Corporate Networks and Peer Effects in Firm Policies: Evidence from India

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Discussion
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Contribution of the Paper I

- Analyses effect of corporate network peer groups on firm policies related to investment, executive compensation and R&D.

- Peer group effects channeled through interlocking directorships.

- Case study of Indian firms based on firm level data between 1998-2010.

Key findings:
- Existence of positive peer group effects
- Stronger network ties lead to higher likelihood of mimicking peer group.
- Heterogeneity in peer group effects - Type of network peers matter
Contribution of the Paper II

- Novelty in focusing on interlocking directorates as a source of peer group impact.

- Empirical contribution – Identification of endogenous peer effects through natural breaks in network.

- Breaks occurring from death/retirement of shared directors (external event).

- Evidence of peer group impact in the context of a developing country, India.

- Results similar to that in developed country settings.

- Policy relevance:
  - Desirability of network effects.
  - Formulation of CG regulations (presumably regulating multiple directorships, inter-industry interlocks)
Comments

- Positioning the paper
- Empirical Analysis
Estimating firm-level social interactions in a developing country setting.

However, the questions asked as well as the analysis not distinct from developed country studies.

- Leary and Roberts (2010) analyse peer firm effects on financial policy
- Fracassi and Tate: External Networking and Internal Firm Governance, forthcoming in Journal of Finance

A developing country/emerging economy setting can be used to product differentiate and raise more interesting questions.
Comments : Positioning the Paper

- Developing/Emerging economy context:
  - Phenomenon of multiple directorships and therefore the possibility of interlocking directorates much more prevalent in developing countries like India.
  - In uncertain environments endemic in emerging economies, more use of directorial interlocks to obtain better coordination with other organizations to reduce uncertainty.
  - Social ties more in the nature of family ties given the predominance of business groups....Implications?
  - More variation in data especially w.r.t nature of peer group interaction.
  - The effect of emerging market based institutions and evolving regulations on firm level social interactions.

- Indian data allows one to examine these issues in detail ....potential not fully exploited.
Specific questions with Indian data

- Heterogeneity of peer effects
  - Peer effects disaggregated by peers in the same industry and those who are not.
  - Disaggregate peers by those in other group affiliated firms and those that are not…more goal congruence and group synergy? Stronger spillovers?

- Evidence of Inner Circle: Multiple directorships of inside and independent directors of a group firm originate in other group firms.

- Evidence of a ‘great divide’ between the directors associated with group-affiliates and non-affiliates.
  - Large majority of inside and independent directors are interlocked within the network of group-affiliates. Same for directors of non-affiliates.
Policy changes and peer effects.

- In Figure 1 stability comes in mostly after 2004 when CG regulations with respect to board composition stabilised.

- In Figure 2, spike in new appointments around 2003 and new links in 2005.

- Change in extent and nature of connectedness following reforms...does importance of peer effects change?
Empirical Analysis I

- Sense of the raw data for the period 1997-2010 thru splicing:
  - Year-wise number of firms/observations (Prowess/Prime database)
  - Total number of connected and unconnected firms year-wise, by ownership groups and industry groups.
  - Type of connectedness by nature of director.
  - Total number of deaths and retirements in sample including deaths/retirements of connected and unconnected firms.
  - Summary statistics on director death/retirement for connected and unconnected firms
    - By type of director (CEO/independent director/non-executive director)
    - Average age at death/retirement
    - Duration of connectedness.
  - Some comparable estimates of phenomenon of shared directorships (corporate network ties) for US/UK and India.
Connectedness by Type of Firm

- SI/NG
- DI/SG
- DI/NG
- DI/DG
- SI/DG
- SI/SG

Connectedness by Type of Director

- CEO
- Independent Director

- Independent Director
- Independent Director
Empirical Analysis II

- Use of death/retirement of connected directors to identify endogenous peer group effect.

- Similar approach in Fracassi and Tate.

- Use the average outcome of those peers lost due to death/retirement as instruments for the average peer outcome of the next period.

- This should be uncorrelated with the error term.
Empirical Analysis III

What does the error term include?

- Unobserved firm-specific factors that impact investment policy/compensation policy. Firm specific factors controlled for are PBDITA, Assets and Sales.

- Corporate governance variables such as board size, board structure, director characteristics, does affect outcomes but not controlled for...are part of the error term.

- Consider director characteristics like age and experience which can systematically impact choice of investment policy.
Empirical Analysis IV

- If age/experience is an explanatory variable and older directors are more likely to die/retire, then the validity of the instrument comes into question.

- Peer effect not distinguishable from director characteristics effect.

- In a dynamic network setting, director characteristics cannot be differenced out in firm fixed effects.

- One approach is to include accidental death…sparse data.

- Can control for director characteristics to identify network peer effects.
Empirical Analysis IV

- Differentiating between the death/retirement of CEO and independent director.
- CEO and independent director perform different functions.
- CEO focuses on operational and strategic matters and independent directors on advising CEO on strategic matters.
- Average outcomes may be differentially affected with death/retirement of CEO as CEO looks at operational matters that can affect investment along with the effect of lost ties.
- May bias estimates.

- Approach is to exclude CEO deaths/retirements from total.
- Can re-estimate to see whether such exclusion affects results.
Concluding Comments

- Technical content high.

- Stronger motivation/positioning needed.

- Additional insights from developing country study. Do institutions matter in peer effects?

- It would be good to focus on peer effects with respect to one outcome variable and undertake a more detailed analysis.

- Check the ultimate question: do peer effects add value in the context of a developing country?
Thank You