Chapter 13

Corporate Governance and Firm Performance: A Study of Listed Firms in India

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ABSTRACT

Ownership structure is considered to be of prime importance in corporate governance of a firm. The ownership structure significantly varies across the nations. The main focus of this chapter is twofold: firstly to see the impact of ownership structure on performance of the firm and secondly to investigate the relationship between stock market performance and ownership structure during the crisis period. Panel data analysis of CNX 200 companies has been done for the time period of 2006-2013. The study also takes into account the relationship between crisis period stock return and ownership structure. The results of this study reveal a positive relationship of promoter’s shareholding with performance while a negative relationship of performance is found with the non-promoters shareholding. The regression of stock price performance on ownership variable gives a significant negative relationship during the crisis period.

INTRODUCTION

Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting return on their investment (Shliefer & Vishny, 1997). The development of corporate governance is a global occurrence and is a complex area having legal, cultural, ownership and other differences. Corporate governance systems are usually classified according to the following five key features (Miguel, Pindado & Torre, 2003): the level of ownership concentration, the effectiveness of boards, the development of capital markets, and the role of the market for corporate control and the legal protection of investors. The publication of Jensen and Meckling’s model resulted in a voluminous body of research, both theoretical and empirical. Through the 1970s
and 1980s that research was largely focused on the governance of US corporations, and US-based corporate governance research continued to expand. By the early 1990s, however, research on governance in countries other than the US began to appear. In the beginning, that research focused mainly on other major world economies, primarily Japan, Germany, and the United Kingdom. More recent years, however, have witnessed an explosion of research on corporate governance around the world, for both developed and emerging economies. The governance mechanisms that have been most extensively studied in the US can be broadly characterized as being either internal or external to the firm. Gompers, Metrick and Ishii (2003) identify four dimensions of corporate governance at the level of the firm that can help to minimize the agency problem: board of directors, ownership structure, executive incentive contracts and charter and bye law provisions. Among these the board of directors and the equity ownership structure of the firm can be defined as internal factors. The primary external mechanisms are the external market for corporate control (the takeover market) and the legal/regulatory system.

There are many opposing views regarding the role of controlling shareholder and family owned businesses in corporate governance. Wiwattanakantang (2001) investigate whether the presence of controlling shareholder has negative effects on firm value. The literature suggests that the firms with more than one controlling shareholder have higher ROA relative to firms with no controlling shareholder. They focus on pyramidal ownership and cross shareholdings. Pyramidal ownership is the process of controlling via layers of companies. Cross shareholding is a mechanism for not only assuming effective control, disproportionate to ownership, but also to protect the power of controlling shareholders (Bebchuk, Kraakman & Triantis, 2000). The family as controlling shareholders has two opposite arguments—the first argument states the family might put their own interest above the interest of shareholders. The second argument states family firms provide good monitoring services thus reducing agency costs (Fama & Jensen, 1983). Miller, Le Breton-Miller and Scholnick (2008) suggest two major perspectives of family owned business namely stewardship perspective and stagnation perspective. The stewardship perspective includes stewardship over continuity which views family owned businesses having favourable relationship with stakeholders, stewardship over employees and stewardship over customer relationship. The stagnation perspective on the other hand provides an opposing view and suggests that family owned business face problems like resource restrictions follow conservative strategies and are slow growing. The authors find a significant support for all three elements of stewardship perspective of family owned business while no evidence is found in support of stagnation perspective. Lee and O’Neil (2003) suggest that there is a disparity between the interests of owners and managers. The authors observe that the stewardship theory offers an alternative perspective that is interests of managers are aligned with that of owners. Davis, Schoorman and Donaldson (1997) suggest that a steward will gain more satisfaction by serving the group not himself. They opine that national culture is an important aspect of this kind of behavior. They focused on two measures of national culture that is individualism or collectivism and power distance. In collectivism the group is seen beyond the individual and managers act on the basis of long term relationships. In high power distance situation the manager yield to the way of hierarchy and avoid conflicts with the principals. Jung and Kwon (2002) also suggest two opposing views regarding the role of institutional investors and earning informativeness namely active monitoring and strategic alliance hypothesis. According to active monitoring institutional investors are long term investors with significant incentives to actively oversee managers. On the other hand strategic alliance hypothesis suggest that owners and institutional investors cooperate which reduces
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