

Discussion of

Corporate Governance Reform and Risk Taking: Evidence from a Natural Experiment from an Emerging Market

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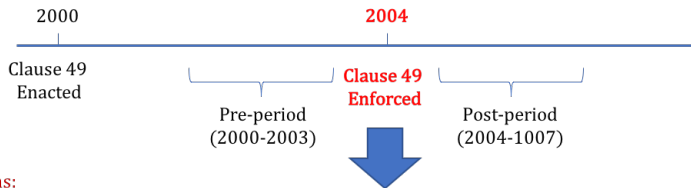
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What is This Paper About?

What is Clause 49? **Corporate Governance Reform SOX of India**

- Board independence
 - Independence of audit committee
 - Certification by CEO/CFO
- ➔ More disclosure



Treated firms:

Paid-up equity capital > INR30M

Control firms:

Paid-up equity capital < INR30M

Corporate Risk-taking

- Earnings volatility – 3-year SD of earnings
- Capital expenditures
- R&D expenditures

Higher market valuation

Empirical Setting

$$\begin{aligned} Risk_{ijt} = & \alpha + \beta Treated \times After + \lambda Treated \\ & + \rho After + X_{ijt} \cdot \delta + FirmFE + IndustryFE + TimeFE + e_{ijt} \end{aligned}$$

- Risk proxies
 - Earnings volatility
 - Capital expenditure
 - R&D expenditure
- Why is “capital expenditure” a risk proxy? It could go higher or lower as agency costs become less severe.
- How could we include both firm fixed effects and industry fixed effects?

Comment: Empirical Methodology

- Assignment variable is firm size. Any macro policy change in 2004 that affects large firms relative to small firms would yield observationally equivalent results.
- Table 5 is a good attempt, but the samples are very different.
- Two solutions:
 - Propensity score matched samples can better control on observables.
 - Regression discontinuity around the \$30 million threshold.

Comment: Understanding Costs and Benefits of CGR

- Do all firms benefit from CGR? What determines the benefits and costs of CGR on firms?
 - We expect Clause 49 to be costly for some firms and beneficial for other firms. Board independence has both costs and benefits.
 - Board independence is costly for firms with high information asymmetry.

Comment: Understanding the Mechanism

- What is the mechanism by which Clause 49 increases corporate risk-taking?
- Does it lead to greater disclosures? Is firm transparency increasing? Are analysts' forecasts more informative?
- Proxies for consumption of private benefits: Evidence for the improvement in monitoring?

Comment: Additional Implications

- We expect capital expenditures to be more responsive to growth opportunities. Size of CapEx tells us little.
- Debt values should fall. Spreads should increase. Maturity shorter. Banks will require more collateral.

Conclusion

- The paper is asking important questions. Has a credible experimental setup. Results are robust.
- My comments:
 - Important to understand the mechanism through which the governance reforms affect corporate policies.
 - Is it risk-taking or investment efficiency? More direct evidence on improvements in investment efficiency.
 - Effects on debtholders?
 - Additional tests to improve validity of results.