

Discussion on
Income Diversion, Corporate Governance and Firm Value
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Summary

- ▶ Research question:
 - ▶ Through which channel are corporate governance and firm value related?
 - ▶ Income diversion vs. operating efficiency
 - ▶ Which governance policies are more effective in reducing income inversion?
- ▶ Main finding
 - ▶ External governance improvements, such as public or cross-listing in the US as an ADR, are significantly correlated with a lower income diversion
- ▶ Contributions
 - ▶ Quantify the income diversion directly and interact it with corporate governance and firm value

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Comment 1: Why do firms divert income?

- ▶ Who benefits from income diversion?
 - ▶ Top management? (Principal-agent problem)
 - ▶ Controlling shareholders? (Expropriation of minority shareholders)
 - ▶ Or both?
 - ▶ Or even more?
 - ▶ e.g. Bribe to get a positive NPV project; tax evasion

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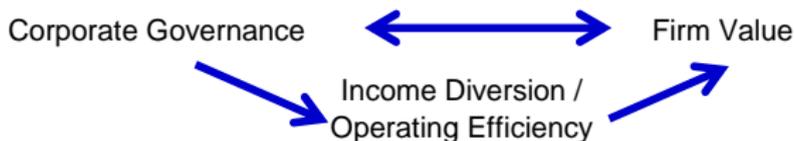
Comment 2: Which firms are more likely to divert income?

- ▶ Compare firm characteristics in addition to corporate governance
 - ▶ Current Table 6 controls for *Log(Revenue)*, *Revenue growth*, *Debt/Assets*
 - ▶ What about industry, firm age, ownership concentration, dual-class stock, executive compensation, institutional ownerships, politically connected CEO, and so forth?
- ▶ Explore the changes in governance over time
 - ▶ Current Table 6 includes year dummies
 - ▶ Add the firm fixed effect

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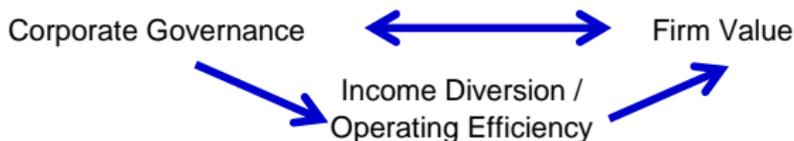
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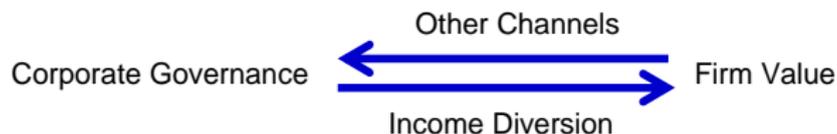
- ▶ Income diversion vs. operating efficiency
 - ▶ Table 2: *Audit by Big 5* and *Foreigner serves on board* are associated with a higher firm value; *Owned by Government* is associated with a lower firm value
 - ▶ Table 6: *Publicly traded* and *ADR* are associated with less income diversion
 - ▶ Table 7: *ADR* and *Audit by Big 5* are associated with a higher EBITDA margin

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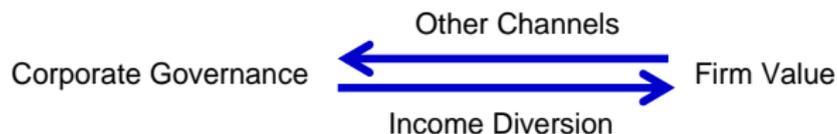
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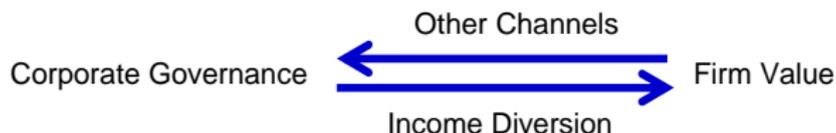
- ▶ A causal effect between corporate governance and firm value?
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 - ▶ Wintoki, Linck, and Netter (2012) find no causal relation between board structure and current firm performance
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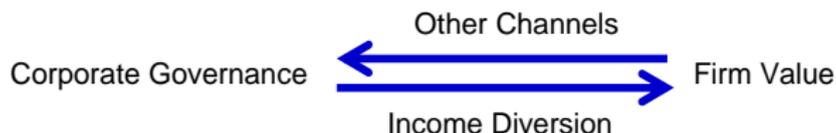
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Comment 5: A potential way to address endogeneity

- ▶ Use Putin's actions in 2002 as an exogenous shock
 - ▶ "... significantly decreased its transfers to spacemen starting in 2002, after Putin started a series of actions to enforce tax payment by top oil companies in Russia."

Ticker	Name	1999	2000	2001	2002	2003	2004
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
LKOH	Lukoil	.	3,134,821	3,647,323	263,772	228,527	174,024
GAZP	Gazprom	54,278	107,446	141,176	141,459	587,887	1,152,517
CHMF	Severstal	73,649	147,183	177,769	53,926	94,647	360,786
GMKN	Norilsk Nickel	.	.	443,168	80,928	20,724	76,340
NLMK	NLMK	27,625	43,348	38,356	47,563	121,348	78,177
TATN	Tatneft	.	72,253	42,344	97,873	100,554	29,105

- ▶ Other methods:
 - ▶ Dynamic panel GMM estimator (Wintoki, Linck, and Netter, 2012)
 - ▶ Simultaneous equations (Bhagat and Bolton, 2008)

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Minor Issues

- ▶ Does the market anticipate the income diversion by firms?
 - ▶ Event study: Data leakage from the Russian Central Bank in 2005
- ▶ Relate income diversion to private benefits of control
 - ▶ A new measure (the lower bound) for private benefits of control?

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