



Which bundles of corporate governance provisions lead to high firm performance among restaurant firms?

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ABSTRACT

This study defends the view that the adoption of corporate governance provisions should not be seen as a detriment to firms' financial performance. On the contrary, we contend that some combinations of corporate governance provisions may indeed lead to higher firm performance among U.S. restaurant firms. Using a set-theoretic method, such as the Qualitative Comparative Analysis (QCA), our findings revealed that there are three configurations of governance provisions that lead to superior financial performance. The presence of poison pills appeared as a core condition in all solutions. Negated analysis indicates that the inappropriate bundling of governance provisions leads to poor firm performance.

1. Introduction

Corporate accounting scandals in the early 2000s sparked major public and academic interest in corporate governance provisions to protect shareholders against abusive managerial conduct. A key issue for any given corporation is which provisions to adopt or avoid. The combinations of various corporate governance provisions such as, the presence of poison pills and/or a classified board, complement and substitute for each other as a bundle of related practices in a company's governance mechanisms. For instance, more than 30 years ago, McDonald's – the torchbearer of the U.S. restaurant industry – adopted and used a poison pill provision, which is a tactic to overcome an unwelcome takeover bid to make the company unattractive to the bidder and to avoid any hostile takeover. Many years later, McDonald's remains a successful company that has been able to weather several storms pertaining to shareholder rights and corporate governance.

Over the past two decades, the adoption of such corporate governance provisions was interpreted as weakening (or restricting) shareholder rights (Agrawal and Chadha, 2005). For example, the governance index (G-index) in Gompers et al. (2003), which consists of 24 such governance provisions, is negatively related to firm value. Other studies (e.g., Bebchuk et al., 2009; Brown and Caylor, 2006) employ governance indices that support the findings of Gompers et al. (2003) by analyzing the total count of governance provisions. However, more recent studies indicate that examining the total count of provisions usually fails to fully assess and observe firm performance; thus, such

analyses are responsible for inferior firm performance. These studies contend that the use of aggregate indices of governance provisions masks the specific and directional impacts of a given subset of governance provisions on firms' financial performance. Studies in this opposing camp (e.g., Misangyi and Acharya, 2014) claim that there are several different configurations of governance provisions that may indeed lead to superior financial performance. Some studies took a decisive step to resolve this issue by identifying configurations of firms that adopted certain governance provisions but avoided adopting others. Misangyi and Acharya (2014) established that it is not the score or the index of governance provisions that matters for firms' financial performance. Rather, the combination or configuration of the strategic presence (adoption) of some and the absence (avoidance) of other provisions leads to superior or inferior firm performance. In other words, some configurations of provisions may enhance firm performance, while other combinations may lead to poor firm performance.

This puzzling phenomenon is even more critical for firms in service-oriented industries such as restaurants because their volatile financial structure leads to lasting effects of governance provisions on firm financial performance. For instance, those firms report varying degrees of earnings, retention rates, free cash flow, cash holdings, high levels of capital expenditure, and leverage on their books. This tangled financial nature of restaurant firms adversely affects the configuration of robust governance provision bundles causing those firms to have low liquidity and reduced possibilities for risk diversification with constricted ownership (Kizildag, 2015; Altin et al., 2016; Kizildag and Ozdemir, 2016;

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Madanoglu et al., 2012). Additionally, concentrating on a single industry eliminates cross-industry performance outcomes and allows for control of independent variables designed to “hold other things constant” (Bradley et al., 1998). This is mostly because every corporation has its own business culture, strategies, and competitive landscape. Further, firms in the restaurant industry are closely embedded in the society as a whole. Those companies are very well aware of their public image and of possible negative press for failing to comply with community standards and to maintain an image of good corporate citizens. For this reason, this is evident not only on the emphasis of these companies put on their public image efforts, but also by the substantial efforts they make to maintain a good reputation and serve their stakeholders (e.g., stockholders, employees, customers, and the community), via well-established corporate governance provisions (Raifeld et al., 2006). Therefore, to achieve a long-term financial success in corporate operations (e.g., maximized and customized service delivery, optimized labor output and cost, etc.), restaurant firms need to develop efficient configurations of governance provisions for corporate innovation, venturing, and renewal activities (Madanoglu and Karadag, 2016). Taken together, these clarifications stand to reasons why our study concentrates solely on restaurant companies so that our performance assessment derived from the set of governance provisions will be economically meaningful and significant.

Extant literature (e.g., Guillet and Mattila, 2010; Madanoglu and Karadag, 2016) shows that using traditional governance provisions indices has limited performance implications, as firms in the restaurant industry rarely, if ever, adopt more than 2/3 of the 25 provisions included in the G-index (Gompers et al., 2003). That is, if one was to use the criteria of at least 14 out of 24 corporate governance provisions of Gompers et al. (2003) as a cutoff for firms with “high management power” (e.g., weak shareholder rights), there would be no restaurant firms in that portfolio. Generally speaking, this is mostly because there is a significant insider presence on the Board of Directors of restaurant companies. They sometimes have more than 20% insiders on their Boards as Cheesecake Factory did for many years. In a nutshell, this indicates the level of influence that the CEOs can exercise upon the members of the Board. As a result, this pattern dramatically reduces the independence of the Board, and hence, restricts those companies from adopting numerous corporate governance provisions (Raifeld et al., 2006). Due to these reasons, we contend that looking at the sheer count of governance provisions has limited implications for the restaurant industry and suggest that studies should focus on the configurational effect of provisions rather than their total count to better analyze firm financial performance. We also posit that, how firms bundle those provisions matters for achieving high or experiencing low financial performance. Thus, we aim to extend and advance the approach of previous methodologies (e.g., Madanoglu and Karadag, 2016) by using the six corporate governance provisions of Bebchuk et al. (2009) to demonstrate that different causal recipes of corporate governance provisions account for high financial performance in restaurant firms. We contend that neither a single provision nor the adoption of all governance provisions is sufficient to hurt firms’ financial structure, operations, and performance. We also contend that any analysis exploring which governance provisions truly matter should not examine provisions in isolation but should consider which combinations of provisions (causal recipes) influence firm financial performance. Further, we postulate that the poison pill is a core condition (a necessary ingredient) in all provision configurations of restaurant firms’ financial performance. In so doing, we use set-theoretic methods such as a Qualitative Comparative Analysis (QCA), which focuses on cases (e.g., firms) instead of variables, to identify configurations of high-performing firms that either adopt or avoid certain governance provisions. We complement the existing evidence by providing an extensive economic outlook, a practical understanding, and an empirical assessment

of governance provisions and firm performance for restaurants. Our key contribution is that we put forward causal recipes of corporate governance provisions that may lead to high or low restaurant firm performance.

2. Related literature and background

2.1. Corporate governance

Corporate governance can be explained as the complex set of constraints that shape the ex-post bargaining over the quasi-rents generated by a firm (Zingales, 1998). Gillan and Starks (1998, p. 4) define corporate governance as “the system of laws, rules and factors that control operations at a company.” Taking a micro perspective, Shleifer and Vishny (1997, p. 737) express it as “the ways in which suppliers of finance to corporations assure themselves of getting return on their investment.” Irrespective of a definition, corporate governance mechanisms fall into two broad categories: 1) factors that are external to firms such as, law and regulation, capital markets, market for capital control, labor markets, and product markets, and 2) factors that are internal to firms such as boards of directors, managerial incentives, capital structure, bylaws and charter provision, and internal control systems.

Corporate governance studies predominantly use the agency theory (Dalton et al., 1998; Shleifer and Vishny, 1997) as the underpinning theoretical foundation. Agency theory is predicated on the assumption that managers are self-interested and do not bear the full wealth effect of their decisions. Therefore, managers’ interests are not fully integrated with those of shareowners, which could be detrimental to shareholders’ wealth maximization goals. Internal and external governance mechanisms provide shareholders with tools to align the interests of managers with their own (Walsh and Seward, 1990) and to ensure that managers strive to achieve outcomes that are in the shareholders’ best interests (Shleifer and Vishny, 1997). While agency theory dominates corporate governance research, other theoretical perspectives have been developed for governance studies. Among these are resource dependence theory, which addresses board members’ contributions as boundary spanners of the organization (Dalton et al., 1999; Hillman et al., 2000), and stewardship theory, which argues that managers’ interests are frequently isomorphic with those of shareholders (Davis et al., 1997) and that in many situations managers believe that serving shareholders’ best interests also serves their own interests (Lane et al., 1998).

2.2. Corporate governance provisions and firms’ financial performance

A firm with good governance provisions provides more transparent disclosure of the allocation of decision and control rights between the firm and its investors, and this fair practice makes it more investor friendly relative to firms that do not disclose (Anderson and Gupta, 2009). In line with this argument, because “better governance enables firms to access capital markets on better terms” (Doidge et al., 2007, p. 2), firms with good governance provisions should enjoy higher market performance and firm valuation. Previous governance research explores this matter in depth, with a long stream of research relying on individual governance proxies such as board structure (Zahra and Pearce, 1989; Müller, 2014; Bhatt and Bhattacharya, 2015), board independence (Ghosh and Sirmans, 2003), managerial stock ownership (Mehran, 1995), top management compensation (Mehran, 1995; Carpenter and Sanders, 2002), and ownership concentration (Cho, 1998; Demsetz and Villalonga, 2001) to operationalize corporate governance. Another line of research uses summary measures of corporate governance (governance indices) such as the G-index (Gompers et al., 2003), the “Entrenchment Index” (E-index) in Bebchuk et al. (2009),

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