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ARTICLE

On the relationship between corporate governance and value creation in an economic crisis: Empirical evidence for the Spanish case

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Abstract This paper analyses the effect of corporate governance on value creation. It relies upon a dataset that includes the companies listed on the Spanish Stock Exchange for the period from 2005 to 2012. Attention is focused on the structure and composition of boards. In particular, four variables are analyzed: *BOARD_SIZE*, *BOARD_INDEPENDENCE*, *BOARD_DILIGENCE* (measured by the number of meetings), and *DUALITY* (chairman and chief executive officer being the same person). Over the period of the deepest economic crisis (2009–2012) the most significant variables that had a positive effect on value creation were *BOARD_INDEPENDENCE* and *BOARD_SIZE*. Hence, the global financial crisis has highlighted the need for effective corporate governance. Policy makers should think about translating the recommendations of the Good Governance Codes into legislation (mandatory), to improve corporate governance.

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Introduction

Financial scandals (Enron, Parmalat, Tyco, WorldCom, and others) have led to an increasing interest in the relationship between corporate governance and firm performance when control mechanisms are challenged. In this context, the

board is considered to be a mechanism for corporate governance, assigned the task of protecting and increasing assets and maximizing the return on corporate investments (Castro et al., 2010; Silva et al., 2011; Huang et al., 2012; Rossi et al., 2015). The board becomes the main internal control mechanism for companies, allowing agency problems arising from the separation of ownership, and management control problems that cause information asymmetries, to be overcome. In this way, the board serves as a link between shareholders and the management team, with supervision as its main task; it sometimes plays a disciplinary role, replacing executives when there is poor or negative

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performance. Therefore, the literature mainly analyses board size and board composition as characteristics that influence the supervisory capacity of the board. In line with this, the different codes set out a series of recommendations on the ideal structure and composition of boards.

For this reason, the drafting and implementation, through national laws and regulations, of corporate governance codes significantly increased at the beginning of the new millennium (He et al., 2009). Nowadays, more than sixty countries have drafted codes for good governance. Companies, as well as countries, seek to make their corporate governance practices more effective, in part because of corporate governance scandals, but also to attract investors (Aguilera and Cuervazurra, 2009). Worldwide, codes provide sets of recommendations that listed companies should take into account when issuing their annual reports on corporate governance. In particular, they include several key universal principles for effective corporate governance, to achieve a balance between executive and non-executive directors and a clear division of responsibilities between the chairman and the chief executive officer.

The aim of this paper is to analyze the effect of board composition and structure on firm performance under adverse economic conditions. It involves studying whether board size, CEO – chairman duality, board independence and the frequency of board meetings are relevant for a company. We propose as main hypothesis that there is a direct effect of board on firm value under adverse economic conditions. The idea is clear-cut: the board of directors is much less relevant when market conditions are favourable, and when market conditions are not, the board is crucial in explaining differences in value creation. To test this set of hypotheses, we have carried out an econometric study using panel data for listed companies on the Spanish Stock Exchange over the period 2005–2012.

Our results confirm the idea that board structure and composition are far more relevant in difficult and challenging times. Moreover, the number of independent board members and the board size are significant variables during a crisis period, having a positive effect on value creation. These results allow us to come to the conclusion that companies should worry about their board structure and composition when economic conditions are adverse. With regards to composition, the bigger the board size, the better the performance of the company during the crisis period. Regarding structure, companies should bear in mind that the greater the independence of the board, the greater the firm value; furthermore, in order for the board members' presence to be sufficiently relevant for them to influence board decisions, it is not only the number of board members that is important, but also the relative weight of independent members.

From the institutional point of view, they have drawn different good governance codes that have not had the desired effect. It would be desirable that the recommendations included in these codes became laws which allow improving the corporate governance of companies.

While the link between corporate governance and firm performance has been widely studied in the financial literature (Brown and Caylor, 2006), the analysis of the effect of corporate governance on value creation in adverse economic contexts is much more limited (Gupta et al.,

2013). In addition, we should bear in mind the fact that these studies have focused on financial entities (Erkens et al., 2012), while our paper sheds light on the behaviour of non-financial companies with regards to their responsiveness, through corporate governance, to value creation in times of economic crisis. Specifically, our work focuses on how the effect of corporate governance on performance differs according to the economic context for the company (performing a post-crisis versus a pre-crisis comparative analysis).

The paper is organized as follows. The next section presents the institutional background, to provide the characteristics of the Spanish context and describe the set of Spanish codes of corporate governance. The third section reviews the literature, to determine the relationship between the different variables and the process of value creation, and establishes several hypotheses. The fourth section describes the methodology, data and variables, empirical analysis and results. Finally, we draw conclusions and discuss implications.

Institutional background

On top of the recent financial crises, we should add the economic crisis that has affected many countries in recent years, rocking countless economies. The so-called "Great Recession" has shocked the world economy as a whole, but in an asymmetrical way. Some countries are facing the worst economic scenario in decades. Among the biggest economies in the OECD, Spain provides the most interesting case for a study of the causes and consequences of this recession, including the influence of corporate governance on value creation in different economic scenarios. In the years running up to the crisis, Spain was characterized by strong credit growth, which was derived from the low interest rates that prevailed throughout the country following the Monetary Union and that led to a housing bubble. Real estate prices grew year after year as the result of a sharp increase in market demand, to the extent that by 2006 the building sector represented 16% of the country's GDP in real terms and up to 20% of all employment generated within the country. The building sector caused significant increases in GDP until 2008, when the first results of the crisis triggered by the financial scandals in the US the previous year appeared. Unemployment rose from 8% to 25%, and real GDP growth rates have been significantly negative since 2009. The crisis also led to an increase in credit risk, and in Spain the effect was observed in the restrictions imposed by financial entities on new loan authorizations. Despite having diminished in the years prior to the crisis, public debt once again grew in 2008 because of economic efforts to mitigate the effects of the recession. In the financial markets, the IBEX 35¹ lost 50% of its value between 2010 and mid-2012 (BME, 2007–2014).

¹ "The IBEX 35[®] is the index made up by the 35 most liquid securities traded on the Spanish Market, used as a domestic and international benchmark and as the underlying index in the trading of derivatives. Technically it is a price index that is weighted by capitalization and adjusted according to the free float of each company comprised in the index" (www.bde.es).

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