

International corporate governance and firm value

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Corporate valuations around the world

- Valuations differ widely across countries, in spite of financial market globalization
- E.g., average Tobin's q in 2006 ranges from 1.16 in Malaysia & South Korea to 2.24 in Denmark
 - Substantial variation within countries as well
- Why?
 - Corporate governance
 - Growth opportunities; trade & / or investment barriers; industry composition; taxes; accounting rules, etc.

Corporate governance

- Agency conflict
 - Insiders vs. outside investors
 - Insiders can divert corporate resources for their own benefit
- Corporate governance
 - Deals with ways in which suppliers of finance to corporations assure themselves of getting a return on their investments
- Country & firm-level mechanisms, e.g.,
 - Laws & the institutions that enforcement them
 - Financial reporting & disclosure
 - Board composition
 - Ownership structure & executive compensation, etc

Main research question

- Does corporate governance affect firm value?
 - Better governance limits expropriation by insiders
 - Increases firms' ability to finance growth opportunities
 - Focus is on the international literature
- Related questions
 - Why do some countries provide better legal protection for investors?
 - Why do some firms adopt better governance?
 - Which governance mechanisms matter?

International corporate governance

- In 2000 & 2003, the JFE & JFQA published special issues on “International corporate governance”
 - Single-country → non-US data, often follows US-based research
 - Cross-country → usually based on LLSV “Law & finance” paradigm
- Cross-country studies can exploit differences in
 - The nature of the agency problem
 - Laws, institutions, rules
 - Economic outcomes
 - Firms that are “domestic” vs. those that “cross” borders

Outline of talk

- Governance & firm value: evidence evidence
 - Country-level governance measures
 - Firm-level: governance indices
 - Firm-level: cross-listings
- In each case, discuss
 - The basic idea
 - The key results
 - Questions & limitations
- Conclusions

Country-level investor protection

- Are firm values higher in countries that protect investors better?
- Motivated by a series of papers by LLSV
 - Importance of laws that protect investors' rights
 - Provide country-level measures
- Empirical approach: cross-sectional regressions
 - $q = a + b \times \text{Investor protection} + \text{controls}$

Country-level investor protection

- LLSV (2002, JF)
 - Key result: Valuations are higher in common law countries & in countries with higher scores on the anti-director rights index
- Chua, Eun, & Lai (2007, JBF)
 - Key result: Valuations are higher in countries with common law origin, better shareholder rights, enforcement, disclosure, less corruption, & enforced insider trading laws

Country-level investor protection

- Questions & limitations
 - Corporate law? Securities law? Disclosure? Rules on the books vs. enforcement?
 - Different authors use different measures → changing samples
 - Measurement error, comparability, & relevance of investor protection proxies?
 - Small sample sizes
 - Many cross-country differences → omitted variables problem
 - Ignores within-country variation in valuations & governance

Firm-level governance

- Do firms with better governance have higher values?
- Firms can adopt governance mechanisms over & above the protection granted by the state, e.g.,
 - Better disclosure; independent, reputable auditor
 - More independent board members; non-classified board
 - Transparent ownership structure
 - Eliminate dual class shares
 - “Opt in” to another country’s regulatory regime, etc.
- Different measures of firm-level governance

Firm-level governance: indices

- Governance indices
 - CLSA, S&P, ISS (CGQ rankings)
 - Advantages / disadvantages of each index
- Empirical approach: cross-sectional regressions
 - $q = a + b \times \text{Firm governance} + \text{controls}$

Firm-level governance: indices

- Klapper & Love (2004, JCF) & Durnev & Kim (2005, JF)
 - Focus mainly on CLSA data
- Key results
 - Positive relation b/w q & firm-level governance
 - Positive relation b/w q & country-governance
 - Better firm-level governance is valued more highly in low governance countries

Firm-level governance: indices

- Questions & limitations
 - Firm / country coverage & sample composition
 - Endogeneity problems
 - Governance is “sticky”
 - Isolating firm governance?
 - Which elements of firm / country governance matter?
- Three recent studies use the ISS CGQ data
 - Chhaochharia & Laeven (2007)
 - Bruno & Claessens (2007)
 - Aggarwal, Erel, Stulz, & Williamson, (2008, RFS forth)

Firm-level governance: cross-listing

- Large literature that studies why firms cross-list
 - Many theories offered → recent focus is on commitment to better governance & disclosure
 - Focuses mainly on cross-listings in the US
- Compared to governance indices?
 - Larger samples across & within countries
 - Time series data
 - Potential costs & benefits unrelated to governance
 - Governance measure may be less precise

Firm-level governance: cross-listing

- Doidge, Karolyi, & Stulz (2004, JFE)
 - Prior literature focuses on event studies
 - Regression: $q = a + b \cdot \text{Cross-listing dummies} + \text{controls}$
- Key results
 - Foreign firms listed in the US are worth more → the “cross-listing premium”
 - Premium is higher for firms from countries with weak investor protection
 - Premium is higher for firms with more growth opportunities

Firm-level governance: cross-listing

- Questions & limitations
 - Enforcement?
 - Specific monitoring mechanisms – formal vs. informal?
 - Other explanations for the premium?
 - Cross-sectional data for 1997 only
 - Endogeneity
 - Premium is temporary
 - Focuses on the US only → listings in other markets?
 - SOX?

Firm-level governance: cross-listing

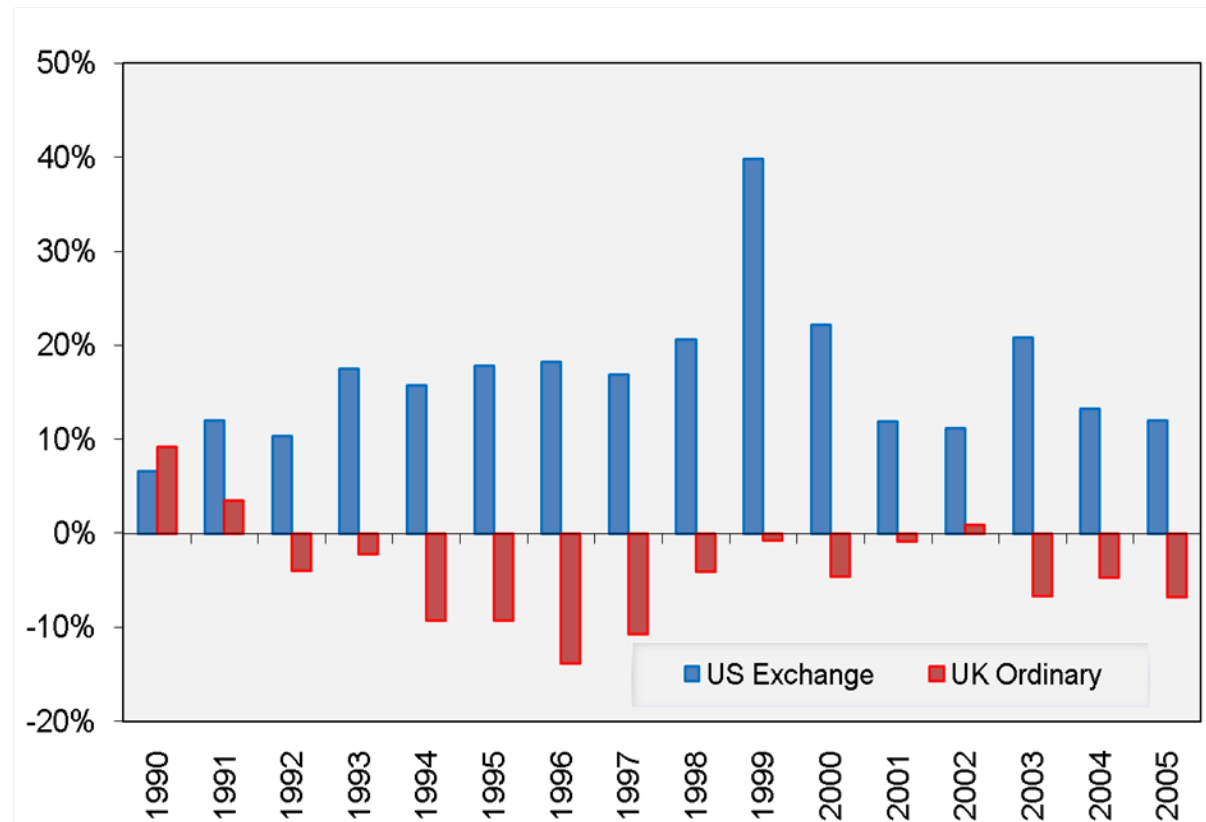
- Doidge, Karolyi, & Stulz (2008, JFE forthcoming)

- **US listings**

- Premium each year
- Average is 17%

- **UK listings**

- No significant premium in any year



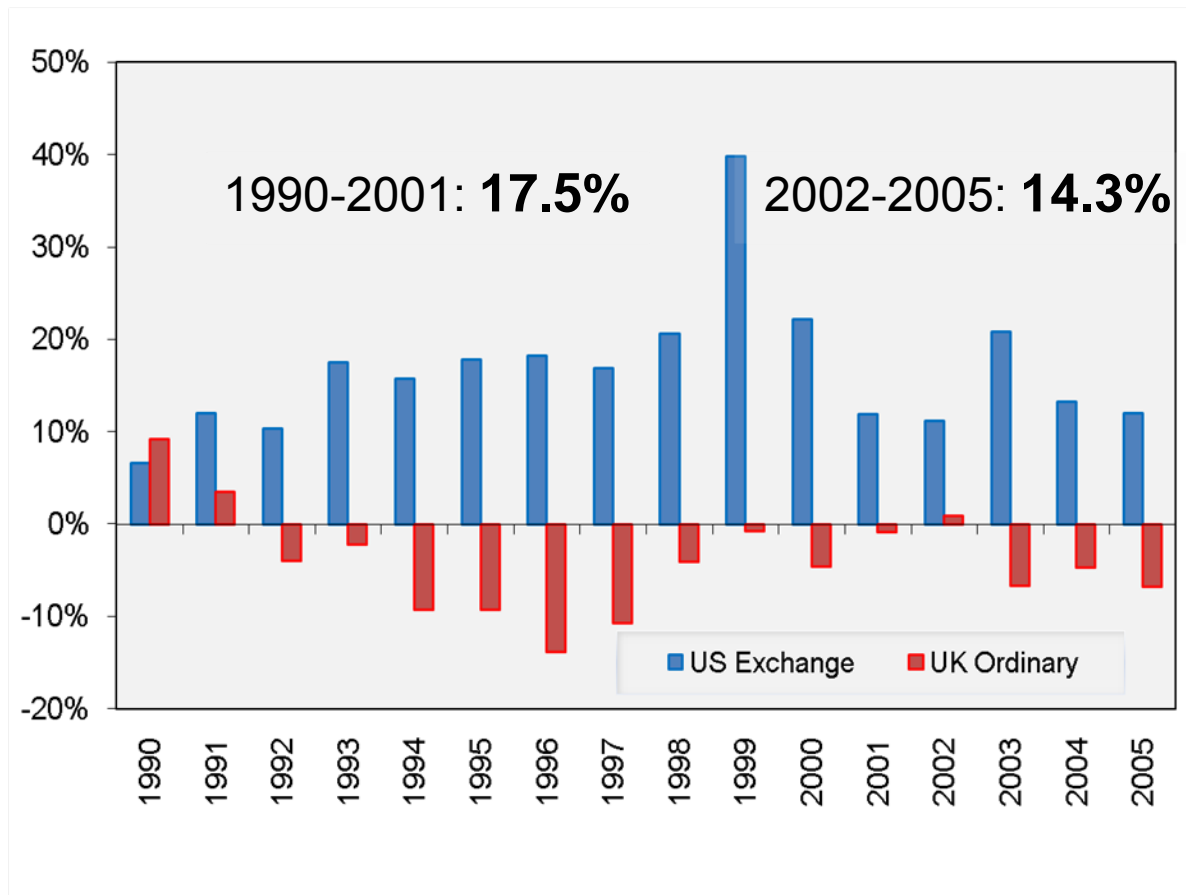
Firm-level governance: cross-listing

“Is a US Listing Worth the Effort? --- Premiums Paid for Shares In Foreign Firms Are Reduced Since Crackdown, Study Finds” - WSJ, Nov 2006

- Have the additional requirements imposed by SOX lowered the “governance benefit” of a US listing?

Firm-level governance: cross-listing

- Is the premium lower after SOX?
- Pre/post difference
 - Not significant
 - Tiny if 1999 is excluded
- More sophisticated statistical tests
 - Same conclusion



Conclusions

- Clear evidence of association between governance & value
 - Variation in valuations across countries & firms is sensible
- Skeptic can still argue that the relation is not casual
- Which aspects of governance matter? Unclear
 - Which firm & country governance mechanisms matter?
 - Overall importance of country vs. firm governance
 - Generalizable results? Different mechanisms may be more/less important in different countries → back to single country studies?