Watching the Wolves: Unvelling the Moderating Role of Corporate Governance on CEO Power

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8th Emerging Market Finance Conference
Mumbai, INDIA, December 17-20, 2017

Discussion

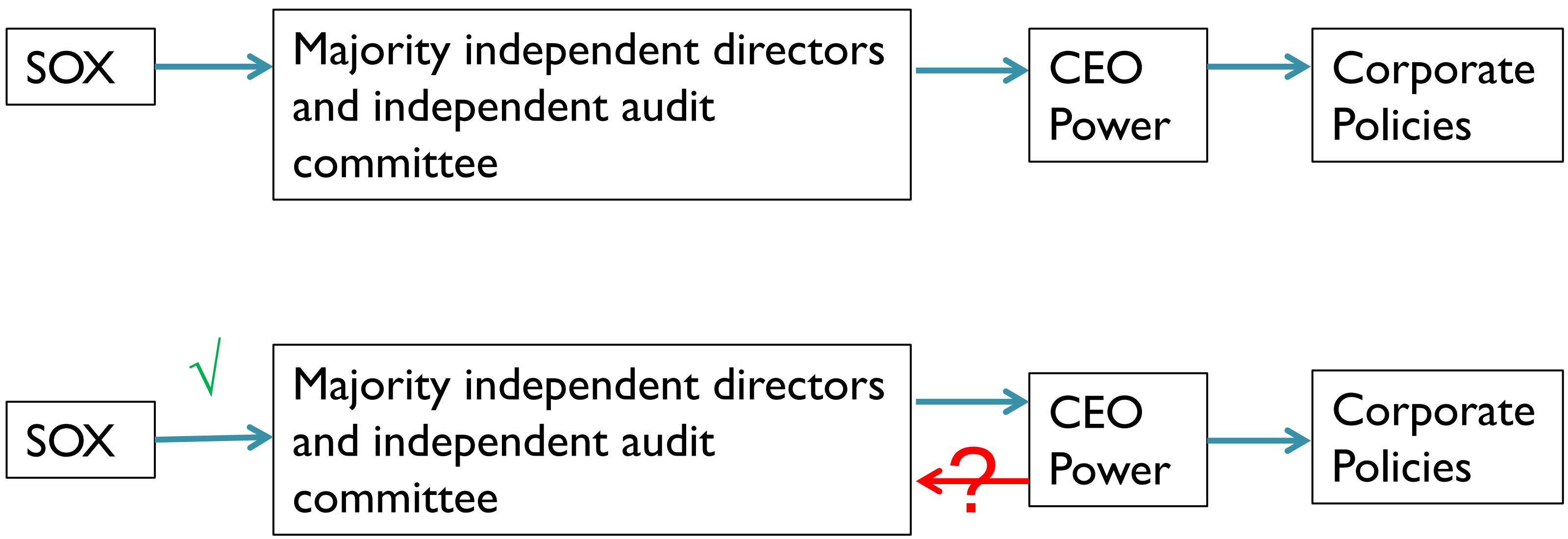
- The core idea
- Conceptual issues
- Measurement issues

The Core Idea

- CEO power impacts performance through influencing corporate outcomes such as innovation, capital expenditure, M&A deals, leverage, dividends.
- Extant literature: positive and negative effects of CEO power.
- CEO power and corporate outcomes may be endogenously related.
- Identification strategy to break causality: Exogenous shock on corporate governance variables (change in board composition and independent audit committee) due to enactment of SOX leads to strong corporate governance exogenously impacts CEO power which impacts corporate outcomes.
- Stronger CG due to SOX can channelise CEO power to better outcomes.
- Measured through comparing the post-SOX effect of CEO Power on outcomes in pre-SOX compliant and non-compliant firms.
- Changes in CG in "compliant" firms does not change the effect of CEO Power on outcomes whereas in "non-compliant" firms, CEO Power is channelised productively through stronger CG post SOX into better outcomes.

Conceptual Issues - I

Is SOX an exogenous shock on internal firm governance?



- While composition of board exogenously determined by SOX, but quality of board (independence) can be influenced by CEO power.
- "Powerful CEOs can use their influence to select board of directors to ensure a pliable board (Tirole (2001))." SOX does not necessarily ensure that CEOs cannot influence board composition. Powerful CEOs will influence all the more (Westphal and Zajac ,1995)
- Study period 1992-2014: Independent boards may be influenced by powerful CEOs over time. (Morck, 2009).
- Endogeneity exacerbated by long-horizon outcomes.

Conceptual Issues - II

- Sample divided into Compliant and Non-Compliant firms
  - Compliant firms voluntarily complied with higher SOX requirements in pre-SOX years
    → over compliant in pre-SOX years
  - Non-Compliant firms complied with higher SOX requirements only in post-SOX years
    → just compliant in pre –SOX years

- Main finding: Stronger corporate governance in non-compliant firms with powerful CEOs led to better outcomes compared to that of compliant firms with powerful CEOs.

- Paper assumes one-to-one correspondence between voluntary over-compliance and better governance
  - Leap of faith -- Not sure why compliance or over-compliance necessarily means better governance and better outcomes.
  - Non-compliance/compliance defined with respect to SOX. What if "overcompliance" in pre-SOX years was in-optimal and that non-compliance to SOX standards in pre-SOX years was optimal?
  - More independent directors voluntarily chosen may not necessarily imply higher quality of governance if the directors are connected to the powerful CEO.
  - Need to demonstrate at least with summary stats whether compliant firms are on an average better governed than non-compliant firms. No data presented on board and audit committee characteristics to motivate issue.
  - Are better firms compliant or non-compliant?

Measurement Issues I

- Compare moderating effect of better CG on CEO Power measured in terms of corporate policies between compliant and non-compliant firms.
- Run separate regressions and examine the sign and significance of interaction term CEO Power x SOX.
- Difference in effect - Significant for non-compliant firms and not significant for compliant firms.
- No explicit consideration of CG variables; disciplining effect of SOX captured in reduced form in terms of dummy.

Measurement Issues II

- Result Consistent with scenario :
- Assumption Pre-SOX Compliant > Pre-SOX Non-Compliant
  - Non-compliant : pre-Sox outcome 10, post SOX outcome 13 – Better CG incentivises CEOs to take optimal decisions
  - Compliant: pre-Sox outcome 15, post SOX outcome 15 --- CEO Power already optimal
  - Conclusion : SOX has positive effect on poorly governed firms with powerful CEOs through better CG and no effect on well-governed firms.

- Alternative scenario: Pre-SOX Non-Compliant > Pre-SOX Compliant
  - Non-compliant : pre-Sox outcome 10, post SOX outcome 13 – Better CG incentivises Powerful CEOs further to take better decisions.
  - Compliant: pre-Sox outcome 5, post SOX outcome 5
  - Similar result but Conclusion Reversed: --- SOX has positive effect on better governed firms with powerful CEOS and no effect on poorly governed firms !!

- If differences in compliant and non-compliant groups are permanent, and the time effects on the two are different, why not try the Difference-in-Difference Estimation methodology?

A very interesting paper and hope to see it published.

THANK YOU