



ELSEVIER

Journal of Economics and Business 57 (2005) 288–316

**Journal of
Economics
& Business**

The linkage between the firm's financing decisions and real market performance: A panel study of Indian corporate sector

Arindam Bandyopadhyay*, Sandwip Kumar Das

*International Trade and Development Division, CSDIL&E, School of International Studies,
Jawaharlal Nehru University, New Delhi, India*

Received 5 April 2002; received in revised form 22 October 2004; accepted 23 November 2004

Abstract

We examine the relationship between quality and reputation signals and firm's product market performance at empirical level. Using data of 533 Indian listed firms over the period 1989–2000, we compare the behavior of top 50 business group firms with the small group and private standalone firms. The empirical results suggest that real market signals like advertisement, marketing, distribution, research and development, ISO third party quality certifications significantly affect firms' performance. Financial decisions by firms in the capital market like issue of commercial paper and debentures may also act as additional signals of firm specific qualities in the product market. For instance, the total sales go up by 2.4% for top 50 business group firms and by 2.5% for non-top 50 firms with a one standard deviation increase in commercial paper as a fraction of assets. Similarly, an increase in debentures relative to assets leads to 9.5% increase in sales for non-top 50 firms in comparison to a 4.7% increase for top 50 firms. We also find that DFI lending helps firms increase expenditure on advertising for product promotion, build distribution networks, increase marketing efforts and research and development, and thereby, boost sales growth significantly in the long run. From regression results and various univariate tests, we find strong empirical evidence that firms' financial decisions drive product market outcomes.

© 2005 Elsevier Inc. All rights reserved.

JEL classification: G31; G32; L15

Keywords: Capital structure; Product market competition; Information and product quality

* Corresponding author at: Room No. 3203, National Institute of Bank Management (NIBM), Kondhwe Khurd, Pune 411048, India. Tel.: +91 20 26833080 87x451/561.

E-mail addresses: arind@hotmail.com, arindam@nibmindia.org (A. Bandyopadhyay).

1. Introduction

With the removal of all quantitative restrictions on imports and falling import tariffs under the WTO regime, Indian manufacturing companies are now facing the challenges of international competition both at home and abroad. As a result, aspects like productivity, efficiency, quality and competitiveness rather than just the price of the product have come to the forefront. Indian companies are taking full advantage of falling trade barriers and increasing market access that the new era of globalization has provided. Thus, it has become crucial for them to recognize the importance of quality and reputation as necessary requirements for long-term survival in today's competitive world.

One of the primary problems that firms face in the product market is that of information asymmetry. When true quality of a product is not known before purchase, consumers may rely on a firm's reputation to form expectations about the product's quality. Since it is impossible to ascertain firm quality before purchase due to the presence of information asymmetry, buyers seek and good quality sellers send credible signals of quality. Under conditions of such uncertainty, potential exchange partners experience greater transaction risk with regard to the actual quality of the product or service that is being exchanged (Akerlof, 1970). Firm reputation is an important uncertainty reducing mechanism in such environments for promoting its sales (Klein & Leffler, 1981; Shapiro, 1983; Allen, 1984).

Advertising is one such costly signal that can be viewed as an investment in reputation building by the firms (Nelson, 1974; Shapiro, 1983; Allen, 1984; Milgrom & Roberts, 1986). Firms use advertising through television or radio or newspaper to inform potential consumers about the existence, characteristics and prices of the commodities they offer. Shapiro (1983), in his classic article, argued that high-quality producers have more incentives to incur the costs of investing in reputation building through advertising because they more likely to generate repeated purchases. Nelson's (1974) crucial insight was that if high-quality brands advertise more and if advertising expenditures are observable, then rational and informed consumers would respond positively to advertising even if it does not have much direct informational content. Spending an astronomical amount of money on the ad campaign transmits the information that the firm wants to establish reputation with the intention of staying in the market for a longer time. Hence, enterprises with advertising and promotional activities are likely to do better in the product market.

Firms may use ISO quality certification from a third party underwriter, as a signaling device in markets where consumers rely on information specialists and experts to screen various products to ascertain their quality. Quality certification signals that the firm maintains a quality system and is concerned with customer expectations and satisfaction, and thereby, raises their willingness to pay for it. Similarly, in order to sustain competitive advantages in the domestic market as well as in the foreign market, companies need to establish marketing and distribution networks in enhancing their sales operation.

R&D is also a performance promoting activity as it improves both the product quality and process quality. The firm's decisions on R&D activities are explicitly seen from the strategic point of view. Firms with large R&D expenditure may move to the forefront of the technology boundary in their market when they invest in new products or new production processes. Therefore, a firm can increase its market share by spending on R&D, especially in a much more competitive export market where competition is mostly on the technology front.

متن کامل مقاله

دریافت فوری ←

ISIArticles

مرجع مقالات تخصصی ایران

- ✓ امکان دانلود نسخه تمام متن مقالات انگلیسی
- ✓ امکان دانلود نسخه ترجمه شده مقالات
- ✓ پذیرش سفارش ترجمه تخصصی
- ✓ امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
- ✓ امکان دانلود رایگان ۲ صفحه اول هر مقاله
- ✓ امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
- ✓ دانلود فوری مقاله پس از پرداخت آنلاین
- ✓ پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات