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The valuation effect of corporate governance on stakeholder wealth: Evidence from strategic alliances

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A B S T R A C T

This study aims to investigate the critical debate in corporate governance research concerning the boundary of the efficacy of the corporate governance mechanism. With particular focus on a specific set of firms' primary stakeholders, strategic alliance partners, our research design facilitates the examination of this issue. The results show a significantly positive association between a firm's corporate governance quality and the gains of its alliance partners. The proposition that firms with good governance more greatly value the interests of stakeholders whose devotion is critical is further supported by our findings of significantly positive moderating effects of the following three factors: a firm's growth potential, its business relatedness with its counterparts, and the activity types that the alliance encompasses (technical versus non-technical). Our research results suggest that firms, and thus shareholders, would economically benefit from managing their stakeholder relationships in a manner that positively affects firm prospects and shareholder wealth.

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1. Introduction

The question of whether the soundness of a firm's corporate governance mechanism has implications for stakeholders other than shareholders has received increased attention over the past decade. Conventional corporate governance research follows agency theory, arguing that managers, due to their fiduciary duties to shareholders, should prioritize the interests of the shareholders over the concerns of all others, including those of stakeholders (e.g., Jensen & Meckling, 1976; Manne, 1965). This traditional view thus suggests that the corporate governance mechanism only has implications for shareholders. It is challenged by the more recent stakeholder theory, which views the corporation as a locus of responsibility in relation to the wider range of stakeholders' interests (e.g., Arora & Dharwadkar, 2011; Letza, Sun, & Kirkbride, 2004). This theory postulates that shareholders are but one of a number of major stakeholder groups that are affected by a firm's prospects (e.g., suppliers, customers, creditors, employees, and local communities), and that all should receive a “fair” return on their investment. This suggests that a firm with good governance should reconcile the interests of both its shareholders and other major stakeholders; corporate governance quality would thus carry a positive signal not only for shareholders but also for these other stakeholder groups.

Empirical evidence mirrors the theoretical debates regarding the boundary of the efficacy of the corporate governance mechanism. Several studies find that a firm's governance quality positively impacts stakeholder interests. However, opposite evidence is also reported, while still others show no relationship between the two (see Arora & Dharwadkar, 2011, for a review). In exploring the underlying attributes, we posit that one of the important determinants may be the salience of the various stakeholder groups in terms of their level of contribution to the firm. In particular, primary stakeholders control resources critical to a firm's survival and exert considerable influence (Clarkson, 1995). A well-governed enterprise should therefore highly value

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the interests of their primary stakeholders in order to ensure their commitment and continued provision of competitive resources. In contrast, secondary stakeholders are not engaged in transactions with corporations and are thus not as essential for firm survival. Their claims can therefore be subordinated to those of shareholders and other primary stakeholders when executives weigh the relative costs and returns of various strategies and seek efficient allocation of a firm's scarce resources. However, existing studies on the relationship between a firm's governance quality and stakeholder welfare generally take into account the interests of all stakeholders without considering their disparate contributions (e.g., Arora & Dharwadkar, 2011; Mahoney & Thorn, 2006; McGuire, Dow, & Argheyd, 2003; Neubaum & Zahra, 2006).[1] The failure to differentiate between the contributions of individual stakeholder groups may explain why the findings regarding the valuation effect of corporate governance on stakeholder interests have been inconclusive.

To address this research void, we assess whether the quality of a firm's governance mechanism affects primary stakeholders' interests by investigating a particular stakeholder group—the counterpart(s) in a firm's alliance engagement. We select this stakeholder group due to the following reasons. The first relates to the relative position alliance partners hold in a firm's stakeholder system. Based on studies of stakeholder classification, alliance partners and suppliers are grouped in the same category of primary stakeholders (Christopher, Payne, & Ballantyne, 2002). However, while suppliers provide physical resources to the business, alliance partners supply competencies and capabilities that are typically knowledge-based rather than product-based, and thus are deemed more influential due to their greater impact on a firm's prosperity. Echoing this sentiment, researchers from different theoretical perspectives have indicated that there are unique advantages underlying a firm's alliance engagements that can provide the basis for sustainable competitive advantages, including learning expertise from another party, gaining access to critical external resources, breaching in-house resource limitations, increasing the speed of entry into new markets, and obtaining follow-on growth options (e.g., Hennart, 1988; Raff, Ryan, & Stähler, 2009; Reuer & Tong, 2010). Consistent with the theoretical reasoning, anecdotal reports provide evidence for the popularity of inter-firm cooperative activities. For example, in typical large US companies, firm collaborations are reported to account for 15% to 25% of turnover (Heimeriks, Klijn, & Reuer, 2009). The preceding discussion taken together suggests that alliance partners hold a prominent position in a firm's stakeholder framework.

Furthermore, with the employment of the event study approach and an alliance data, our study facilitates the examination of an important, yet under-researched question: whether a salient stakeholder's wealth is affected by the quality of a firm's governance mechanism, and how the relative contribution of a stakeholder determines the gains it may obtain from this mechanism. To this end, we first investigate the effect of a firm's governance quality on its partners' interests in general. If a well-governed enterprise more greatly values the interests of its primary stakeholders, we should observe a positive relation between a firm's governance quality and its partners' gains in their joint alliance investments. To strengthen the validity of this proposition, we further investigate whether the prominence of the partners' assistance, assessed by the focal firm's growth potential, its business relatedness with its counterparts, and the activity types the alliance encompasses (technical versus non-technical), moderates the linkage between a firm's governance quality and its partners' gains. With the presumption that a well-governed corporation will act in its partners' best interests in order to increase their devotion to the joint investment platform, the positive message carried by a sound corporate governance system should take on greater significance when assistance from the partners is crucial. The empirical results yield consistent support to our inferences, which are robust to different event windows of wealth gains and regression model specifications, are not sensitive to the potential bias of multiple alliance announcements, and are free from problems of heterogeneity and unobservable firm-specific effects.

We argue that our investigation into the governance–stakeholder interest relationship, with our particular focus on alliance partners and the employment of the event study approach, can be informative. Conventionally, a firm's stakeholder welfare engagement is measured by the KLD index, which assesses the corporate social policies for various stakeholders with an aggregated rating (e.g., Arora & Dharwadkar, 2011; Mahoney & Thorn, 2006; Neubaum & Zahra, 2006).[2] However, such a simplified measure clouds the identification of the valuation effect of corporate governance on individual stakeholders. This may result in misleading conclusions since stakeholders are heterogeneous in their relationships with a firm's prosperity, and thus could be rewarded differently due to the constraint of limited firm resources. Moreover, the employment of selective social behavior items in the KLD index makes it not possible to completely evaluate the context of stakeholder welfare, nor test the dynamics of how a relative change in stakeholder contribution moderates the benefits they may obtain. With the employment of the event study approach and a particular focus on enterprises' alliance activities, our research design can address this concern as it provides a viable path to assess how the wealth of primary stakeholders is affected by a firm's governance quality. It further allows the comparison of the influence of stakeholders' relative contribution on the association between the soundness of a firm's governance system and its stakeholder interests. The event study approach has been widely adopted in alliance research to investigate how characteristics of the firms, their counterparts, and the cooperative contexts influence shareholder gains in firm alliance investments (e.g., Chan, Kensinger, Keown, & Martin, 1997; Chang, Chen, & Lai, 2008). Our study follows this research

[1] For example, the KLD index is the most widely adopted measure of corporate stakeholder performance that assesses a firm's stakeholder policy by aggregating the disparate policy attributes of five categories (employee relations, community relations, the environment, treatment of women and minorities, and product quality) into a single summary score.

[2] Specifically, the KLD index assesses corporate stakeholder performance through a diverse set of stakeholder policies that cover issues of employee relations, community relations, the environment, treatment of women and minorities, and product quality. It also covers sociopolitical issues, including whether firms produce alcoholic beverages, have contracts with the military, or do business in certain countries such as Burma or Mexico. Hillman, Keim, and Luce (2001) comment that KLD ratings are not representative of the interests of primary stakeholders.

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