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Authors: Farooq Ahmad Shah, Nufazil Altaf

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Slack Heterogeneity and Firm Performance: Investigating the Relationship in Indian Context.

Dr. Farooq Ahmad Shah [1] and Nufazil Altaf [2]

[1]*Professor, School of Business Studies, Central University of Kashmir, EMAIL ID*
farooq_dms@cukashmir.ac.in

[2]*Research Scholar, School of Business Studies, Central University of Kashmir, EMAIL ID*
nufazil.ahangar@cukashmir.ac.in

Abstract

The present study aims to investigate the impact of diverse forms of slack on firm performance in the Indian context: By investigating a panel data set of 426 non-financial Indian firms over a period of 5 years, the empirical results of both fixed effects model and generalized method of moments (GMM) reveal that different forms of slack have a negative impact on firm performance in Indian firms. The results of the study provide support for the agency view of the negative impact of slack resources on firm performance Moreover, the results remain robustly negative across alternative specifications and sub-samples.

Keywords: Financial slack; Human slack; Innovational slack; Firm performance; India

1. Introduction

Over recent years, managers and researchers have been devoting considerable time and effort in developing strategies that impel organization to excel and survive in the continuously changing environment. One of the critical aspects that has the direct impact on the development and implementation of strategies are organizational resources. Organizational resources act as persuaders to experimentation, building competencies, maintaining coalitions and play a critical role in making proactive strategic choices. If an organization maintains resources in addition to what is needed to run an organization, such resources are termed as slack resources. Organizational theories like resource-based theory (Penrose, 1959); the behavioral theory (Cyert and March, 1963); the pecking order theory (Myers, 1984) and the agency theory (Jensen and Meckling, 1976) are divided over the issue whether slack affects the firm performance positively or negatively. While, the resource-based theory and the behavioral theory hold that slack acts as a buffer in times of environmental turbulence, reduce the conflict among employees and foster innovation, the hierarchical or pecking order theory suggests that in the presence of information asymmetry between the firm and outside investors, firms would prefer internal funds over external funds to finance investment. Contrary to these theories, agency theory views slack as a potential source of agency problems, which breeds inefficiency, inhibits risk-taking capacity and hurt performance. Further, the empirical literature concerning the slack-performance relationship is also divided into two camps, where one camp belongs to those who documented support to resource-based theory, behavioral theory and pecking order theory suggesting that slack affects the firm performance positively (see e.g., Shahzad et al., 2016; Bradley et al., 2011; Daniel et al., 2004). While the other camp belongs to those who support agency theory amplifying that slack has negative impact on firm performance (see e.g., Kang, 2013; Chiu and Sharfman, 2011; Barnea and Rubin, 2010).