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)

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

Bad governance more penalized in bad times

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

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<tbody>
<tr>
<td>Gindex/Eindex</td>
<td>-0.106*** (-4.92)</td>
<td>-0.0249*** (-2.64)</td>
<td>-0.081*** (-3.45)</td>
<td>-0.1645*** (-4.95)</td>
<td>-0.0559*** (-3.33)</td>
<td>-0.1085*** (-2.91)</td>
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<td>Debt</td>
<td>0.573* (1.86)</td>
<td>0.293*** (5.55)</td>
<td>0.583* (1.88)</td>
<td>0.291*** (5.58)</td>
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<td>R&amp;D</td>
<td>1.013 (0.56)</td>
<td>0.849*** (2.77)</td>
<td>1.065 (0.59)</td>
<td>0.849** (2.78)</td>
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<tr>
<td>R&amp;Ddum</td>
<td>-0.115 (-0.99)</td>
<td>0.079 (1.37)</td>
<td>0.134 (1.16)</td>
<td>0.079 (1.35)</td>
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<td>Lsales</td>
<td>0.223** (2.04)</td>
<td>0.131 (1.56)</td>
<td>0.225** (2.05)</td>
<td>0.129 (1.55)</td>
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<tr>
<td>Lsales2</td>
<td>-0.026** (-2.47)</td>
<td>-0.009 (-1.59)</td>
<td>-0.026** (-2.52)</td>
<td>-0.009 (-1.59)</td>
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<td>Cons</td>
<td>1.515*** (2.97)</td>
<td>0.639** (1.97)</td>
<td>0.939* (1.94)</td>
<td>0.551* (1.72)</td>
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<td>R²</td>
<td>0.003</td>
<td>0.011</td>
<td>0.005</td>
<td>0.013</td>
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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 correlated with some price characteristic with time-varying importance
  - E.g. probability of a takeover bid
  - Well governed = more likely to accept a bid = more likely to be a target (e.g. Cremers Nair 2005)
  - In recessions, no bidders = governance not as valuable
  - 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