Global Corporate Governance Colloquia 2019

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House of Finance

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Protocol – Session 1

Illuminating the Corporate Governance Black Hole: Contextualizing the Link to Performance

Speaker: Merritt Fox

Discussant: Bo Becker

Merritt Fox is the Michael E. Patterson Professor of Law and the NASDAQ Professor of the Columbia Law School-Columbia Business School Joint Project on the Law and Economics of Capital Markets. B.A., 1968, Yale; J.D., 1971; Ph.D. (Economics), 1980. Practiced with the firm of Cleary, Gottlieb, Steen & Hamilton, 1974-80. Adjunct professor teaching law and economics, Yale and Fordham, 1974-80. Taught at Indiana University Law School in Bloomington before joining the University of Michigan Law School faculty in 1988, where he was the Alene and Allan F. Smith Professor of Law and faculty director of the school's Center for International and Comparative Law. He is author of Finance and Industrial Performance in a Dynamic Economy (1987); The Signature of Power: Buildings, Communication and Policy (with H. Lasswell, 1979).He is also co-editor, with Michael Heller, of Corporate Governance Lessons from Transitional Economies (2006). Much of his recent scholarship is in the areas of international securities regulation, the value of mandatory disclosure, and comparative corporate governance.

Bo Becker is a professor at the Stockholm School of Economics. His research is on corporate finance, especially corporate credit markets. Recent topics include corporate bank lending through the business cycle, conflicts of interest in credit ratings industry, the covenant structure of loans and bonds, and comparing out-of-court restructuring to bankruptcy. Prof Becker has served on the board of directors of the Swedish National Debt Office and currently serves as an associate editor of RFS, Management Science and Financial Management. He is a Research Fellow of CEPR, and serves as Program Director for Mistra Financial Systems

<u>Protocol of Session 1, Saturday 8 June (10.00 a.m. – 11.00 a.m.)</u>

In the first part of the session, a paper by Merrit Fox, Ronald Gilson, and Carius Palia is presented. The paper tests a signaling-related hypothesis aiming to explain the empirical link between corporate governance and firm performance. The underlying chain of arguing goes; changes in governance structures that result in better ratings tend to make a firm's management more vulnerable to a hostile takeover, or give independent directors or activist shareholders more voice. These effects impose lower costs on high quality managers, who have less to fear, than on poor quality ones. The willingness of a firm's managers to make such a change thus signals that they are high quality. This positive signal leads to a share price improvement and hence a higher Tobin's Q. The hypothesis suggests that this signal would be particularly strong in a period where there was unusually high uncertainty about the quality of firm managers. Consequently, the period 2001-2002, characterized by an unprecedented cascade of corporate accounting scandals that was associated with high levels of market uncertainty, compared with surrounding and less uncertain timeframes (1992-2000 and 2003-2006). The underlying hypothesis is found to be consistent with data as it is found that an improved governance index score is associated with a much larger increase in Tobin's Q in the accounting scandal years as opposed to comparably sized rating improvements occurring in the surrounding years.

During the second part of the session, the discussion, Bo Becker expressed his appreciation for the paper's high quality. Subsequently, he briefly summarized the content and strategy of the paper and discussed opportunities for potential extensions of the paper. Among others, a general concern about undetected correlations between corporate governance measures with other price-relevant and time-varying variables is expressed. To illustrate the concern, a channel through which high-quality corporate governance potentially increases the likelihood of takeover bids, and as a result, Tobin's Q, the used variable to measure firm performance, is sketched. To counteract potential problems caused by time-related differences in the characteristics of the main variables (gradually moving market valuation and abrupt changes in governance), it was recommended to focus on announcement effects around decisions that drive G/E index improvements. Becker also pointed to the interest in looking outside the annual panel of Q ratios and G/E index data, for example outside the US, at later times.