Comments on Black-Jang-Kim paper

Tetsuji Okazaki
The University of Tokyo,
and RIETI

Question:

Do good governance structures cause increase of firm value ?

Alternative hypotheses:

1. Signaling.

   Firms adopt good governance structures to signal quality

2. Reverse causality.

- Firms with high value more likely to adopt good governance structures to raise firm value still higher

Data and methodology:

- 1. Data
  - Survey data by KSE on governance structure (540 firms in 2001)
    - →Constructing corporate governance indices (CG)
- 2. Methodology
  - 2SLS and 3SLS estimation, using asset size dummy as an instrument

Result

- The authors' hypothesis is accepted.
- The two alternative hypotheses are rejected.

→

- Good CG causes increase of firm value.

Comment 1: Effect of endogenous portion of CG

- Firms with low value tend to have governance structure with higher CG index (Table 7)
- What does this relationship mean ?
- Does a certain restructuring mechanism work for firms with poor performance like contingent governance in Japan or take over in US ?

Comment 2: Relative magnitude of CG effect

- Positive effect of CG1 on Tobin's q is larger for Chaebol firms than for non-Chaebol firms (Table 6)
- Positive effect of CG1 on Tobin's q is larger for firms with asset larger than KRW 2 trillion than for the others (Table 6)
- The result on Chaebol firms is robust, if we control for endogenity (Table 10)
- How can we explain the difference of CG effect depending upon Chaebol affiliation and firm size?

Comment 3: Another way to test the signaling hypothesis

- Information value of good governance structures is smaller for firms with asset larger than KRW 2 trillion, because some of the elements are mandatory by regulation
  - →Signaling hypothesis predicts that the effect of CG1 is smaller for firms with asset larger than KRW 2 trillion
- On the other hand, positive effect of CG1 on Tobin's q is larger for firms with asset larger than KRW 2 trillion than for the others (Table 6)

Comment 4: Qualification of the conclusions

- Regulation concerning the firms with asset larger than KWR2 trillion is relevant only to the subindices C and D, and not to A, B, E and P
- The asset size dummy is an good instrument only for C and D
- Even in the cases of CG1 and the other composite indices, what can be evaluated as exogenous variance is only the portion of variance due to C and D
- The hypothesis rigidly tested in this paper is the causality from outside director and audit committee to firm value

Comment 5: Some more instruments ?

- Are debt/equity and sales growth exogenous ?
- If not, we should add instrument variables