Does corporate governance predict firms' market values? Evidence from Korea.

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**Abstract**

We report strong OLS and instrumental variable evidence that an overall corporate governance index is an important and likely causal factor in
explaining the market value of Korean public companies. We construct a corporate governance index ($KCGI, 0 \times 100$) for 515 Korean companies based on a 2001 Korea Stock Exchange survey. In OLS, a worst-to-best change in $KCGI$ predicts a 0.47 increase in Tobin's $q$ (about a 160% increase in share price). This effect is statistically strong ($t = 6.12$) and robust to choice of market value variable (Tobin's $q$, market/book, and market/sales), specification of the governance index, and inclusion of extensive control variables. We rely on unique features of Korean legal rules to construct an instrument for $KCGI$. Good instruments are not available in other comparable studies. Two-stage and three-stage least squares coefficients are larger than OLS coefficients and are highly significant. Thus, this article offers evidence consistent with a causal relationship between an overall governance index and higher share prices in emerging markets. We also find that Korean firms with 50% outside directors have 0.13 higher Tobin's $q$ (roughly 40% higher share price), after controlling for the rest of $KCGI$. This effect, too, is likely causal. Thus, we report the first evidence consistent with greater board independence causally predicting higher share prices in emerging markets.

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