REGULAR ARTICLE

Reducing risk in the emerging markets: Does enhancing corporate governance work?

Naz Sayari\textsuperscript{a,∗}, Bill Marcum\textsuperscript{b}

\textsuperscript{a} Department of Business Administration, Middle East Technical University, Universiteler Mahallesı Dumlupınar Bulvarı No: 1, 06800 Cankaya, Ankara, Turkey
\textsuperscript{b} School of Business, Wake Forest University, 1834 Wake Forest Road, Winston Salem, NC 27106, USA

Received 18 July 2017; accepted 19 January 2018

Abstract This study examines emerging market firms that adopt corporate governance standards similar to those in the US. The investigation highlights the impact governance standards may have on corporate risk taking, as measured by stock return volatility, under varying political and socioeconomic regimes. In a cross-sectional time-series setting, the analysis reveals that enhanced governance standards are associated with risk reductions among US domiciled firms, cross-listed American Depository Receipt companies (ADRs) and non-cross listed emerging market (EM) firms. The effect of these governance standards on risk taking, however, does not deviate considerably between cross-listed ADRs that are exposed to Securities and Exchange Commission (SEC) mandated regulations and non-cross-listed EM firms that are not subject to the same regulatory constraints. Also, in some respects, Chinese firms seem to exhibit corporate behavior that is contrary to that of the rest of the world.

© 2018 Published by Elsevier España, S.L.U. on behalf of ACEDE. This is an open access article under the CC BY-NC-ND license (http://creativecommons.org/licenses/by-nc-nd/4.0/).

Introduction

A considerable body of literature supports the notion that the corporate governance environment (i.e., effective internal control systems and board oversight, reduction in risk taking behaviors, increase in firm value) in the US has improved since the passage of the Sarbanes-Oxley Act (SOX) in 2002 and the promulgation of US governance standards set by the Securities and Exchange Commission (SEC) in 2003 (Beasley et al., 2009; Chang and Sun, 2009; Chiao-chiahia and Grinstein, 2007; Cohen et al., 2008, 2010; Jain et al., 2008; Wang, 2010). Also, given audit committees’ strengthened role in monitoring the financial reporting process and heightened responsibility for reporting accuracy, firms have become more conservative during the SOX era (DeZoort et al., 2008). This is substantiated by research showing a reduction in the acquisition of risky investments as new governance rules are...
implemented (Bargeron et al., 2010; Cohen et al., 2007; Shadab, 2008).

Few studies have examined the relationship between governance and risk behavior of firms operating in the emerging markets (Braga-Alves and Morey, 2012; Chang et al., 2015). It follows then that scant research has been dedicated to the governance – risk relation among cross-listed EM firms that are exposed to SEC regulations through the issuance of an American Depository Receipt (ADR) or non-cross-listed EM firms (Jayaraman et al., 1993; Litvak, 2007a, 2007b, 2008). Currently, the literature lacks an overarching theoretical model that depicts international corporate convergence in which firms commit to more rigorous regulatory and disclosure standards as a form of “bonding” in an effort to strengthen their governance while reducing their exposure to agency costs so that they may remain competitive both in local and global markets. To build our theoretical model, we employ four individual rules to determine if the riskiness of both cross-listed (ADRs) and non-cross-listed EM firms is affected by US best practices governance standards. Each of the rules are compulsory for firms listed on the NYSE or NASDAQ and identified in Section 303A of the New York Stock Exchange’s (NYSE) Listed Company Manual.

Specifically, the four mandated rules employed are: the establishment of three independent committees (i.e., nomination, compensation and audit committees), independent directors, duality of the Chief Executive Officer (CEO) and the existence of a corporate ethics policy. The rules are employed to determine (1) if EM firms that adopt standards of corporate governance set in the US have the same impact on risk taking as US firms; and (2) if the effect of corporate governance on risk taking measures differs between cross-listed ADRs that are subject to US governance standards and non-cross listed EM firms that are not held to those standards.

Because of their potential for double-digit economic growth and commensurate investment opportunities, the emerging markets garner a great deal of interest. Nonetheless, the multifaceted risks confronting investors at both the company and national levels has created potential impediments to the inflow of capital. One such impediment is a perception that shareholders in the emerging markets are left relatively unprotected by lax corporate governance standards (Gibson, 2003; Klapper and Love, 2004). To overcome this perception, firms based in the emerging markets pursuing global capital may elect to “migrate” toward exchanges with more stringent governance standards than their home market, thereby “bonding” their commitment to such standards (Abdioglu et al., 2015; Coffee, 1999, 2002; Stulz, 1999). This suggests that the relatively rigorous governance standards of US exchanges may add to the attractiveness of cross-listing through an ADR. This is especially true for Level 2 and Level 3 ADR programs that entail listing on an exchange (i.e., NYSE, AMEX or NASDAQ) and commit firms to governance standards equivalent to those of US firms (Boubaki et al., 2010). Coffee (2002) further argues that global competition for corporate listings and trading volume will foster an enhanced regulatory environment by market exchanges or by “firms seeking to distinguish themselves”. To compete for capital, EM economies will find it necessary to impose more stringent corporate governance standards and this is especially applicable to countries seeking to fuel growth. In this study, we examine the best performing EM countries that are identified by Bloomberg’s 2014 Emerging Markets rankings.

In an effort to identify sources of risk and potentially viable control mechanisms, some researchers have investigated country-specific governance practices among the emerging markets. These studies, however, have delivered mixed outcomes regarding the types of practices companies should adopt in order to fashion a more effective governance environment (Abdoli and Royaee, 2012; Abdullah, 2006; Chang et al., 2015; Gibson, 2003; Jaikengkit, 2004; Johnson et al., 2000; Klapper and Love, 2004; Lang et al., 2003; Llattemann, 2014; Lee and Yeh, 2004; Mitton, 2002). Some research focuses on ADRs and the impact of governance mechanisms on investment decisions, financial performance and other firm attributes. These studies either employed aggregated emerging and developed market data (Braga-Alves and Morey, 2012; Chira, 2014; Li, 2014) or market-wide governance rankings or governance attributes related to the legal protection of investors rather than evaluating individual governance standards imposed by the US authorities (Aggarwal et al., 2007; Boubaki et al., 2010; Doidge et al., 2009). Consequently, there remains little solid evidence to inform investor opinions regarding the impact enhanced corporate governance structures have on firm-level risk in the emerging markets or the effect cross-listing in the form of an ADR has on a firm’s risk.

To analyze the relation between corporate governance and risk, we employ a two-step GLS random effects model and firm-specific data on a large sample of US firms and companies operating in EM countries covering the 2008–2014 period. In an attempt to isolate the effect of US best practice governance rules on risk taking behavior in the emerging markets, it is important to compare US firms, that are subject to SEC regulations, to cross-listed ADR firms that are most like US firms in that they are partially bounded by the same regulations, and to non-cross-listed EM firms that are not subject to these regulations at all.

This study has theoretical and practical implications for international corporate governance practices in that it identifies mechanisms that could enhance investor trust leading to new opportunities for investors and increased capital for the emerging markets. Using a large sample of American (i.e., US) firms, cross-listed and non-cross-listed EM firms, we find that stronger governance is associated with lower risk among firms in the US, cross-listed ADR firms and non-cross-listed EM firms (Braga-Alves and Morey, 2012; Gibson, 2003; Haripriya et al., 2006). Also, we find that some of the governance related parameter estimates of the non-cross listed EM firms (i.e., Committees, CEO Duality and Ethics Policy) are affected by the exclusion of Chinese companies from the sample, both with regard to the sign of the coefficient as well as the statistical significance. These results are consistent with the existing literature in that they indicate that the negative relationship between risk and governance is stronger for Level 2 and Level 3 ADRs; firms in which governance and disclosure requirements are more restrictive than for those of the Level 1 ADRs (Boubaki et al., 2010; LeL and Miller, 2008). In general, it appears that US governance standards impose an element of risk mitigation among EM firms, and the effect of these standards on risk taking

دریافت فوری متن کامل مقاله

امکان دانلود نسخه تمام متن مقالات انگلیسی
امکان دانلود نسخه ترجمه شده مقالات
پذیرش سفارش ترجمه تخصصی
امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
امکان دانلود رایگان ۲ صفحه اول هر مقاله
امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
دانلود فوری مقاله پس از پرداخت آنلاین
پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات