Abstract

Business groups are a set of legally independent firms engaged in diversified business lines, controlled by a central authority and linked by complex socio-economic ties. Previous studies in the context of western conglomerates observed that over-diversification leads to poor performances. However, affiliation to diversified business groups in developing economies has been observed to result in better market valuations. Hence, the existence of diversified business groups as a prevalent organizational form in developing economies has challenged the conventional wisdom of the Anglo-Saxon world. This has created a substantial interest in academia about these developing economy diversified business groups. Business group literature uses multiple lenses to explain the emergence and existence of business groups. However, empirical findings are ambiguous and fail to reach a consensus. This dissertation, using an 18-year panel data of the Indian corporate sector, investigates three specific issues: business group heterogeneity in value creation potential for member firms; effects of group level diversification and diversification strategies on affiliate performances; and effects of group affiliation on capital structure and cost of debt financing of member firms.

Business groups create as well as destroy value for member firms. Institutional void theorists argue that over time, the value-creating potential of business groups will erode out. They consider the existence of business groups as an anachronism that will disappear during institutional transitions. However, business groups have typically 'defied predictions of their imminent demise'. In *First Essay* we explore *whether size of a business group create value for affiliate firms* during institutional transitions. We hypothesize that the size of a business group is an important determinant of value-creating potential during institutional transitions in developing economies. Contrary to institutional void theory, we argue that large business groups ensure preferential access to different factor markets for member firms rather than mimicking missing market institutions within the group. The nature of institutional transitions in developing economies has opened up the opportunity to grow for large business groups and we find that affiliation to large business groups is beneficial for member firms. In contrast, smaller business groups fail to cope with the institutional transitions as costs of affiliation to a small business group outweigh the benefits. Our empirical evidence also reveals the existence of heterogeneity even within individual business groups.

Prior literature anticipated that with the growth of well-functioning capital markets in developing economies, the value premium associated with business group diversification will gradually disappear. Contrary to this prediction, some business groups have successfully used market-oriented institutional reforms to accelerate their growth through aggressive diversification strategies. Hence, *Second Essay* explores *whether business group diversification creates value for affiliated firms* during institutional transitions. Our cost-benefit analysis leads us to hypothesize an inverted U-shaped relationship between business group diversification and affiliated firm performance during institutional transitions. Considering institutional transitions as a two-stage process, we also find that aggressive diversification strategies have a significant positive impact on affiliate performances in the initial phase of institutional transitions.

Before financial deregulations in developing economies business group affiliated firms enjoyed preferential access to capital from state controlled financial systems. It was anticipated that institutional transitions in developing economies from bank-based financial systems to well-functioning equity market systems will change the scenario for business groups. *Third Essay* explores *whether business group affiliated firms still enjoy superior access to capital markets compared to unaffiliated firms*. Existing literature has observed that business groups reduce the bankruptcy probability of weaker firms through intra-group cross investments. Financial transactions and mutual co-insurance between group affiliated firms lead to positive externalities for recipients of finance. Our findings indicate that the positive effects of group affiliation on leverage remained consistent. We find that group affiliation enhances the firm's access to deficit financing. We also observed that group affiliation leads to higher costs of debt financing, mainly for firms affiliated to smaller business groups. Our empirical evidence also indicates a U-shaped relationship between costs of debt financing and firm's leverage.

Finally we explore the dynamics of the Indian corporate sector for the last two decades using firm-level data. Our analysis does not reveal any drastic change in the last two decades, especially in the manufacturing sector. The Indian economy is still dominated by Indian business houses and SOEs. SOEs or business group affiliated firms are significantly larger in size than stand-alone firms, though stand-alone firms are large in numbers. Our sub-sample analysis of business group firms reveals a significant turnover of ranking in the list of top-25 business groups. We also find that leading business groups dominate the overall Indian corporate sector with a high concentration of wealth.