Discussion of

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

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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

2000

Clause 49
Enacted

2004

Clause 49
Enforced

Pre-period
(2000-2003)

Post-period
(2004-1007)

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

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

- 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.