Essays on Agency Conflicts

Abstract

Agency theory has long been one of the major perspectives which has guided and motivated corporate finance research. In this thesis, we examine agency related issues in three different contexts. Our first essay examines the presence and nature of agency conflicts among not-for-profit organizations, a subject which has received limited research attention as compared to similar studies on for-profits. Using a unique dataset comprising financial information of all section 8 companies incorporated in India, we explore the presence and nature of agency problems among the NPIs. We focus on four agency related issues particularly relevant in the NPI context, namely, commercialisation, profit orientation, financialization and empire building. We find that over the years of our study, Indian NPIs have witnessed a significant increase in their reliance on commercial income from ~20% levels in 2006 to over 50% levels in 2017, while the mean net profit margins showed a modest decline. Examining the impact of commercialization and profit-maximizing behavior on donative incomes, we find that both behaviors are associated with increased levels of donative incomes, contrary to the negative relationship observed between the two income variables in the European context (McKay et al., 2015). Studying the role of commercialization and profit-maximizing behavior on organizational survival, we find that while profit-maximizing behavior is associated with lesser exits, commercialization displays an inverted U-shaped (U-shaped) relationship with organizational survival (exit). We further examine the relationship between commercialization and profit maximization behavior on agency problems associated with use of assets, namely, financialization and empire-building, and find that while commercialization is associated with both empire building and financialization, profit maximization behavior is associated with neither. Our work contributes to the literature on NPIs by providing an empirical enquiry on agency-related concerns from outside the Anglo-Saxon context from which most of the current research has originated. A non-Anglo-Saxon perspective is particularly critical at this juncture in the NPI research context given a slew of recent research which suggests that results found in the Anglo-Saxon contexts may not hold in the developing economies and calling for evidence from non-Anglo-Saxon contexts (Yu and Chen, 2018; Vaceková, Valentinov and Nemec, 2017; Suykens, Rynck, and Verschuere, 2018). Our overall results suggest that while low levels of commercialization may be beneficial for organizations, higher levels of commercialization could have negative implications for continued organizational survival, implying that both managers and regulators of NPIs should focus on maintaining commercialization at healthy levels.

In the second essay we use a structural shock in the form of a policy decision by the Department of Investment and Public Asset Management (DIPAM) in May 2016 to require central public sector enterprises (CPSEs) to follow a rule-based payout policy as a natural experiment to examine the impact of payout policy on firm outcomes. We find that while the compliance to

the guideline has improved over the years and the dividend payout ratios of the CPSEs increased significantly post the implementation of the guidelines, a large share of CPSEs in the sample continued to remain non-compliant. However, we find that the guidelines resulted in an overall increase in dividend payouts among CPSEs. We find that larger CPSEs are more likely to comply with guidelines and that firms with higher capital expenditures are less likely to comply with the guidelines suggesting that smaller companies and companies with high projected capex find workarounds around complying with the guideline. We find no evidence that the increase in dividend came at the cost of discretionary investments in CPSEs and find no significant difference in research & development (R&D) or capital expenditures by CPSEs pre and post DIPAM implementation. Examining the market reaction surrounding the announcement of the guideline for listed CPSEs, we find negative and significant abnormal returns suggesting that the shareholders adversely reacted to the guideline. Further examining the market reactions to CPSE dividend announcements, we find a positive market reaction to companies which met the dividend norms as per the guideline, suggesting that the market rewarded CPSEs which complied with the guideline. Overall, our results are in line with the DIPAM guidelines being successful in raising the dividend payouts of CPSEs without any adverse impact on their capital investments or firm value.

In the third essay, we examine the impact of the presence and nature of Multiple Large Shareholders (MLS) on an important, but so far ignored firm outcome - firm transparency. Researchers have suggested that MLS may solve both principal-agent and majority shareholder-minority shareholder agency problems as the large shareholders monitor both the manager as well as each other. On the other hand, large shareholders may collude with each other and come together to exploit the minority shareholders. Firm transparency also has important implications for agency conflicts as an increase in transparency can result in reduced information asymmetry and thereby a reduction in agency conflicts. Further, non-controlling shareholders will require access to transparent and high quality firm information in order to effectively perform their monitoring role. Therefore, we examine the impact of MLS on firm transparency and find that the presence of MLS is associated with a decrease in firm transparency. Examining whether the identity of the large shareholder impacts firm transparency, we find that the presence of a non-promoter large shareholder is associated with increased firm transparency. We further examine the impact of an increase in contestability among the large shareholders and find that increased contestability is associated with more opacity or less transparency. Our results are consistent with blockholders with similar ownership shares colluding to reduce firm transparency and seeking information rents. Finally, we examine the moderating role of the presence of retail shareholding on the impact of MLS on firm transparency and find that MLS presence is associated with lower transparency only when retail ownership is low. Our results are consistent with large shareholders competing with each other for control of retail shareholders proxy votes when retail ownership is high, resulting in improved firm outcomes.