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Internet-based corporate disclosure and market value: Evidence from Latin America

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ABSTRACT

We examine the relationship between an Internet-based corporate disclosure index and firm value in the seven largest stock markets of Latin America. We find, after controlling for firms' characteristics, industry and country of origin, that an increase of 1% in the Internet-Based Corporate Disclosure Index causes an increase of 0.1592% in the Tobin's Q and an increase of 0.0119% in the firm's ROA. These findings are robust after considering the potential endogeneity of our regression variables. The evidence contributes to the literature suggesting that firms can differentiate themselves by self-adopting better financial and corporate disclosure measures using the Internet.

1. Introduction

The modern company operates surrounded by a series of conflicts of interest, particularly those that arise between managers and shareholders, and between controlling and minority shareholders. One of the main objectives of the study of corporate governance consists of trying to eliminate or, at least, attempt to mitigate these conflicts. The other main objective consists of assuring that the assets of companies are used efficiently and in the best interests of shareholders. In order to make sure that shareholders perceive an appropriate yield on their investments, throughout the years they have defined a range of rights in an attempt to safeguard their interests, such as: rights of decision, rights of control, rights of protection, the right to perceive dividends and the right to be informed. This paper is focused on the last of these rights.

We argue that in the 21st century the use of Internet in corporate governance communication is of utmost importance. Before the Internet became a mass phenomenon, starting around the mid-nineties,

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paper-based reports were the medium for corporate reporting. While these reports are still used by stockholders, they are not generally sufficiently detailed, accessible, timely or interactive as some investors may desire (Allam et al., 2004). In contrast, the Internet makes it easier for companies to distribute information to an extensive array of investors in a more opportune and convenient way. The Internet also offers managers with the prospect to contact all investors and to make available daily updates of relevant information. According to Orens et al. (2010), Internet reporting allows companies to communicate directly with their stakeholders in a timely, cost-effective and potentially dynamic way. In this regard, and similar to Geerings et al. (2003) and to Grzybkowski and Wojcik (2006), we explore the extent of the use of the Internet in Latin America as a technology that facilitates firms' transparency which is one important element of the firms' corporate governance system. We examine not only whether specific information is disclosed by Latin American companies on the Internet, but also the manner in which information is disclosed and whether actual or potential investors are offered the means to use such information effectively.

According to La Porta et al. (1997, 1998, 2000, 2002) and Chong and López-de-Silanes (2007) the legal framework that investors and firms face vary substantially around the world. This is partly due to differences in legal origin. In the case of Latin America, all countries share the same French Civil Law origin. La Porta et al. (1997, 2000) argue that investors are less protected in French Civil Law countries, particularly when compared to countries from the Common Law origin. La Porta et al. (1997, 2000) and Chong and López-de-Silanes (2007) also argue that the small size of stock exchanges and the low level of financial development that is characteristic of Latin American countries can be explained by the fact that they perform even worse than the average French Civil Law countries in terms of investor rights.

This is one of the reasons why Latin America offers an interesting setting to study the impact of self-adopting governance practices. As explained in Garay and González (2008) the weak investor protection inherent in many Latin American countries presents firms with the opportunity to distinguish themselves from the others and to send credible signals to draw investors' attention. For example, the voluntary adoption of better corporate governance practices, such as disclosing financial and corporate governance information through the Internet, partly compensates investors for the weak legal environment in which these firms operate.

In this regard, Klapper and Love (2004) and Durnev and Kim (2005) found that emerging countries are characterized by poorer corporate governance practices and inferior judicial systems than those of the developed countries, and that the increase in the market value that a company can obtain when it improves its corporate governance practices is much greater in emerging markets, this means, that corporate governance practices matter more in countries where legal protection is weak. As a result, companies may enhance their market valuation by improving the quality and the amount of the voluntary information that they disclose (Patel et al., 2002). The other reason why Latin America is an interesting case to study is because the success of corporate governance codes, such as the Corporate Governance Andean Code (CAF, 2005) and the Corporate Governance Principles enacted by the OECD in 2004 will largely depend on the real impact that they may have on the improvement of the financial performance and market value of the companies that implement them.

We know relatively little about the potential impact that certain corporate governance practices, including corporate disclosure using the Internet, may have on the market value of companies in Latin America. As commented in Garay and González (2008), in the case of the U.S. the empirical evidence reveals either no effect or an economically small effect and suggests that this weak evidence arises because there exists small corporate governance variation in the U.S., given that the minimum levels of corporate governance are relatively high in that country as a result of the existence of stricter laws and norms. On the other hand, interfirm corporate governance variation has been found to be much larger in Latin America (Black et al., 2010; Chong and López-de-Silanes, 2007). This can be explained by the fact that this is a region where laws and norms are among the weakest, thus offering a wider range for corporate governance differences between firms and the possibility for a firm to self-improve its corporate governance practices and, therefore, the prospective for more powerful results on the effects of corporate governance practices and policies, such as an Internet-based corporate disclosure, on firm valuation.

In this paper we review and evaluate the financial information and other elements of corporate governance that are presented in the web pages of the companies listed in the seven largest stock exchanges of the region (Argentina, Brazil — Bovespa and Novomercado — Chile, Colombia, Mexico and Peru). More specifically, for our sample of companies listed in these stock markets we construct an Internet-based corporate disclosure index (ICDI) which is based on the information that these companies offer to investors through their web pages, and following a procedure similar to that already developed