have significant explanatory powers. The estimated results are reported in Table 4.

It can be observed from the table that the estimated value of the R-Square is 0.90 for whole automobile industry, 0.98 commercial vehicles sector, 0.97 for passenger cars and multi-utility vehicles sector and 0.93 for two and three wheelers sectors. This implies that more than 90 percent of the variation in profitability of the firms is jointly determined by the said variables. The value of F-statistic indicates that the overall model is good. The Durbin-Watson statistic is also close to 2 which imply that the successive values of estimated residuals are not dependent on each other. This means that there is evidence to accept that there is no auto correlation problem in the estimated model.

Regarding the significance of individual variables, the empirical results shows that size has statistically significant effect on profitability in the Indian Automobile Industry. However, in the overall pooled sample, firm size showed significant negative relation with profitability in the Indian Automobile Industry. This is consistent with the findings of **Singh and Whittington (1968)** and contradictory to the findings of **Samuels and Smith (1968)**, who postulated positive relationship between size and profitability. The sector wise analysis showed that the size had a significant positive relationship with profitability in case of commercial vehicles and passenger cars and multiutility vehicles sector. This could be due to the changes in output either because of increased demand or reduction of costs. On the other hand, there was a significant negative relationship reported between size and profitability in the two and three wheelers sector. This was due to the reasons that larger firms can lead to organizational inefficiencies, higher bureaucratization and concept of x-inefficiency. X-inefficiency is a measure of the degree to which costs are higher than they need to be. X-inefficiency reasons that general managerial or technological inefficiency in larger firms cause higher production costs which end up in reductions in the bottom line i.e., profit rates decline. Among the various firms selected for the study, some firms showed positive relationships while others not so.

Table 4 also showed the results of regression of profitability fitted on growth of sales in all the selected firms, three sectors and whole industry. It is evident from the table that there was a significant variation in the regression co-efficient relating profitability to growth of sales between firms. Further, there is a positive relationship between the two variables (growth and profitability) except Hyundai Motors Ltd under passenger cars and multi-utility vehicles and Kinetic Motor Company Ltd, Hero Honda Motors Ltd and Majestic Auto Ltd under two and three wheeler sector. These results are consistent with the results of **Singh and Whittington (1968)**, who also found positive relationship between growth and profitability in their study. This was due to increased motivation among employees who expect greater gains in the future, gains resulting from greater company size.

Consistent with **DeLoof (2003)**, **Reheman and Nasr (2007)**, **Garcia-Teruel and Martinez-Solano (2007)** and **David M. Mathuva**, a negative relationship exists between the liquidity (cash conversion cycle) and profitability of selected automobile firms, three sectors and whole automobile industry. This was due to the fact that minimizing the investment in current assets can help in boosting profits. This ensures the liquid cash is not maintained in the business for long and that it is use to generate profits for the firm. These results suggest that managers can create value for their shareholder by reducing the number of days of the cash conversion cycle to its minimum.

Regarding the significance of the leverage, the empirical results presented in Table 4 showed that the majority of the Indian automobile firms, profitability are negatively significantly associated with the leverage. This piece of evidence is in line with Pecking Order Theory which postulates a negative correlation between the profitability and leverage. This is consist with the findings of **Rajan and Zingales (1995)**, that is, higher profitable firms uses less debt. There are other evidence for this relationship such as informational asymmetry, high costs of external resources and inefficiency of the market. However, this piece of evidence is in contrast to the Static Trade-off Theory that states that more profitable firms have lower expected bankruptcy costs and higher tax benefits. Despite this, Scooters India Ltd under two and three wheelers sector continue to enjoy such large profit margins that firms using higher proportion of debt in their capital structure were still more profitable than firms using lower proportion of debt.

It is also apparent from Table 4 that firm age has significant effects on profitability. Perhaps, it is one of the strongest determinants of profitability in all the selected automobile firms. The co-efficient of the age of firms carries a positive sign, support our a priori expectation. This indicates that older firms to be more profitable because managing the licensing process yields significant experience in pre-empting market capacities, which can then yield superior profitability because of market capture. However, apart from profitability arising from market pre-emption activities, through superior management of the licensing process, firms also become more profitable because of several strategic or operational reasons, one of which is that they are able to tap in to the relevant customer segment and provide differentiated products that meet demand. All though, this results is consistent with the work of **Stanger (2000)**, Stanger (2000) argues that the relationship should be positive, since older firms are more likely to have attained diminishing costs of production over some range of sales and hence be able to operate more economically and efficiently than recently established ones. However, the study by **Hannan and Free man (1989)** suggest that older firms are more resistant to change in a competitive environment and newer technologies which may, as a result of the need to operate in an age-old standardized manner, leave older firms progressively outdated and lead to organization failure.

As far as past profitability's relation with profitability of the selected firm of Indian automobile industry is concerned, there was a significant positive relation during the years 1996-2009 as well as for the pooled sample. This indicates positive influences on profitability, confirming our hypothesis. This result conforms to the conclusions of **Singh and Whittington (1968)**. Table 4 also showed that the co-efficient of capital-output ratio supported our hypothesis, suggesting positive relationship between increased capital-output ratio and profitability. This result is consistent with the work of **Hurdle (1974)**. Further, regression results suggest that market share is the most important determinant of profitability. The corresponding positive co-efficient suggests that selected Indian automobile firms have increased their profitability by increasing their market share.

POLICY IMPLICATIONS

It has been often argued that larger firms in an industry are relatively more efficient than the smaller ones. If this is not so, then why does a firm aspire to be larger and larger; and if this is so, then how do smaller and larger firms co-exist in the same industry. Every business is normally encountered with risks and uncertainties; bigger the firm it is expected to be stronger to face such risky and uncertain situations. Moreover a big firm because of its control over the market can buy up the best sites with location advantages, the superior technology, R&D and best professional experts. However, the findings of the study showed that "law of proportional effect" does not hold in the selected Indian automobile firms. While relatively bigger firms perform better in commercial vehicles and passenger cars and multiutility vehicles sector, the opposite hold true in two and three wheeler sector and the whole industry. These findings should be useful to the managerial authorities to decide on the extent to which firm size needs to be monitored and controlled.

Based on the empirical results obtained in this study, it is concluded that there is tendency of positive relationship between profitability and growth. Also the extent of this positive relationship is different in different firms, depending upon their ability and willingness to grow, which may further depend upon their factors like extent of monopoly power, growth of demand, market share, better labour relations and other managerial conditions etc.,. Further, the analyze of liquidity and profitability have identified critical management practices and are expected to assist managers in identifying areas where they might improve the financial performance of their operation. The results have provided owner-managers with information regarding the basic financial management practices used by their peers and their peers' attitudes towards these practices. Firms are capable of gaining sustainable competitive advantage by means of effective and efficient utilization of the resources of the organization through a careful reduction of the cash conversion cycle to its minimum. Therefore, managers can create profits for their companies by handling correctly the cash conversion cycle and keeping each different component (accounts receivables, accounts payables and inventory) to an optimum level. The relationship between leverage and profitability showed that the successful selection and use of the debt-to-equity ratio is one of the key elements of the firm's financial strategy.

The study is mainly of theoretical interest, as it examines size, growth, liquidity, leverage, age and profitability of firms and their inter-relationships. However, the empirical results obtained from the analysis of data are of importance to the owners and managers, interested in the growth and profitability of the firms. The policy of increasing total assets or sales with a view to increase profitability may not be rewarding in all cases. Therefore, such policies have to be carefully

examined in view of the findings of this study, so that these may not lead to over-capitalization and ultimately reduce profitability. From the point of view of the economy, significant relationship between size and profitability supports the policy of liberalization, initiated in the Indian Economy since 1991. The study suggests that this policy of liberalization should further be strengthened.

CONCLUSION

The study has contributed to our knowledge on the series of factors associated with the profitability of selected firms in the Indian Automobile Industry. The primary aim of this study was to test the postulated hypotheses and to provide evidence with respect to the impact of firm structure to firm profitability, by examining such major factors as firm size, growth, liquidity, leverage, age, post profitability, market share and capital-output ratio. The study employed regression model in order to test the hypotheses, using profitability measured by the Rate of Return on Assets (PR) along with other independent variables using sample of 20 automobile firms in India. The results demonstrate that firm size and growth are important determinants of profitability in the Indian automobile industry and a positive relationship between profitability and firm size and growth. Further, the results suggest that liquidity and leverage had a negative impact on profitability. Referring the firm as a variable affecting the profitability, the study shows significant result which implied that firm age affect the profitability of a firm. Further more, this study has found empirical evidence that past profitability, capital-output ratio and market share are important determinants of profitability in the Indian automobile Industry. These principal findings can be summarized as in Table 5.

In conclusion, these finding have an interesting policy implications, which may add to the ongoing debate on the issue of firm structure and the firm profitability relations. The empirical findings of this study suggest that firm structure emerges as important factor affecting profitability. However, the results indicate that some of the independent variable considered in this study has weak impacts on profitability. These findings should be useful to the management authorities to decide on the extent to which firm structure needs to be monitored and controlled. The validity and the generalization of the conclusions mentioned are pending future research in other industries or sectors that ratifies or refutes them.

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TABLES

TABLE 2: DESCRIPTIVE STATISTICS OF INDEPENDENT AND DEPENDENT VARIABLES

20 Indian Automobile Firms-1996-2009 – 216 Firm-year observations (N = 216)							
Variables	Mean \pm SD	Standard Error of Mean	Median	Minimum	Maximum	Kurtosis	Skew ness
PR	22.29 \pm 105.3	6.62	14.58	-189.39	1638.92	222.83	14.44
Ln sales (size)	6.90 \pm 1.70	0.11	6.86	0.92	10.39	0.01	-0.27
Growth	10.60 \pm 36.83	2.32	10.13	-97.62	356.66	31.46	3.48
Liquidity (CCC)	29.90 \pm 65.81	4.14	19.07	-225.76	312.03	5.58	-.18
Leverage	1.40 \pm 3.18	0.20	0.71	0	41.37	106.68	9.18
Age	0.06 \pm 0.02	0.001	0.06	0.02	0.19	5.38	1.62
Past profitability	18.67 \pm 130.38	8.23	15.82	-1190.08	1638.92	124.98	4.51
Capital-output ratio	1.07 \pm 130.38	0.44	0.26	-1.89	79.78	111.18	10.40
Market share	2.05 \pm 2.85	0.18	0.12	0.01	9.66	-0.08	1.14

PR-Profit rate on total assets; Ln Sales-Natural logarithm of sales (Proxy for size); Growth-Sales Growth; CCC-Cash Conversion Cycle (proxy for liquidity); Leverage – Debt/ Equity; Age-Ratio of Depreciation of fixed assets; Past Profitability- Profitability for previous year; Capital-Output Ratio – Ratio of total capital to total sales; Market Share – Ratio of sales to total industry sales.

Source: Computed

TABLE 3: CORRELATION MATRIX

	PR	Ln Sales	Growth	Liquidity	Leverage	Age	Past profitability	Capital output ratio	Market share
PR	1.00								
Ln Sales	0.04	1.00							
Growth	0.03	0.18	1.00						
Liquidity	-0.09	-0.11	-0.05	1.00					
Leverage	-0.003	-0.09	-0.01	0.02	1.00				
Age	0.04	0.29	-0.03	0.08	-0.05	1.00			
Past profitability	0.02	0.05	0.001	0.005	-0.01	0.34	1.00		
Capital output ratio	0.02	0.31	0.005	-0.02	-0.03	0.04	0.003	1.00	
Market share	0.10	-.58	-0.05	-0.05	0.11	-0.28	-0.11	0.06	1.00

PR-Profit rate on total assets; Ln Sales-Natural logarithm of sales (Proxy for size); Growth-Sales Growth; CCC-Cash Conversion Cycle (proxy for liquidity); Leverage – Debt/ Equity; Age-Ratio of Depreciation of fixed assets; Past Profitability- Profitability for previous year; Capital-Output Ratio – Ratio of total capital to total sales; Market Share – Ratio of sales to total industry sales.

Source: Computed

TABLE 4: REGRESSION ANALYSIS FOR OTHER FACTORS AFFECTING PROFITABILITY
[PR = β_0 + β_1 Size + β_2 Growth + β_3 Liquidity + β_4 Leverage + β_5 Age + β_6 Past Profitability + β_7 Capital Output Ratio + β_8 Market Share]

Particulars	Constant	Size	Growth	Liquidity	Leverage	Age	Past Profitability	Capital Output Ratio	Market Share	R ²	Adj R ²	F Value	DW
Ashok Leyland Ltd	87.97	7.71 (3.94)*	0.07 (2.58)**	-0.03 (3.41)*	-16.53 (2.47)***	96.77 (3.56)*	0.67 (1.68)	44.13 (1.75)	54.01 (4.20)*	0.99	0.97	56.38*	1.94
Tata Motors Ltd	36.87	0.89 (3.07)**	0.05 (3.57)*	-0.05 (0.83)	-33.09 (4.01)*	3.56 (3.84)*	0.43 (2.19)***	15.49 (3.91)*	94.63 (2.61)**	0.99	0.97	57.98*	2.01
Bajaj Tempo Ltd	-828.66	-183.1 (3.60)*	3.34 (2.29)**	-1.65 (2.69)***	-160.9 (2.22)***	112.4 (1.44)	4.93 (2.13)***	257.1 (0.93)	13.40 (2.79)**	0.88	0.81	28.20*	1.97
Eicher Motors Ltd	103.17	14.41 (3.69)*	0.15 (1.32)	-0.02 (4.07)*	-37.38 (2.67)***	87.34 (3.88)*	0.02 (3.07)**	87.19 (2.21)***	2.80 (2.56)***	0.94	0.89	7.84**	1.33
Swaraj Mazdar Ltd	32.59	20.33 (3.12)**	0.08 (4.08)*	-0.12 (3.19)**	-1.21 (1.16)	166.14 (4.15)*	0.17 (0.37)	226.1 (4.26)*	16.77 (0.89)	0.81	0.79	12.2*	1.98
Commercial Vehicles	23.07	0.55 (3.37)*	0.05 (2.46)***	-0.03 (2.45)***	-10.75 (3.90)*	3.34 (1.68)	0.19 (2.68)**	7.26 (2.48)**	8.53 (0.72)	0.98	0.95	26.77*	2.01
Hindustan Motors Ltd	-138.74	13.67 (3.63)*	0.16 (2.70)**	-0.01 (0.01)	-3.36 (3.34)*	780.0 (1.62)	0.04 (4.08)*	69.72 (3.57)*	2.96 (0.35)	0.86	0.81	18.26*	1.80
Mahindra and Mahindra Ltd	73.25	4.49 (3.41)*	0.01 (3.02)**	-0.12 (4.39)*	-26.15 (2.64)**	109.37 (3.26)*	0.52 (1.64)	62.44 (2.64)**	145.01 (3.23)*	0.97	0.91	16.69*	2.03
Maruti Udyog Ltd	257.71	13.58 (4.14)*	0.14 (2.86)**	-0.45 (1.81)	-75.09 (4.60)*	93.65 (1.02)	0.20 (2.32)***	195.78 (5.79)*	19.95 (3.25)*	0.99	0.96	41.15*	1.99
Hyundai Motors	0.11	8.01 (7.41)*	-0.01 (4.03)*	-9.33 (3.97)*	-45.03 (8.11)*	101.33 (2.72)*	0.17 (1.20)	0.90 (4.44)*	8.0 (5.81)*	0.99	0.97	56.32*	1.96
Honda Sael Ltd	0.04	2.26 (4.19)*	0.32 (3.17)**	0.22 (2.86)**	-38.49 (3.98)*	199.95 (1.25)	0.41 (4.36)*	26.80 (2.29)***	1.14 (3.65)*	0.93	0.88	6.24**	1.72
Ford India Ltd	-0.25	9.79 (3.48)*	0.16 (3.08)**	-0.55 (4.15)*	-7.15 (1.12)	916.67 (3.37)*	0.83 (5.48)*	129.11 (3.53)*	17.46 (1.41)	0.83	0.76	8.62**	1.65
Passenger cars and Multi-utility Vehicles	86.33	6.54 (2.13)***	0.08 (3.09)**	-0.12 (4.77)*	-12.79 (2.50)***	102.14 (1.19)	0.47 (2.42)***	23.19 (3.38)*	26.91 (0.51)	0.97	0.90	14.54*	1.98

TABLE 4 (Continued)

Particulars	Constant	Size	Growth	Liquidity	Leverage	Age	Past Profitability	Capital Output Ratio	Market Share	R ²	Adj R ²	F Value	DW
Bajaj Auto Ltd	-82.17	12.56 (3.92)*	0.01 (4.09)*	-0.22 (2.36)***	-7.70 (3.22)**	30.14 (0.26)	0.48 (2.64)**	-16.82 (1.99)	21.89 (4.42)*	0.96	0.89	11.07**	1.92
LML Ltd	178.86	24.34 (0.65)	0.39 (2.79)**	-1.27 (2.59)***	-14.90 (5.93)*	286.65 (6.45)*	1.53 (2.32)***	128.90 (3.91)*	6.50 (1.56)	0.97	0.90	14.39*	1.75
Maharashtra Scooters Ltd	-17.06	1.47 (4.24)*	0.08 (3.67)*	-0.08 (2.96)**	-161.12 (3.61)*	126.80 (0.41)	0.18 (2.43)***	0.02 (0.06)	0.37 (2.44)***	0.80	0.72	12.00*	1.52
TVS Motor Company Ltd	83.88	-11.49 (3.56)*	0.04 (4.17)*	-0.48 (3.10)**	-28.50 (2.86)**	196.64 (4.78)*	0.24 (2.73)**	115.27 (0.75)	48.31 (1.49)	0.93	0.89	6.66**	1.81
Kinetic Motor Company Ltd	-4711.76	-923.72 (4.52)*	-9.49 (3.83)*	-3.61 (3.28)*	-5.51 (0.17)	371.18 (3.54)*	0.48 (4.68)*	290.42 (3.68)*	7.18 (1.18)	0.98	0.94	24.75*	1.86
Hero Honda Motors Ltd	247.99	36.06 (3.33)*	-0.32 (2.55)**	-0.64 (2.35)***	-41.92 (4.52)*	179.26 (2.47)***	0.16 (0.82)	-209.98 (3.99)*	79.12 (4.45)*	0.99	0.96	35.41*	1.66
Kinetic Engineering Ltd	-65.06	7.38 (6.02)*	0.54 (3.01)*	-0.14 (2.28)***	-0.42 (3.60)*	339.54 (4.51)*	0.71 (3.15)**	11.24 (2.95)**	3.15 (1.76)	0.95	0.86	10.21**	1.45
Majestic Auto Ltd	14.98	-9.34 (4.03)*	-0.04 (3.65)*	-0.03 (0.27)	-6.11 (3.91)*	971.39 (3.80)*	0.08 (0.22)	73.54 (3.51)*	2.45 (2.11)***	0.92	0.81	5.51**	1.37
Scooters India Ltd	804.21	-162.5 (3.52)*	1.23 (2.47)***	-0.53 (2.33)***	40.15 (1.58)	556.58 (4.39)*	0.01 (0.04)	4.52 (3.43)*	2.67 (1.12)	0.92	0.86	5.68**	1.25
Two & Three Wheelers	194.82	-14.88 (2.95)**	0.23 (2.80)**	-0.44 (3.67)*	-19.68 (2.73)**	520.54 (2.78)**	0.20 (3.41)*	22.98 (4.46)*	33.52 (0.59)	0.93	0.89	6.78*	1.88
Whole Industry	19.54	-0.46 (4.50)*	0.06 (2.13)***	-0.04 (3.75)*	-6.91 (1.80)	146.73 (3.96)*	0.56 (2.96)**	20.39 (2.09)***	-	0.90	0.85	6.54**	1.68

TABLE 5: FINDING ON FIRM STRUCTURE VARIABLES AND PROFITABILITY RELATIONSHIPS

Firm Structure Variables	Measure of Performance on Profitability
Size of Firm	Larger firms are more Profitable (+)
Growth	Positive effects of growth on profitability
Liquidity	Negative relationship between profitability and liquidity (-)
Leverage	Positive effect with operating leverage (-)
Age	Older firms are more profitable (+)
Past profitability	Positively affect profitability (+)
Capital – output ratio	Positive association with the profitability
Market Share	Increased market share leads to improved profitability

Source: Empirical results of the study

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