BRQ Business Research Quarterly (2016) 19, 13–25

BUSINESS RESEARCH QUARTERLY

www.elsevier.es/brq

ARTICLE

Do investors react to corporate governance news? An empirical analysis for the Spanish market☆

Natalia Utrero-González*, Francisco J. Callado-Muñoz

Centro Universitario de la Defensa Zaragoza, Spain

Received 22 May 2014; accepted 15 April 2015
Available online 6 June 2015

JEL CLASSIFICATION
G34;
G14

KEYWORDS
Corporate governance;
Best practice;
Codes;
Price reaction;
Event studies

Abstract This work adds to the debate on corporate governance regulations and its effects on performance and firm value. The paper empirically tests whether there is a significant price reaction to corporate governance announcements following the publication of the Aldama Code of Best practice (2003) in Spain. In particular, news announcements are classified according to the code principles to distinguish among different dimensions of corporate governance and have a better understanding of investors' reaction. Results show first, that investors react to this kind of practices, second, that the sign of their reaction depends crucially on the nature and extension of the recommendation and finally that firms that disclose more do not enjoy higher market prices or return on the medium-long term.
© 2014 ACEDE. Published by Elsevier España, S.L.U. This is an open access article under the CC BY-NC-ND license (http://creativecommons.org/licenses/by-nc-nd/4.0/).

Introduction

Corporate governance structure helps to solve agency problems inside organizations (Hermalin and Weisbach, 2003). The managerial power view of governance suggests that certain arrangements are associated with managerial rent extraction. Accordingly, listed firms are prompted to follow good governance practices to mitigate corporate risks (Werder et al., 2005). Codes of best practice (Codes) are considered to promote governance quality (Shleifer and Vishny, 1997). Provided stock market functions correctly, it should monitor compliance with Codes and adjust capital allocation accordingly (MacNeil and Li, 2006).

☆ Natalia Utrero González acknowledges financial support from the Spanish Ministry of Education (SEJ 2010-16353/ECON) and (SEJ 2010-21393-C04-01/ECO). Francisco J. Callado Muñoz acknowledges financial support from the Spanish Ministry of Education (SEJ 2010-16353/ECON). We thank participants at 2007 SAE annual meeting, 2008 FMA European meeting, 2008 IEA World meeting and 2008 AEFIN Foro de Finanzas and especially M.A. García Cestona and C. López Gutiérrez for helpful comments on previous versions, the usual disclaimer applies.
* Corresponding author at: Centro Universitario de la Defensa Zaragoza, Academia General Militar, crta. de Huesca s/n, 50090 Zaragoza, Spain. Tel.: +34 976 739 877; fax: +34 976 739 824.
E-mail address: n.utrero@unizar.es (N. Utrero-González).

http://dx.doi.org/10.1016/j.brq.2015.04.002
2340-9436/© 2014 ACEDE. Published by Elsevier España, S.L.U. This is an open access article under the CC BY-NC-ND license (http://creativecommons.org/licenses/by-nc-nd/4.0/).

However, governance choices are endogenously decided and value maximizing decisions for one firm may not serve another. Therefore, the relationship between governance choices and shareholder value is ambiguous and may explain the mixed empirical evidence of previous literature (Larcker et al., 2011). One way to overcome this reverse causality problem is to analyze short term market reaction to recently passed corporate governance regulations (Hermalin, 2010; Larcker et al., 2011). Since only firms whose corporate governance do not comply with the new regulation would need to make changes, stock market reaction to these changes will give a direct estimate of the value effect associated to corporate changes discarding alternative explanations (Kruger, 2015).

This paper relates to the analysis of new corporate governance regulations impact on value (Larcker et al., 2011; Bebchuk et al., 2013; Armstrong et al., 2014) and also to Code adoption effects on share value (Black et al., 2006; Goncharov et al., 2006; Bebchuk et al., 2009). In particular, the purpose of this study is to analyze whether corporate governance news, following the approval of the Spanish Corporate Governance Code (Aldama Code: ACGC from now on), are regarded as a signal of actually good corporate governance or if, on the contrary, they are not in fact considered value-relevant at all. The main contribution to the literature comes from the individual and timeliness analysis of corporate governance announcements. By taking advantage of the Spanish code classification of recommendations, and contrary to previous papers on the matter, it develops a disaggregate analysis to analyze the effects of different kinds of corporate governance news. This is done with a unique hand-collected database on Spanish firms corporate governance individual announcements for the period of existence of the ACGC (2003–2005). Spain as a case of analysis is also interesting due to the increasing financial activity, security market expansion and investor participation increase in those years.

Results show first, that investors react to corporate governance announcements, second, that the sign and significance of their reaction depends crucially on the nature and extension of recommendations. Therefore, distinguishing among different types of announcements is shown to be crucial to understand market reaction. Additionally, it is shown that firms that disclose more news on corporate governance do not enjoy higher return or market prices. The short-run association between governance and share value disappears when lengthy periods of time are considered.

The structure of the paper is as follows. First, hypotheses are derived and discussed. Second, the data and methodology used are presented. Results are then exposed and finally we draw some conclusions.

Main hypotheses

Provided existing governance practices are the result of managerial rent extraction, regulation that limit rent-extracting governance arrangements would increase shareholder value (Larcker et al., 2011). Had Codes' recommendations improved corporate governance practices through which outside investors protect themselves against expropriation by the insiders, asymmetric information would diminish and capital markets efficiency would increase (MacNeil and Li, 2006). Therefore, market value of a company with bad corporate governance mechanisms should be lower than that of a company without corporate governance problems (Gompers et al., 2003 and Goncharov et al., 2006). Accordingly, investors would not tolerate a higher risk of expropriation without receiving a higher risk premium for such investments.

As stated in the introduction, the main objective of ACGC it to define a set of recommendations that helps improving corporate governance of Spanish listed firms. Following the above discussion, announcements about compliance would be associated to good corporate governance practices. Our first hypothesis should therefore be as follows:

Hypothesis 1. *Provided the ACGC recommendations are generally associated to good corporate governance practices, announcements about compliance should have a positive effect on stock price.*

Literature on voluntary disclosure claims that an important motivation to disclose is that companies want to send a signal to the market to obtain economic benefits (Fung et al., 2007). However, voluntary disclosure is likely to be biased, because firms have an incentive to overstate the good and understate their bad practices (Kruger, 2015). Therefore, for a signal to be credible, it must have economic benefits and it should be sufficiently costly to show firm commitment. In particular, if disclosure of code compliance were a credible signal, this would be because the cost of the signal is significantly higher for firms with bad governance than for firms with good governance: the ''bad'' company cannot mimic the ''good'' one (Spence, 1973). The content and costs of code recommendations will therefore affect the credibility of the signal. Provided that recommendations are relatively trivial, like the ones of formal box-ticking, and costless in mitigating agency problems, they may not be considered as a credible signal (Arcot and Bruno, 2006). Accordingly, markets will not react or even react negatively. Therefore, investors will be sensitive to corporate governance practices that are costly for the firm, since they would be the ones that allow distinguishing between ''good'' and ''bad'' firms. In this case, as Lombardo and Pagano (2002) suggest shareholders would be willing to pay higher price for firms that follow code recommendations that reduce expropriation risks. We then can formulate the following hypothesis:

Hypothesis 1b. *The more trivial and less costly the ACGC recommendation announced to comply, the less of the positive impact it has on the value of the company.*

Data and methodology

Data

Market reaction to corporate governance news related to compliance with the code approved in 2003 is analyzed. ACGC is an attempt to balance effective legal protection to shareholders, basic for capital market development, and flexibility demanded by listed companies to organize

Download English Version:

https://daneshyari.com/en/article/1004294

Download Persian Version:

https://daneshyari.com/article/1004294

Daneshyari.com