Business groups, capital market participation have complementary effects for Indian companies

July 16 2014

Being a part of a business group and participating in capital markets can have a significant positive impact on an Indian company's performance in the stock market, according to a new study on Indian entrepreneurship by emerging-economy experts at Rice University, the Indian School of Business in Hyderabad, India, and the graduate business school INSEAD Singapore.

The findings contradict prior research that suggests business groups in developing economies act mainly as substitutes to poorly developed economic institutions in these countries. Business (or corporate) groups are entities that control and coordinate two or more distinct legal companies through commonly held ownership stakes, often complemented by social and familial ties. Business groups are ubiquitous in emerging markets and even in some developed economies.

The paper will be published in *Strategic Management Journal*.

The authors argue that although business groups may have initially emerged as alternatives to well-developed economic institutions, they are not necessarily substitutes for them.

"While the absence of well-developed capital markets may indeed have stimulated the emergence of business groups, we propose that business group affiliation and the scrutiny that maturing capital markets impose on firms that participate actively in them nevertheless can play a complementary role in influencing a firm's performance," said

Prashant Kale, one of the co-authors of the study and an associate professor of [strategic management](#) at Rice's Jones Graduate School of Business.

The authors find support for their predictions in a novel longitudinal data set of 10,453 business-group-affiliated and nonbusiness-group-affiliated Indian companies, comprising both listed and unlisted companies, during India's postliberalization period of 1994-2009.

"Business groups in emerging economies like India have been widely criticized as entities that suffer from a variety of agency issues," Kale said. "Family owners are seen to run business-group-affiliated companies for their own benefits to the detriment of other shareholders, and they are accused of tunneling capital for personal gain and of subverting proper corporate governance practices. This is possibly due to minimal oversight of market scrutiny and control.

"However, we show that a defining feature of business groups—the listing of some of their affiliates on maturing capital markets—may in fact help to mitigate some of these concerns. In addition, as capital markets and other institutions develop further, this effect may strengthen, allowing business groups to survive as an enduring—rather than an endangered—species."

The authors acknowledge that they tested and found support for their theoretical arguments only in the context of the Indian environment. "It would be useful to replicate this analysis for business groups in other settings and emerging economies too to establish the generalizability and external validity of our findings," Kale said.

Provided by Rice University