Chapter 15
Corporate Governance and Firm Innovation:
The Effect of Ownership and Board of Directors on R&D Investments

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ABSTRACT

Innovation is a key factor for firms' competitive advantage in the long-term and for their financial success. Scholars highlight the underinvestment problem with respect of R&D investment. This chapter focuses on two relevant variables of corporate governance that influence firms' innovation performance: firm ownership and board of directors. In the first section, the effect of ownership structure on R&D investment is analyzed. More specifically, the chapter will illustrate the effects of family ownership and institutional ownership on innovation investments. The second section explores the main theoretical perspectives investigating the functions of board of directors and the main board tasks. Lastly, three attributes of board structure and their effect on R&D investments are explored.

INTRODUCTION

A firm's innovation ability is essential because it leads to a new combination of its resources and generates effects throughout the lifetime of the firm. Firms' competitors are not able to possess adequate resources to adopt an imitation strategy (Miller & Shamsie, 1996). Accordingly, innovation activity represents one of the fundamental pillars of competitive advantage, mostly because it is an inimitable resource (Monreal et al., 2012).

Using the consolidated process-based conceptualization (Tidd & Bessant, 2009), technological innovation can be viewed as the set of activities through which a firm identifies, designs, produces, and introduces a new product, technology, system, or technique (Freeman, 1976). To start and continue to drive

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this process, investments in Research and Development (R&D) are essential. They permit the exploration and exploitation of activities and, accordingly, the identification of new products or new processes.

If, on one hand, scholars acknowledge that investment in R&D represents a key driver for firms' enduring competitive advantage, on the other hand, within the context of public companies, it is not obvious that managers have incentive to undertake R&D investment at their optimal level.

Drawing on the corporate governance literature, scholars emphasize the main mechanisms aimed at aligning the interests of management and owners. This chapter focuses on two of these mechanisms that may discourage the R&D underinvestment problem. More specifically, ownership structure, board of directors' attributes, and their effects on R&D investments are investigated. These are relevant ways that scholars have emphasized to solve some managerial opportunistic behaviors, such as ones connected to R&D underinvestment.

The discussion of the main issues regarding the relationship between innovation and the corporate governance mechanisms mentioned above allows us to illustrate the research areas where scholars find a consensus and other areas where the literature shows conflicting results and debate is still open. In order to explore the effect of corporate governance on R&D investment, empirical studies will be examined, and the interpretation of the results will rely on the main theoretical frameworks used within the corporate governance literature.

We used a systematic selection process to select the eligible literature for our analysis. The literature review was limited to articles published in peer-reviewed journals, identified through three databases: ABI/Inform ProQuest, Business Source Complete (EBSCO), and EconLit (EBSCO). We searched for all articles up to 2019, using diverse combinations of keywords—("duality"; "CEO-chairman duality" or "dual leadership"), ("board size"), ("outside directors" "or "independent directors"), ("ownership structure"), ("ownership concentration"), ("family ownership"), ("institutional ownership)—as well as three innovation-linked terms ("R&D investment", "R&D expenditures", and "innovation input"). We confirmed the importance of the articles by reading all abstracts, checking for a discussion related to the relationships among ownership structure, board of directors, and R&D investment. The rest of articles were read in their entirety, controlling for substantive relevance by checking for a discussion related to innovation strategies from a corporate governance perspective.

The chapter is divided into three sections:

1) The first section illustrates the debate around the R&D underinvestment problem within the context of public companies. This theme has produced a very interesting strand of corporate governance literature exploring the mechanisms able to stimulate management's propensity to undertake R&D investments, and, in turn, to increase firms' long-term competitiveness. Therefore, this section represents a starting point for the following literature review.
2) The second section is focused on studies exploring the effect of ownership on R&D investment. More specifically, this section first analyzes the R&D investment level, taking into account two different ownership structures: a fragmented ownership structure and an ownership structure with the presence of a large shareholder, emphasizing that the latter may represent a partial solution to the free-riding problem. After investigating the degree of ownership concentration, this section explores the potential identities of large shareholders and their influence on R&D strategies. Family shareholders and institutional shareholders are particularly investigated.
3) The third section examines the role of the board of directors in the process of monitoring and stimulating R&D expenditures. In order to investigate the effect of the board of directors on the

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