Study of business groups in an institutional voids setting

Abstract

Business Groups (BGs), a dominant form of business organisation outside the AngloAmerican universe, are collections of _rms that are legally independent but co-ordinate strategically and operationally amongst themselves. BGs are ubiquitous in several emerging and a few developed economies - including India, South Korea, China, Latin America, Japan and Germany. In spite of their primal role in these economies, business groups are relatively under-researched and poorly understood. This dissertation is an attempt to shed more light on business groups and their working mechanisms. The empirical setting is the Indian economy which is dominated by BGs and has been the subject of continuous institutional reforms for more than 2 decades. We exam-ine the bene_ts and costs of group a_liation over a long period of time by studying _rm value and average stock returns of group _rms relative to non-group _rms. The _rm value analysis is a recon_rmation of the existing evidence (albeit using a larger sample and over a longer sample period as compared to extant studies) whereas, to the best of our knowledge, the stock return analysis using a multi-factor model is one of the few studies on the topic. The results support the institutional voids proposition - i.e. group a_liated _rms are valued more than similar standalone_rms as business groups are able to e_ectively _ll such voids. Further, the value advantage of group _rms reduces with the reduction of institutional voids. The results also support the exten-sion of the institutional voids perspective to systematic risk and suggest that groups _rms have less systematic risk as compared to standalone _rms. Next, we analyze the e_ect of business group structure (scale and scope of operations) on _rm value and average stock returns of group_rms. The results suggest that group scale has a positive impact on a_liated _rms as it increases their value and reduces their risk (as evidenced by lower average stock returns). On the other hand, group scope reduces a_liated _rm value and has no perceptible impact on their risk. We also study group scope dynamics in changing market conditions and _nd that the negative impact of group scope on _rm value is more pronounced when groups contract in expanding markets. Taken together, the results indicate that it is important to disentangle the e_ect of scope and scale as well as to consider the dynamic nature of group scope. Finally, we examine the risk consequences of tunneling in business groups using average stock returns. Drawing upon extant literature, relative promoter cash ow rights, ownership wedge and industry shock sensitivity are used to identify _rms that are prone to tunneling. The empirical evidence indicates that the risk of tunneling in _rms with high wedge is priced in average stock returns with a positive premium whereas we _nd no evidence of industry shock sensitivity and promoter cash ow rights a_ecting average stock returns.

Keywords: Business Groups, Institutional Voids, Scale and Scope of Business Groups, Tunneling,Stock Returns.