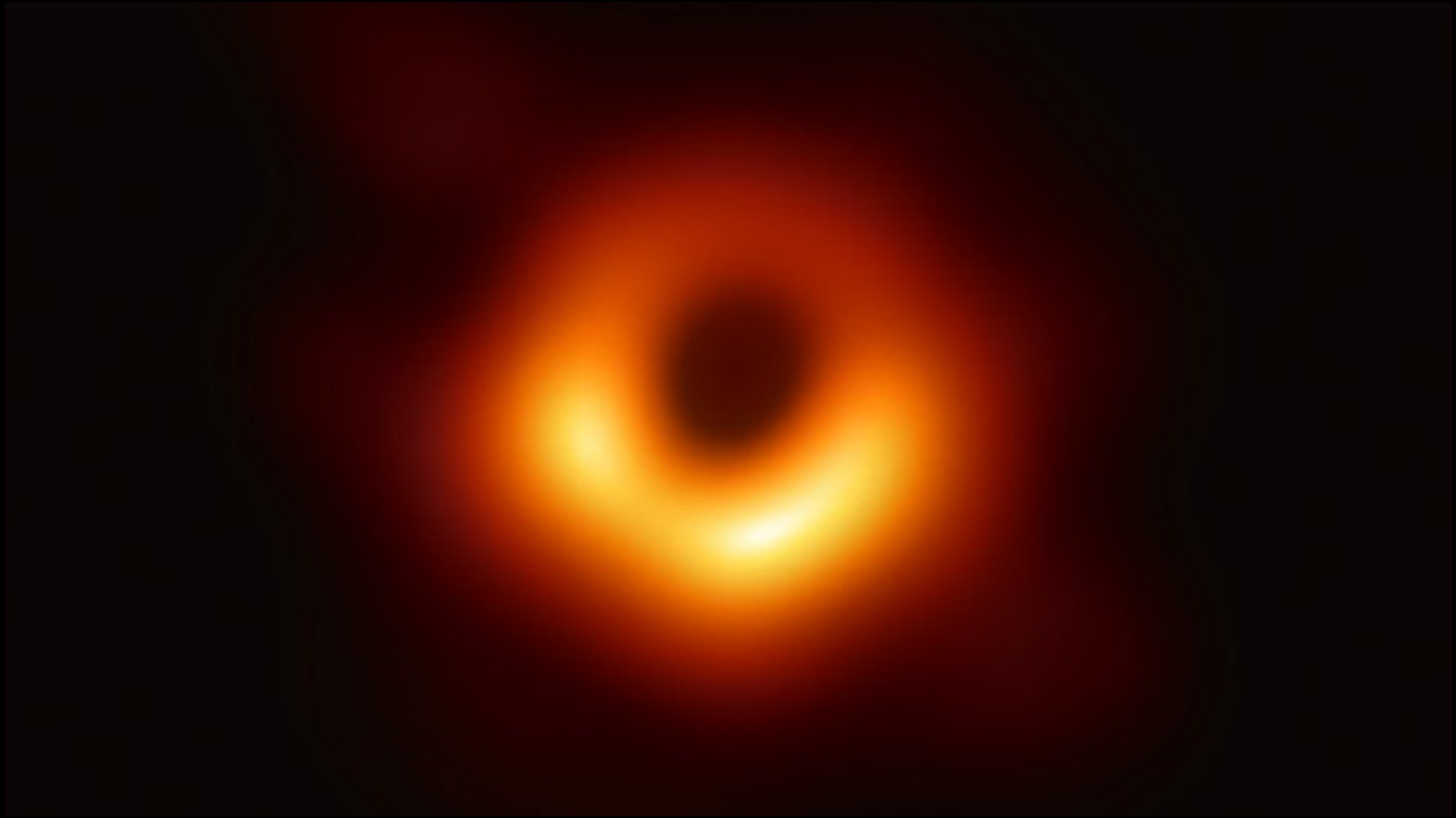
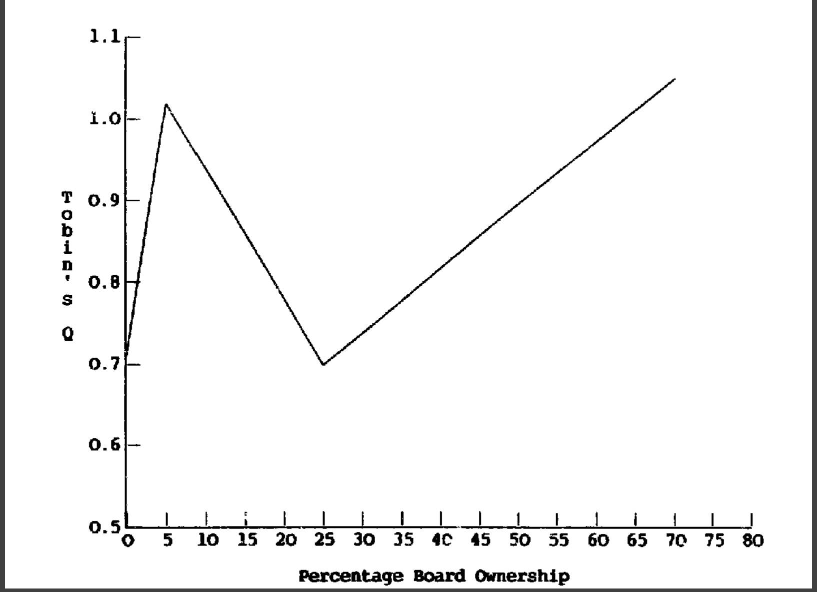
Discussion of “Illuminating the Corporate Governance Black Hole: Contextualizing the Link to Performance” Fox, Gilson, Palia

Bo Becker, SSE, ECGI and CEPR



Relationship between governance and value

- Morck, Shleifer and Vishny (1987)



- Gompers, Ishii, Metrick (2003)

TABLE VI
PERFORMANCE-ATTRIBUTION REGRESSIONS FOR DECILE PORTFOLIOS

	α	*RMRF*	*SMB*	*HML*	*Momentum*
Democracy-Dictatorship	**0.71**** (0.26)	**−0.04** (0.07)	**−0.22*** (0.09)	**−0.55*** (0.10)	**−0.01** (0.07)

- $\Delta Q = \Delta \frac{MCAP}{BV} \approx R - g$

Why is there a positive relationship between corporate governance and value?

- Good corporate governance
  - Raises growth
  - Reduces risk

- High value raises governance
  - “Luxury good”
  - Entrenchment dynamics go other way (Hermalin Weisbach 1998)

This paper

- When market is pessimistic about management quality, governance changes constitute positive signals of value
- Use governance crisis in 2000-2002
  - Enron and WorldCom
  - Arthur Anderson
  - ➔ Governance becomes more salient
- Empirics: compare Tobin's Q slope on G/E index in 2000-2002 vs. non-crisis years (1992-1999 and 2003-2006)

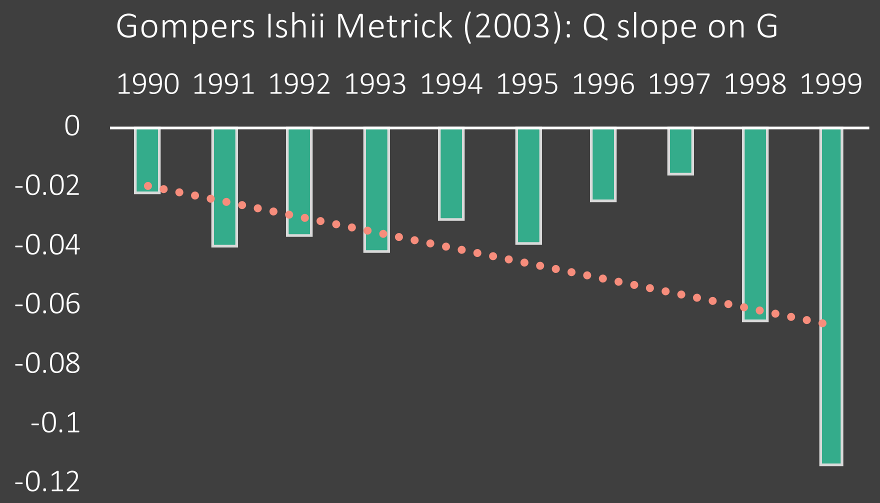
Bad governance more penalized in bad times

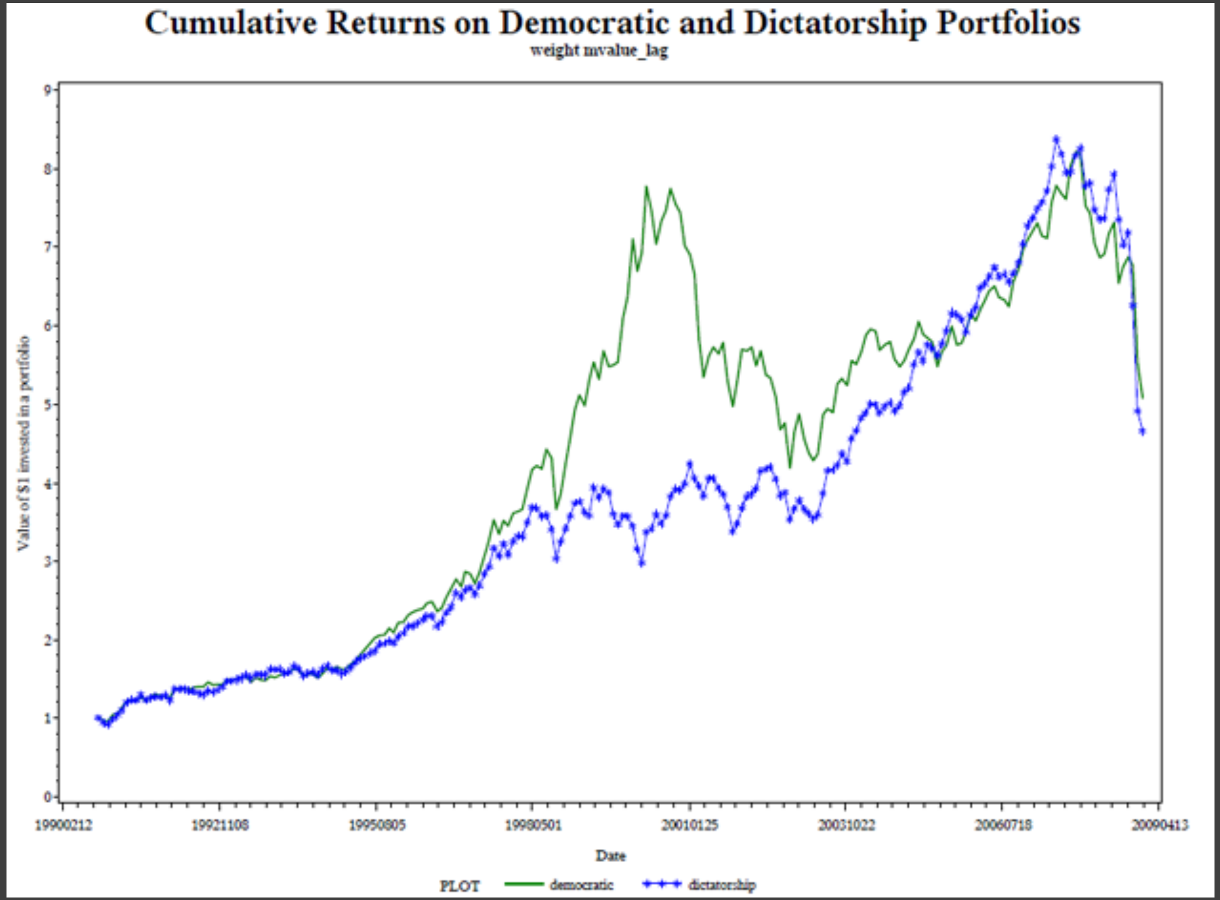
Variable	Gindex			Eindex		
	2000-2002 Scandal Period	Normal Period	Accounting Scandal –	2000-2002 Scandal Period	Normal Period	Scandal – Normal
Gindex/ Eindex	-0.1061*** (-4.92)	-0.0249*** (-2.64)	-0.081*** (-3.45)	-0.1645*** (-4.95)	-0.0559*** (-3.33)	-0.1085** (-2.91)
Debt	0.573* (1.86)	0.293*** (5.55)		0.583* (1.88)	0.291*** (5.58)	
R&D	1.013 (0.56)	0.849*** (2.77)		1.065 (0.59)	0.849** (2.78)	
RDdum	-0.115 (-0.99)	0.079 (1.37)		0.134 (1.16)	0.079 (1.35)	
Lsales	0.223** (2.04)	0.131 (1.56)		0.225** (2.05)	0.129 (1.55)	
Lsales2	-0.026** (-2.47)	-0.009 (-1.59)		-0.026** (-2.52)	-0.009 (-1.59)	
Cons	1.515*** (2.97)	0.639** (1.97)		0.939* (1.94)	0.551* (1.72)	
R^2	0.003	0.011		0.005	0.013	

- Dependent variable = Tobin's Q
- Firm fixed effects
- G/E predict Q with bigger coefficient in crisis period
- NB. D significant (p<1%)

Issue 1. The internet bubble?

- GIM shows increasingly negative slope on G index through 1990-ies





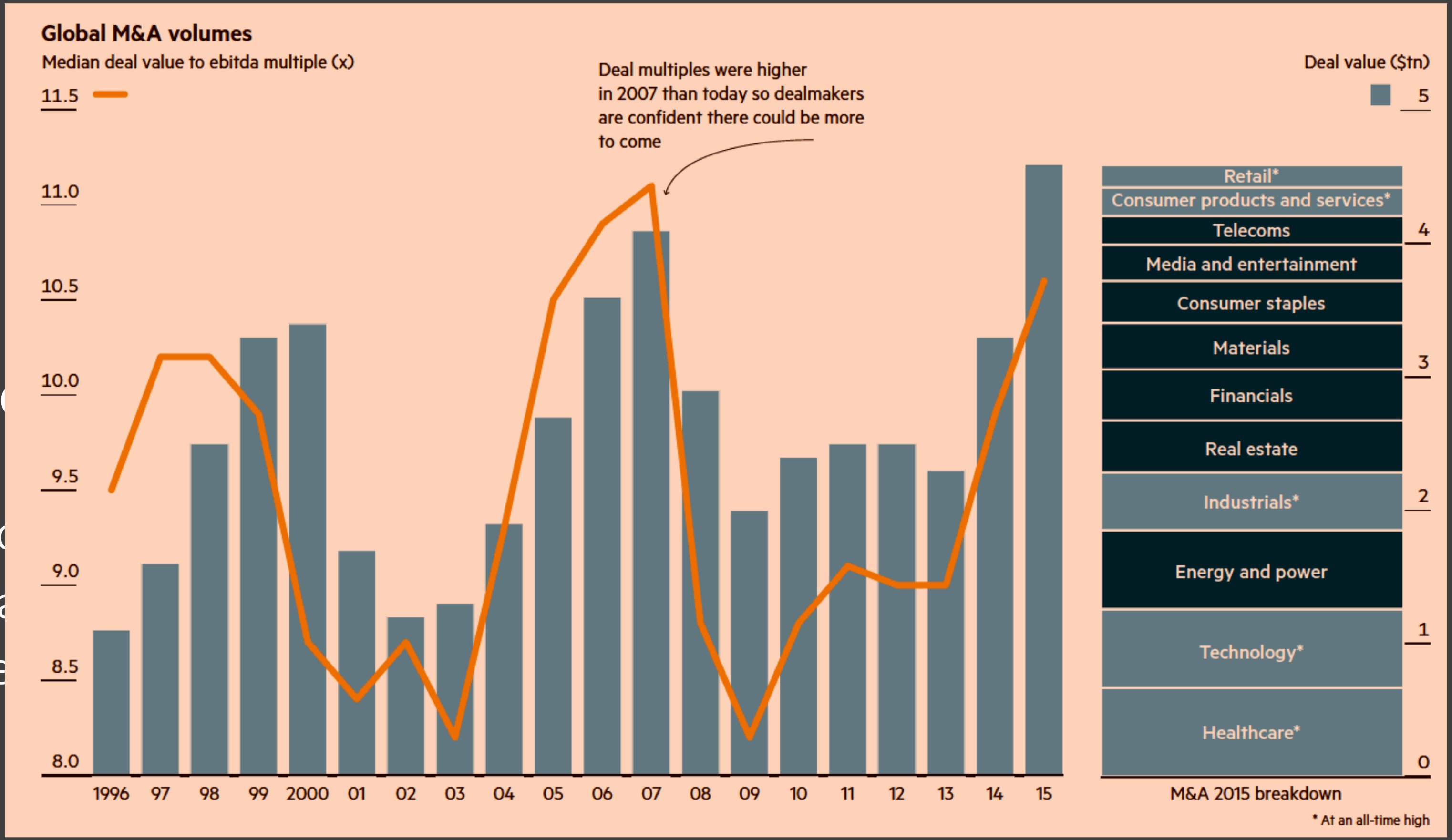
- Reversal post-2002 is more novel?

- Additional tests outside this data set?

Source: GIM (2003) Table VIII; WRDS web site

Issue 2. M&A

- Concern: governance correlat importance
  - E.g. probability of a takeover bi
  - Well governed = more likely to
  - In recessions, no bidders = gove
  - Opposite of findings



- If this is about takeovers:
  - Should be most visible in high takeover industries (those industries experience large drops in likelihood after bubble burst in 2000). Telecoms?
  - Value impact should also change in 1993-94, 2009-2010

Tightening the empirical case for the signaling story

- GIM is related to many things. Omitted variables + slow-moving dependent variables (Q) challenging setting

- Returns and G index space has been very extensively examined. Data mining at level of profession

- Potential remedies
  - Changes in how market valuation move gradually. Changes in governance can be abrupt. Use announcement effects around decisions that drive G/E index improvements
  - Use other governance metrics, other countries