

To Steal or Not to Steal: Firm Attributes, Legal Environment, and Valuation

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ABSTRACT

Newly released data on corporate governance and disclosure practices reveal wide within-country variation, with the variation increasing as legal environment gets less investor friendly. This paper examines why firms practice high-quality governance when law does not require it; firm attributes that are related to the quality of governance; how the attributes interact with the legal environment; and the relation between firm valuation and corporate governance. A simple model, in which the controlling shareholder trades off private benefits of diversion against costs that vary across countries and time, identifies three relevant firm attributes: investment opportunities, needs for external financing, and ownership structure. Using firm-level corporate governance and transparency data on 859 firms in 27 countries, we find that firms with greater growth opportunities, greater needs for external financing, and more concentrated cash flow rights practice higher-quality governance and disclose more. Moreover, firms that score higher in governance and transparency rankings are valued higher in the stock market. Perhaps most important, all these relations are stronger in countries that are less investor friendly, demonstrating that firms do adapt to poor legal environments to establish efficient governance practices.

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