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Global financial crisis, corporate governance, and firm survival: The Russian experience

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Using a unique dataset obtained from large-scale panel enterprise surveys conducted in 2005 and 2009, we clarify the survival status of Russian industrial firms before and after the global financial crisis and empirically examine the determinants of firm survival. The estimation of the Cox proportional hazard model provided evidence that the independence of company's governance bodies, their human resource abundance, and influence over corporate management are statistically significant factors affecting the survival probability of the surveyed firms. In particular, the board of directors and the audit committee are likely to play a vital role in reducing the potential exit risk. We also found that there is a significant difference in the viewpoints of economic logic for firm survival held by independent firms and group companies. *Journal of Comparative Economics* **42** (1) (2014) 178–211. Institute of Economic Research, Hitotsubashi University, 2-1 Naka, Kunitachi City, Tokyo 186-8603, Japan.

1. Introduction

The 2008 global financial crisis triggered by the US subprime loan problem struck not only developed economies but also Russia, which had been promoting economic integration with the world economy in pursuit of the shift from a planned system to a market economy. In fact, Russia experienced a negative real GDP growth rate of −7.8% the following year, 2009. This fall was the second largest after the devastating "transformational recession" (Kornai, 1994) that followed immediately after the collapse of the Soviet Union, exceeding the economic drop during the 1998 financial crisis. The Russian manufacturing industry, which is sensitive to global economic conditions, had shown signs of a change earlier in 2008. Then, in 2009, its value-added production rapidly shrank by 14.9% in real terms compared to the previous year. As a result, both the amount of total output and the number of employees in the industrial sector dropped sharply in 2009. Even after the subsequent V-shaped recovery, they failed to recover to the levels prior to the crisis in 2010. Furthermore, the global financial crisis is considered to have inflicted especially severe damage on large and medium-sized Russian firms during the period, given their close connection with the capital market. In fact, as shown in Fig. 1, the RTS Index, a major stock price index in Russia, nosedived by 75.0% from the highest-ever 13337.03 recorded on May 19, 2008, to 3333.31 on October 24, 2008, in as little as 5 months.

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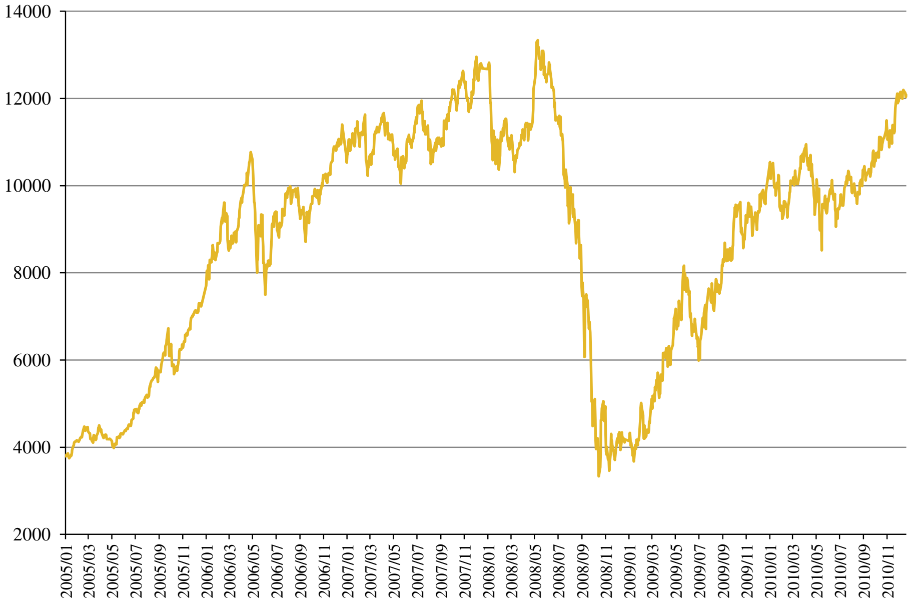

Note : This figure plots the Ruble-denominated closing prices of the RTS Index from 1 January, 2005, to 31 December, 2010. The RTS Index is one of major stock price indices in Russia. The data is derived from the MICEX and RTS groups' website (http://rts.micex.ru/).

Fig. 1. The fluctuation of the Russian securities market: 2005–2010.

Although it has been repeatedly pointed out that various institutional and non-institutional barriers hinder firm entry and exit in Russia (Broadman, 2000; Aidis and Adachi, 2007; Estrin and Prevezer, 2010), it is certain that the global financial crisis caused such serious damage to the Russian industry that an abnormally high number of firms were eliminated. In fact, as shown in Fig. 2, the number of liquidated firms per 1000 domestic companies increased from 2.8 on average from January to August 2008 to 3.7 from September 2008 to December 2010, demonstrating a sharp upward shift after September 2008.[1] Moreover, an urgent interview survey, in which Novosibirsk-based industrial firms were examined in early 2009, revealed that senior management in 14 of the 21 firms surveyed reported that they had difficulty or great difficulty in coping with the latest crisis (Koreli and Kombarov, 2010). Furthermore, according to a questionnaire survey of Russian manufacturing firms in 2009, one of four firms replied that it was facing a grave management problem triggered by the 2008 crisis, and one of five firms replied that it was facing real danger of bankruptcy (Dolgopyatova, 2009).

This study examines the number for Russian firms forced to exit the market in the wake of the world economic shock and the characteristics of the firms that survived this historic adversity. More specifically, based on the results of large-scale panel enterprise surveys conducted across Russia in 2005 and 2009, we clarify the 5-year survival status of Russian industrial firms and empirically examine the determinants of firm survival. To the best of our knowledge, empirical studies concerning firm survival and/or exit from the market in post-socialist transition economies have been confined to the nine studies listed in Table 1, and, thus, transition studies have made only a small contribution to this field. In addition, Rinaldi (2008), the only one who examined the determinants of market exit in Russia using a firm-level dataset, limited his research to the footwear industry; therefore, the overall picture has not been explored.

The significance of our study lies in that it examines transition economies and also pays attention to the role of company's governance bodies as an influential factor of firm survivability. There is a vast amount of empirical literature in which the factors of a firm's failure and survival are investigated; the studies range from the pioneering work of Beaver (1966) and Altman (1968) to the latest work by de Figueiredo and Silverman (2012).[2] However, corporate governance has been examined in only a small number studies, and, in those, the focus was limited to ownership structure as a controlling factor, as in the transition studies listed in Table 1. In fact, the causality between the structures and functions of corporate governance bodies and firm survival is explicitly examined in only a few research works.[3] Furthermore, these few preceding studies focused exclusively on the board of directors and ignored other corporate organs.

[1] The difference between the two period averages is statistically significant at the 1% level ($t = 5.427$, $p = 0.000$).

[2] Santarelli and Vivarelli (2007) and Manjón-Antolín and Arauzo-Carod (2008) provide overviews and recent developments in this research field.

[3] They include Daily and Dalton (1994), Filatotchev and Toms (2003), Howton (2006), He (2008), Dowell et al. (2011) and Chancharat et al. (2012). Except for Chancharat et al. (2012) on the Australian IPO firms, all of these papers focus on either American or British firms.