Shareholder Rights Weak in US Hospitality Industry

Hospitality firms in the United States have relatively low levels of shareholder rights according to the SHTM's Dr Basak Denizci Guillet in a research article published with a co-author recently. The researchers consider the links between corporate governance and measures of firm performance across three industry segments – hotels, restaurants and casinos – offering the interesting observation that firms weak in shareholder rights tend to perform well. While stressing that their findings establish no specific relationships between firm characteristics and shareholder rights, the researchers do provide an important overview of the extent to which corporate governance policies are influencing the industry.

Corporate Governance

A feature of the global economy in recent years has been the rise in concern about corporate governance, especially from shareholders seeking to protect their investments. The researchers define corporate governance as the "processes, customs, policies, laws and institutions" that direct and control companies. The key players in this series of interactions are "shareholders, the board of directors and executive management". The problem is, however, that while shareholders have voting rights at the annual general meeting, and in some cases are represented on the board, executive management, and to a lesser extent the board of directors, has day-to-day control over the firm's direction.

This scenario gives rise to agency problems, observe the researchers. Agency relationships, they note, occur when there is "goal incongruence" between managers and shareholders. As shareholder agents, managers are expected to make decisions that will ultimately benefit the value that shareholders gain from a firm, but this is not always the case. Hence, corporate governance is used to ensure that managers maintain the correct focus.

Yet any causal relationship between corporate governance and firm performance has yet to be established. This is compounded by the diversity of corporate governance strategies across industries. In the hospitality industry, note the researchers, property ownership is common and the separation of that ownership from management can create "a potential conflict of interest". Management, they write, tends to focus on long-term success and customer relationships, whereas owners tend to focus on short-term return.

Other factors that affect corporate governance in the hospitality industry, according to the researchers, include the high levels of capital intensity and low levels of inventory, the high ratio of day-to-day decisions to long-term decisions and sensitivity to changes in the economy.

The researchers also point out that within the industry itself, hotels, restaurants and casinos are sufficiently different in their form and function. Hotel firms are largely involved in 'assembly operations' in which rooms are serviced, with the processing of materials, such as the laundering of linen, performed by suppliers. Restaurants can involve assembly operations, such as the preparation of meals on site, but can extend "to a full blown production facility in which meals are process from raw ingredients". Hotels can, of course, include restaurants, and casinos usually have both hotels and restaurants attached. Casinos are also differentiated, note the researchers, by the compensation schemes for their executives, with pay rates far higher than those enjoyed by executives in hotel and restaurant companies. All of these factors, they write, can lead to different types and extents of corporate governance.

Corporate Governance and Firm Performance in the United States

Given this variety of conditions, the researchers set out to investigate the extent to which investors in hospitality companies "are protected from misconduct by executive management or from dangers from controlling shareholders that could result in poor firm performance", and how the different sorts of companies might differ in their responses to such situations. Drawing on data from firm performance and risk measurement databases, the researchers observed the links between indicators of corporate governance and firm performance in 179 hospitality firms in the United States from 1990 to 2006.

The measures of corporate governance covered five broad categories, including the existence of provisions "devised to set back hostile bidders", voting provisions related to shareholder rights in elections and charter or by-law amendments, provisions that protect executive management from job-related liability, other corporate governance provisions not related to voting or protection, and compliance with related state laws.

In terms of firm performance, the researchers considered market value, return on assets, return on equity, profit margin, capital expenditure per asset, the ratio of the market value and replacement value of assets (otherwise known as Tobin's q) and debt levels. Market value, capital expenditure per asset and debt levels were also measures that they thought might influence corporate governance.

Weak Shareholder Rights

The researchers find, overall, that the hospitality firms had "relatively weak shareholder rights". This is particularly true of larger firms with higher returns on equity and debt levels, and lower capital expenditure per asset. However, restaurant firms with stronger shareholder rights had significantly lower levels of debt than hotels and casinos. The researchers also place their findings in context of the relatively high level of protection afforded to hospitality executives from hostile takeovers and the "strong limitations on shareholders' ability to replace managers".

Another important consideration is that the hotel firms rated highly in the corporate governance measures, except in 1995, leading the restaurant and casino firms. This is tempered somewhat by fluctuations in the commitment of hotel firms, along with casinos firms, during the study period, although restaurant firms managed to keep their corporate governance efforts at a steady level throughout.

Further Investigation Needed

Given that they conducted a 'descriptive' study, the researchers are quick to point out that their findings "do not indicate causality". Nevertheless, they do shed light on light on the extent to which corporate governance shapes the hospitality industry in the United States. With the increasing attention being paid to shareholder rights – which are not particularly strong in the industry – their relationship to firm performance most definitely needs to be investigated. This effort, write the researchers, should just be the start.

Points to Note

- Corporate governance is increasing in importance around the world.
- Yet little is known about the link between corporate governance and firm performance.
- In the US hospitality industry, shareholder rights are relatively weak, but that might not affect performance.
- Nevertheless, US hotel firms tend to have high levels of corporate governance compared to their industry counterparts.

Denizci Guillet, Basak and Mattila, Ann S. (2010). "A Descriptive Examination of Corporate Governance in the Hospitality Industry", *International Journal of Hospitality Management*, Vol. 29, pp. 677-684.