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The corporate governance behavior and market value of Russian firms ☆

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Abstract

I examine the relationship between corporate governance behavior and market value for a sample of 21 Russian firms. I use (1) fall 1999 corporate governance rankings for these firms, developed by a Russian investment bank, and (2) the 'value ratio' of actual market capitalization to potential Western market capitalization for these firms, determined independently by a second Russian investment bank. The correlation between ln(value ratio) and governance ranking is striking and statistically strong: Pearson $r = 0.90$ ($t = 8.97$). A worst (51 ranking) to best (7 ranking) governance improvement predicts a 700-fold increase in firm value. These results are tentative because of the small sample, but they suggest that corporate governance behavior has a powerful effect on market value in a country where legal and cultural constraints on corporate behavior are weak. © 2001 Elsevier Science B.V. All rights reserved.

Keywords: Corporate governance; Russia; Corporate governance rankings

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1. Introduction

How strongly does a firm's corporate governance behavior affect the market value of its shares? Intuitively, governance behavior should matter. But evidence that the governance behavior of United States firms affects their market value is scarce. Most tests of whether variations in corporate governance behavior between US firms affect firm value find either no effect or an economically small effect. And yet, perhaps the weak results are found largely because the variation in US firms' behavior is small. After all, the minimum quality of American corporate governance, set by law and by norms so widely accepted that almost no public firms depart from them, is quite high.

To conduct a stronger test of whether governance behavior affects firm value, I study Russian firms. Russia has weak laws governing behavior by firms and insiders (managers and large shareholders), weak norms for insider conduct, and weak reputational constraints on insider conduct (Black, Kraakman and Tarassova, 2000). Governance differences between firms are much larger than in the United States, and could have measurable effects on firm value.

This article tests the proposition that firms' corporate governance behavior affects their market value, using September 1999 data for a sample of 21 Russian firms. I use corporate governance rankings for these firms, developed by Brunswick Warburg, a Russian investment bank. These estimates were not directly, and their creators believe that they were not indirectly, influenced by the firms' market values. I combine these governance rankings with data on the actual market capitalization of these firms, and estimates by Troika Dialog, a second Russian investment bank, of these firms' potential Western market capitalization. The potential Western capitalization values are based on asset multiples; there is no obvious way for governance behavior to affect these estimates.

The 'value ratio' of actual to potential Western market capitalization offers a measure of the discounts that outside investors apply to these firms' shares. The variation in discounts is huge. The value ratios vary from 0.48 for Vimpelcom to 0.0001 for Yuganskneftegaz.

The correlation between these firms' value ratios and their corporate governance rankings offers a measure of how strongly Russian firms' corporate governance behavior affects their market value. The correlation is striking. The Pearson product-moment correlation coefficient between ln(value ratio) and governance ranking is $r = 0.90$, with a t-statistic of 8.97 ($P < 0.0001$). These results survive various robustness checks.

My results are tentative because of the small sample. Still, they suggest that the governance behavior of Russian firms has a powerful effect on market value. A one-standard-deviation change in governance ranking predicts a seven-fold increase in firm value. A worst (51 ranking) to best (7 ranking) change in governance ranking predicts a 700-fold increase in firm value.

Section 2 of this article briefly reviews research in the US on the extent to which corporate governance attributes affect firm value, and why larger effects might be expected in Russia. Section 3 describes my research design. Section 4 presents