

Governance and the corporate life-cycle

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Abstract

Purpose – The purpose of this research is to examine whether corporate governance changes along the corporate life-cycle.

Design/methodology/approach – In a sample of 205 firms from 21 emerging market countries and using a life-cycle proxy from the dividends literature, we use a *governance-prediction* model which examines whether corporate governance differs along the corporate life-cycle.

Findings – Mature firms tend to practice better overall corporate governance. Discipline and independence improve as firms mature. Firms tend to be most transparent and accountable when they are young. These findings suggest that the resource/strategy and monitoring/control governance functions are relevant but at different life-cycle stages.

Research limitations/implications – In the absence of longitudinal governance data with sufficient coverage to track *within-firm* changes in corporate governance along the corporate life-cycle, we analyze differences in corporate governance *between-firms* at different life-cycle stages.

Originality/value – We use an alternative, yet new measure from the dividends literature to account for the firm's position along the corporate life-cycle. With this new measure, our findings are in line with the predictions of Filatotchev et al. (2006).

Keywords Corporate governance, corporate life-cycle, emerging markets.

Paper type Research paper.

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1. Introduction

In the last ten years or so, much attention has been devoted to the study of corporate governance. For example, a search of “empirical corporate governance” in SSRN returns 1,377 studies. This work has been made possible by the availability of corporate governance measures, which makes comparisons of governance quality between firms, in and across countries, possible (e.g., Credit Lyonnais Securities Asia (CLSA (2001)), Institutional Shareholder Services (ISS), and the modified Gompers et al. (2003) “G-Index” of Bebchuk et al. (2009) (i.e. the “E-Index”).¹

Two lines of inquiry which has attracted much attention are *governance-to-value* and *governance-prediction* studies. The former examines whether a *causal* relationship exists between corporate governance and firm value (e.g., Brown and Caylor, 2006; Gompers et al. 2003; Bebchuk et al. 2009, 2011; and Black et al. 2006a). The latter seeks to identify the firm- and country-level factors which shape corporate governance practices in firms (e.g., Klapper and Love, 2004; Durnev and Kim, 2005, Black et al. 2006; and Doidge et al. 2007). While these studies are unlikely to be completely free from concerns relating to endogeneity, they typically conclude that governance *causes* value, and a range of country- and firm-level factors determine corporate governance choice (see Black et al, 2012). The collective findings suggest that, among others, large, high growth firms, with a need for external finance are better-governed, but that firms that exhibit these characteristics may not practice better governance in countries where the benefits of adopting better-governance do not outweigh the costs of doing so (see Doidge et al. 2007).

Notwithstanding the voluminous nature of corporate governance research, one aspect that has been largely neglected in the literature is, whether and to what extent, governance evolves along the corporate life-cycle. In fact the scarcity of work in this specific area led Filatotchev et al. (2006, p.257 and 274) to assert that:

“Much attention has been focused on the largest mature companies listed on a stock market, concentrating on the static theorising of the principal-agent perspective. Less attention has therefore been paid to the change processes in governance and variations in the principal-agent relationship through the life-cycle of the firm from inception to maturity..., and that analysis of the post-IPO evolution of the firm’s governance system is a key research issue”

¹ Others that construct their own corporate governance indices include Black et al. (2006, 2006a, 2012), and Aggarwal et al. (2008). Aggarwal et al. (2008) use 44 of the 64 ISS (2005) governance attributes to compare the governance practices of U.S. and non-U.S. firms.

In defence of researchers, the dearth of work in this area is in large part due to the nature of the data on offer. Consider the type of data required to undertake such an exercise. The researcher requires a measure of the strength of corporate governance from corporate inception through to maturity and beyond.² There are a number of issues here. First, much of the governance data on offer is for publicly-traded firms only. A second issue relates to the duration of governance data for individual firms post-IPO. To the best of our knowledge, no governance measure exists which offers the scope to track corporate governance quality from the IPO stage (or earlier) through the growth stage to maturity, and beyond (i.e. stagnation and decline). For example, the G-Index covers four years, while the governance-index of Black et al. (2006a) dates from 1999 to 2005. The underlying issue here is that while these governance-indices are well-suited to the study of governance in calendar time (e.g. Di Nicolo et al, 2008), none are perfectly tailored to the study of corporate governance over the entire corporate life-cycle, since for many firms, the firm life-cycle is much longer than the coverage of most, if not all, governance indices (see Miller and Friesen, 1984).

With this in mind, we adopt what we believe to be a next-best approach. We use governance data for a sample of firms from emerging markets, and seek to identify differences in corporate governance practices for firms who, at a particular point in time (2001), are at different life-cycle stages.³ In this regard, our paper is materially different to others. Others examine the firm- and country-level factors which shape the governance practices of firms at a particular point in time.⁴ We examine whether these firms, whom are at different life-cycle stages, have different governance practices. Given the nature of our governance data, we do not, nor cannot, track *within-firm* changes in governance along the entire corporate life-cycle. Instead, our focus is on identifying differences in governance practices *between* firms. Filatotchev et al. (2006) outline a framework which hypothesizes that as firms progress along their life-cycle, so too does their corporate governance function, as various aspects of governance facilitates wealth creation and preservation at different life-cycle stages. The governance data we use is suited to test the predictions of Filatotchev et al. (2006), because it covers broad aspects of governance, for example, independence,

² Helwege et al. (2007) examine the evolution of one aspect of internal-governance, namely insider ownership from the IPO and beyond.

³ We do so since we do not have access to other governance data sources.

⁴ An exception is Braga-Alves and Morey (2012) who examine whether *changes* in firm and country-level characteristics lead *changes* in governance.

accountability, and transparency which are cornerstones of the conceptual framework which Filatotchev et al. (2006) develop. A governance index with a much narrower focus (e.g. the G-Index focuses almost exclusively in anti-takeover provisions) would make such an empirical exercise impossible.

To identify firms at different stages of their life-cycle, we use a measure from the dividend literature. DeAngelo et al. (2006) test the life-cycle model of dividends using the ratio of earned (retained) to total equity (or total assets) as a proxy for firm maturity. As firms mature, the contribution of earned equity to total equity (earned plus contributed equity) increases, since as firms mature, they become more profitable, have less growth opportunities, and generate greater cashflow from operations, which all results in an increase in earned equity, and a reduced reliance on contributed (external) equity. We examine how corporate governance changes, if at all, as the firm matures, using the DeAngelo et al. (2006) measure to account for the firm life-cycle.

Using a *governance-prediction* model, we show that governance quality *improves* as firms mature. Transparency, independence and accountability are all prominent at different, but not necessarily the same life-cycle stages. Our findings suggest that a policy which mandates a “one-size-fits-all” governance code will not fit with the needs of all firms in that country, and in some instances, will expose some firms to the costs of adhering to certain governance provisions whose adoption would not prove to be beneficial. Our findings do not necessarily suggest that “across the board” rules are not beneficial (Atanasov et al. (2010) say they can be). Our findings suggest that a more flexible approach which grants firms more discretion over their own governance choices, say for example, along the lines of “comply or explain” would seem to make more sense.

The paper proceeds as follows. The next section reviews the literature. Section 3 describes the data, section 4 the methodology, and section 5 discusses our findings. Section 6 concludes.

2. Related Literature

Our paper is positioned within a field of corporate governance commonly referred to as *governance-prediction* studies. These studies use firm-level governance rankings, performed either using a number of countries (e.g. Klapper and Love (2004)) or using individual country case-studies (e.g. Black et

al. (2006)) to determine the firm- and country-level factors which predict corporate governance practices in firms.

The firm-level variables typically include size, growth opportunities, external financing need, asset tangibility, and whether a firm is cross-listed abroad (in the U.S.). Some add research and development expenditures, and exports to this list. Doidge et al. (2007) also include the cash holdings of firms and the ownership structure of the firm. Black et al. (2006) use the richest set of firm-level attributes. They also use firm risk, leverage, profitability, market share, capital expenditures, and advertising. With some exceptions, these studies find that large, growing firms, with an external financing need, large cash positions, and who are riskier, are better-governed. Cross-listing firms are better-governed. Profitability and asset tangibility substitute for governance.

The country-level variables used capture aspects of financial and legal development. Country (rule of law and/or country shareholder rights) and corporate governance complement one another. Doidge et al. (2007) demonstrate that financial development matters for corporate governance, since poor financial development prevents firms from practicing better governance because the benefits from doing so (e.g. raising equity capital on liquid equity markets) do not outweigh the costs. Hugill and Siegel (2012) suggest that country-level factors do not dominate firm-level characteristics to the extent to which Doidge et al. (2007) say they do.

Individually and collectively, these studies enhance our understanding of what determines the governance practices of firms. However, one drawback is that their focus is narrow and static, and fails to examine how governance *changes* as firms *change*, or specifically, how governance *changes* as firms move *along* their life-cycle. They do include firm-level variables. However, different firm-level characteristics imply differing relationships between corporate governance and the firm life-cycle. For example, consider the effects of profitability and external financing need on the governance practices of firms. All else equal, governance quality increases (decreases) in a firms external finance need (profitability). However, when firms are “immature” they are typically unprofitable, with a large external finance need, which tends to reverse when firms mature. This then implies that, all else equal, firms practice better governance when they are “immature” and governance quality deteriorates as they mature. On the other hand, the free cash flow hypothesis of Jensen (1986, 1993) suggests that the agency costs of free cash flow are most severe

when firms are mature. Thus, one could argue then, that along the lines of Jensen (1986, 1993), governance quality should be the greatest when agency conflicts are most acute, that is, when firms are mature. Filatotchev et al. (2006) also allude to the greater need required of the monitoring role of governance as firms mature. Thus, we tend to agree with the assertion of Filatotchev et al. that an analysis of corporate governance across the life-cycle of the firm is an important avenue of research. It appears to us at least, that based on the existing empirical evidence, a question remains regarding the nature of the relationship between a firms governance practices and its life-cycle.

3. Data

We use the corporate governance scores developed by Credit Lyonnais Securities Asia (CLSA, 2001), which range from a low of 0 to a high of 100. Higher values suggest better governance. All ratings are calculated in 2001. The rating for each individual firm, for which there are 495 in total across 25 countries, is a composite measure of 57 qualitative, binary questions which span seven distinct governance categories, namely management discipline, transparency, independence, accountability, responsibility, fairness (all have a 15% weighting), and social awareness (10% weight). We use the first six governance provisions to construct the composite governance measure. Filatotchev et al. (2006) differentiate between the strategic/resource and monitoring/control functions of governance.⁵ Five (excluding transparency) of the six CLSA governance provisions relate to monitoring and control. Two provisions, namely independence and accountability, likely capture both the resource/strategy and monitoring/control functions, since both measures account for different characteristics of the board of directors.

We use a measure from the dividend literature to proxy for a firm's position along their corporate life-cycle (or firm maturity), namely the ratio of earned equity (retained earnings) to total assets (see DeAngelo et al., 2006; Brockman and Unlu, 2011). Mature (Immature) firms are characterized with high (low, mostly negative) ratios of earned equity to total assets and earned equity to total equity. Since we use public firms alone, our analysis is restricted to how governance changes between quadrants 2

⁵ Of course, resource and strategy are not the same. However, we group them together here as they should be prominent at the same life-cycle stages (see Filatotchev et al. (2006)).

(post-IPO young firms) and quadrant 3 (mature firms) of the Filatotchev et al. (2006) framework.⁶ The retained earnings (to total assets) and other unreported variables, namely dividend payout, profitability, external financing dependence, and free cash flow all suggest that there are firms in our sample in both quadrants 2 and 3. For example, consider Table 3 which divides our sample of firms into quartiles. Quartile 1 firms have negative RE/TA (reported), pay no dividend, have a large external financing need and are unprofitable (all unreported). As we proceed from quartile 2 to quartile 4, firms mature (i.e. RE/TA increases). They initiate and continue to pay larger dividends, have positive free cash flow, no longer rely as much on external finance, and are profitable (all unreported). Finally, the RE/TE (and RE/TA) measure is consistent with the resource-based view of the firm, which is interrelated to the firms governance function, and is also consistent with the notion of the firm's financial life-cycle (see Filatotchev et al. (2006)).

We control for a number of determinants of corporate governance, commonly employed in other studies (see literature review for references). The firm-level controls are firm size, growth, profitability, cash holdings, dependence on external finance, and a cross-listing (in the U.S. (in 2001)) dummy variable. All information on U.S. cross-listings is sourced from the Bank of New York-Mellon (www.adrbnymellon.com), and cross-referenced with data from Citibank (wwss.citissb.com/adr). We group all 66 cross-listing firms together, rather than differentiate by listing type. All firm-level variables are sourced from Worldscope and a description of each is provided in Appendix 1. Based on the existing evidence, size is expected to be positively related to governance. Growing firms with a dependence on external finance invest in governance. In contrast, self-financing, profitable firms have little need to follow suit. Recent evidence suggests that poorly-governed firms hold more cash than well-governed firms (see Ammann et al., 2011). Cross-listing firms are expected to be better-governed than non-cross-listing firms, although it is not clear whether better governance is a prerequisite to, or a consequence of cross-listing. The difference in governance quality between firms may be evident prior to cross-listing (see Wojcik et al., 2005), but for firms cross-listing in the U.S. as Level 2 or Level 3 exchange-traded ADRs, the bonding hypothesis suggests that their governance is likely to improve once they cross-list (see Stulz, 1999; Coffee, 1999, 2002).

⁶ In quadrants 1 and 4, firms are privately-held.

We use four country-level determinants of corporate governance, namely stock market development; (country) shareholder rights, culture and economic development (see Appendix 1 for a full description of each variable). Country and corporate governance tend to complement each other (see Klapper and Love, 2004), while firms reap larger benefits from improved governance where stock markets and the economy is highly developed (see Doidge et al, 2007; Aggarwal et al. 2009). Griffin et al. (2013) find that culture is positively related to corporate governance.

Our final sample of 205 publicly-traded firms is outlined in Table 1. Taiwan (31) provides the most firms. Argentina, Hungary, Peru, and Poland provide a single firm each. The median (MED) and standard deviation (SD) retained earnings (to total assets) suggest that firms are most mature (and at much later stages of their life-cycle) in Mexico and Malaysia, and least so in Brazil.⁷ The greatest variation in firm maturity tends to occur in Hong Kong. Governance quality is highest in Mexico, but less so in Pakistan. Hong Kong (13) and Taiwan (12) provide the largest number of cross-listing firms. Stock markets tend to be developed in Hong Kong, but less so in Pakistan. Shareholder rights are strong in, among others, Brazil and Chile, and weak in China. Individualism prevails in Hungary, collectivism in Colombia. Hong Kong and Singapore are the most developed economies in our sample.

Table 2 outlines the country sample median and standard deviation for each individual corporate governance component. Firms tend to be most transparent (TPY) in Chile, and opaque in Pakistan. Discipline (DIS) is high in Turkey, but not so in Poland. The median firm in Singapore scores highly across all aspects of governance. In contrast, the median firm in Pakistan scores poorly across all six governance components. In some countries, the median firm scores highly in some governance measures, but not so in others (e.g. Hong Kong).

4. Methodology

In this section, we explore the relationship between firm maturity (life-cycle) and corporate governance practices. Consider Table 3. Here we divide our sample of firms into four quartiles based on RE/TA. From lowest to highest quartile, the average (median) ratio of retained earnings (to total assets) changes from -0.157 (0.003) to 0.466 (0.432) (see top panel of Table 3). For the average and median firm,

⁷ To conserve space, we do not report the summary retained earnings to total equity statistics.

corporate governance improves with RE/TA (see middle and bottom panels of Table 3). For the median firm, corporate governance improves from 51.68 in quartile 1 to 61.95 in quartile 4. The improvement in governance over the life-cycle results from improvements in discipline, independence, responsibility, and fairness. Transparency is highest at either ends of the firm-maturity spectrum, while firms are most accountable when they are immature (Quartile 1).

In Tables 4 and 5, we examine whether these same relationships hold once we control for firm, industry, and country-level determinants of corporate governance. To do so, we estimate a series of ordinary and weighted least squares regressions, which regress corporate governance on our corporate life-cycle measure, and a full set of firm, industry (based on four-digit SIC codes) and country-level controls. All regressions are estimated with heteroscedastic-consistent robust standard errors. In the bottom panels of Tables 4 and 5, we estimate a series of weighted least squares regressions to alleviate concerns that our findings are driven by differences in the number of firms across countries. In the weighted least squares regressions, the weight of each observation (firm) is the inverse of the number of observations in each country, so that each country receives an equal weighting.

Our governance prediction model is unlikely to be completely free from endogeneity concerns. First, there is the issue of omitted-variable bias. The issue here is that corporate governance is likely to be correlated with a number of firm/country-level variables, which in turn are likely to be correlated with each other. If we exclude a (relevant) variable, which is correlated with both firm life-cycle (RE/TA) and corporate governance, then we may incorrectly infer that the firm life-cycle and governance are related, where in fact, they are only related through their common relationship with the omitted variable. To try and alleviate some of this concern, we include a rich set of control variables. Given the nature of the corporate governance data that we use, and even with the inclusion of a number of (observable) control variables, we are, nevertheless, unable to control for unobserved heterogeneity. Second, and also of concern is the notion of reverse causality. Rather than firm maturity predicting governance, governance may in fact predict firm-maturity. For example, if we allude to the corporate life-cycle stages of Miller and Friesen (1984) (the stages are birth, growth, maturity, revival, and decline phases), better-governance may facilitate the transition from the birth to the growth stage since better governance helps to reduce the cost

of capital. Since we lack a suitable instrument for corporate governance and use cross-sectional governance data, we cannot address these concerns in this paper.

5. Results and discussion

Consider Table 4. The coefficient estimates suggest that mature firms practice better corporate governance. In all six regressions the coefficient estimates on the firm life-cycle variable is positive, and is statistically significant in five of the six cases. The last column of Table 4 calculates the effect that a two standard deviation change in each independent variable has on corporate governance (see column labelled Ec. Sig). Economic significance is calculated based on the average absolute coefficient estimate for each variable. For firm maturity (life-cycle), the change in governance is 3.08, which implies a 5.52% change in governance practices for the median firm (i.e., $3.08/55.82 \times 100$).⁸ These findings are at odds with Black et al. (2006) who find that the governance practices of Korean firms are unaffected by the number of years listed on the stock exchange.

In contrast to both Klapper and Love (2004) and Black et al. (2006), we find that smaller firms are better-governed. Interestingly, neither profitability nor growth is significantly related to corporate governance. With one exception, both are of the correct sign, but remain statistically insignificant. Better-governed firms hold more cash than their not so well-governed counterparts. As expected, dependence on external finance is positively related to corporate governance, although it is only statistically significant in one of three regressions. External financing need is also statistically insignificant in the regressions of Durnev and Kim (2005) and Black et al. (2006). Cross-listing firms are better governed than non-cross-listing firms, on average by 6.07, which represents a governance premium of 11.05% over the median non-cross-listed firm (i.e. $(6.07/54.93) \times 100$). Where all four country-level variables are included simultaneously, only culture and economic development are statistically significant. The positive coefficient estimate on culture confirms the findings of Griffin et al. (2013). Governance is not necessarily better in more individualistic countries. Rather, the positive coefficient suggests that governance ratings do a better job at capturing the governance attributes of firms in countries with a culture of individualism. Finally, the weighted least squares regressions confirm our earlier predictions

⁸ Our findings are qualitatively the same we use RE/TE and dividend payout (dividends to total assets) in place of RE/TA. This analysis is available from the corresponding author upon request.

that mature firms practice better governance. Filatotchev et al. (2006) show that as firms mature from quadrant 2 to 3, the resource/strategy role of governance becomes less relevant, while the monitoring/control function becomes more important. Our findings suggest that the declining relevance of resource/strategy function is more than offset by the prominence of monitoring/control as firms mature, resulting in higher overall governance. In the next section, we examine this issue in much greater detail (see Tables 5 and 6).

Table 5 presents a series of weighted least squares regressions. The dependent variable is one of the six individual corporate governance provisions described previously. Since growth and profitability are unrelated to governance, we exclude them from Table 5. We present estimates with and without country fixed-effects. The coefficient estimates suggest that discipline, independence, responsibility, and fairness are positively and statistically related to the corporate life-cycle. These findings are all consistent with Filatotchev et al. (2006). Unexpectedly, the coefficient estimates on the transparency and accountability measures are statistically significant. From an economic significance viewpoint, changes in discipline (20.71) matter the most, followed by fairness (10.35) and independence (9.86). Interestingly, the control variables affect the individual governance provisions differently. For example, firms with a need for external finance score highly in terms of discipline and transparency. Cross-listing firms score higher than their non-cross-listing counterparts in terms of discipline, transparency, responsibility and fairness.

In Table 6 we examine how corporate governance and its individual components change *along* the corporate life-cycle, but now using the same life-cycle (retained earnings) quartiles created in Table 2. This analysis potentially provides a much richer picture of how corporate governance evolves along the corporate life-cycle, since it does not impose the same linear constraint as in Tables 4 and 5. It also facilitates a more direct comparison with Filatotchev et al. (2006).

In all regressions, the reference group is Quartile 1 (from Table 3). The coefficient estimates reveal the following. First, the improvement in governance that we observe in Table 4 only comes about for the most mature firms (Q4 firms). For Q4 firms, the coefficient is positive (2.016) and statistically significant. On inspection of the components of governance, it is evident that this improvement in overall governance comes about through improvements in corporate discipline and independence, both of which capture aspects of monitoring and control. In both instances, governance is at its highest for Q4 firms.

For example, in the case of discipline, the coefficient estimate for Q4 firms is 8.850. Given that average discipline for Q1 firms is 43.39, this implies that discipline is 20.40% i.e. $(8.850/43.39) * 100$, higher for Q4 when compared to Q1 firms. Using independence, the coefficient estimate for Q4 firms is 10.566. This implies that independence is 19.19% i.e. $(10.566/55.05) * 100$ higher for Q4 than for Q1 firms. We find that firms tend to be most transparent and accountable at early stages of their (public) life-cycle i.e. Q1 firms, and both transparency and accountability deteriorates as firms mature. The coefficient estimates suggest that Q1 firms are more transparent and independent when compared to Q4 firms in the region of 19.20% (i.e. $(11.808/61.488) * 100$) and 21.14% (i.e. $(10.469/49.528) * 100$), respectively.

To put our findings in perspective, we need to elaborate on the predictions of Filatotchev et al. (2006). They differentiate between the resource/strategy and monitoring/control functions of governance. In our paper, five of our six individual CLSA governance provisions (All except transparency) likely capture aspects of monitoring/control, while accountability and independence likely capture both the resource/strategy and monitoring/control functions. Since, we only observe publicly-traded firms (i.e. quadrants 2 and 3), then, a priori, and according to Filatotchev et al. (2006), we should observe lower transparency, greater monitoring (all individual governance components excluding transparency), and a reduced role for the resource/strategy aspect of governance as firms evolve from quadrants 2 to 3. Since accountability and independence likely capture both the resource/strategy and monitoring/control functions, how they change as the firm evolves is ambiguous.

Our findings are in line with Filatotchev et al. (2006). First, they suggest that as firms mature the monitoring role of governance increases as enhanced monitoring “widens the firm’s access to the financial resource base as it matures and exploits strategic opportunities” (see Filatotchev et al. (2006, pg. 260)). Discipline, independence, and fairness all improve along the life-cycle, which are important aspects of the monitoring/control functions of governance. Second, we also observe the deterioration in corporate transparency that Filatotchev et al. (2006) predict will occur from quadrants 2 to 3. Reduced transparency manifests as “managerial rent-seeking opportunities increase, rendering the governance system less transparent” (see Filatotchev et al. (2006, pg. 260)). Third, corporate independence (of the board) increases as the firm matures, which is in line with the predictions of Filatotchev et al. (2006). Since board independence captures aspects of both resource/strategy and monitoring/control, our

finding that boards become more independent as firms mature suggest that the reduced resource/strategic role played by the board of directors is more than offset by the greater monitoring that they now provide. Finally, we observe that accountability deteriorates as the firm matures. Since, like the independence measure, accountability captures both aspects of resource/strategy and monitoring/control, what we are most-likely capturing here is the decreased importance in the resource/strategy role of governance. In summary, our findings do appear to highlight that the monitoring, and to a lesser extent, the resource/strategy functions of governance change as the firm evolves along its life-cycle. The net result is that overall governance is greatest for mature firms.

Our findings contribute to the debate on how governance rules should be implemented. In some instances, governance standards are implemented across the board, and thus assume that these rules suit and benefit all firms equally. Examples include the Sarbanes-Oxley Act in the U.S., the listing rules on the New York Stock Exchange, and the OECD principles on corporate governance. While there is evidence which says that the implementation of “across the board” rules can work (see Atanasov et al., 2010)), there also exists some evidence that suggests that they may not. For example, “across the board” stock exchange listing requirements do not equally-benefit all firms. Specifically, the fact that many firms cross-delisted from the U.S. post Sarbanes-Oxley (see Marosi and Massoud, 2008), and that many cross-listing firms, particularly from emerging markets, choose to list in the U.S., but not on the New York Stock Exchange (see Boubakri et al., 2010), suggests that the costs of adhering to these additional legal rules may prove not to be beneficial for all. Furthermore, as illustrated by Hope et al. (2013), many firms that choose to cross-list in the U.S. as Level 1 and Rule 144a issues, voluntarily disclose more after they cross-list. This line of reasoning points to a more flexible approach to governance adoption. Other examples include “comply-or-explain” as adopted in Australia and the U.K. for example, or permitting firms to list on different segments of the stock exchange, which is common place in Brazil (see Braga-Alves and Shastri (2011)). Our findings suggest that a policy which mandates a “one-size-fits-all” governance code for all firms in a country will not fit with the needs of all firms in that country. While the adoption of “across the board” rules have proven to be beneficial in some countries, a more flexible approach which grants firms more discretion over their own governance choices, say for example, along the lines of

“comply or explain” would seem to make more sense, a policy prescription which has important implications for the regulatory function in a country.

6. Conclusion

Much of the discussion in the corporate governance literature in recent years concerns the debate about whether a “one-size-fits-all” approach is appropriate or whether governance practices, which are dictated by a number of firm and country factors, and their interaction, should be tailored to the specific needs of individual firms. While the debate is ongoing, Black et al. (2012) present some compelling evidence in support of the latter, and in doing so, propose a flexible governance model, which permits each firm to choose what they believe to their own “optimal” level of governance.

One of the reasons that firms are likely to have very different governance needs at any one point in time is because these firms are likely to be at very different stages in their life-cycle. In turn, firms at different stages of their life-cycle are likely to have very different governance needs, since the wealth creation and protection functions of corporate governance change as the firm matures (see Filatotchev et al. (2006)).

In this paper we explore the relationship between corporate governance practices and the corporate life-cycle. Since we are restricted to the use of cross-sectional governance measures, our focus is on identifying differences in corporate governance quality *between* firms who are at different stages of their life-cycle. We proxy for a firm’s position along their life-cycle using the life-cycle proxy proposed by DeAngelo et al. (2006), and show that, in line with the conceptual framework of Filatotchev et al. (2006), governance does indeed change along the corporate life-cycle. We show that individual governance provisions (e.g. independence, accountability, transparency) are more relevant at different stages of the corporate life-cycle, but not necessarily the same stage. Since we show that overall governance, and more importantly the relevance of individual governance provisions vary along the corporate life-cycle, our results point to a flexible governance model which ensures that firms have sufficient freedom to adopt what they believe is the correct governance model for them. Previous literature finds that young, fast-growing firms are likely to establish good corporate governance practices in order to attract external finance, increase profitability, and therefore create value for the firm. Our findings suggest that since

governance quality is greatest when firms are mature, greater resources are devoted to value preservation rather than value creation.

Finally, given the nature of the governance data that we use, we are cognisant of the fact that the paper has limitations. These limitations are discussed in the introduction and elsewhere, and as such we do not deem it necessary to discuss them in great detail here again. While we cannot address the limitations in this paper, they do, nonetheless, provide a number of important insights and avenues for future research. It would be interesting to extend the sample coverage to a larger number of emerging and even developed market firms. We believe that it is important to extend the sample to include developed market firms since what we do know from the extant literature is that optimal governance is likely to be different between developed and emerging market firms (see Bebchuk and Hamdani, 2009). To address some of the endogeneity issues, researchers should consider using governance data with a time-series dimension.

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Table 1
Sample Description

Country	# Firms	Firm Life-Cycle (RE/TA)		Corporate Governance		CL	Country-Level Variables			
	Firms	MED	SD	MED	SD	# CL	MCAP	SR	CULT	EC DEV
Argentina	1	0.06	-	66.67	-	1	0.672	3	46	7,203
Brazil	3	0.00	0.05	60.48	12.30	1	0.410	5	38	3,130
Chile	7	0.11	0.13	62.40	4.18	3	0.890	5	23	4,636
China	11	0.06	0.07	48.17	11.56	4	0.473	1	20	1,042
Colombia	1	0.03	-	53.18	-	0	0.140	4	13	2,429
Hong Kong	25	0.19	0.81	59.77	14.39	13	3.500	4	25	25,230
Hungary	1	0.01	-	48.45	-	0	0.218	2	80	5,175
India	13	0.10	0.14	53.43	10.42	3	0.272	4	48	460
Indonesia	12	0.23	0.23	36.33	13.59	1	0.153	4	14	742
Korea	13	0.01	0.15	39.68	5.85	3	0.423	4	18	10,655
Malaysia	22	0.31	0.14	60.32	12.82	3	1.354	4	26	3,872
Mexico	4	0.42	0.28	66.99	3.97	2	0.205	2	30	6,139
Pakistan	4	0.02	0.02	33.58	20.25	0	0.081	5	14	490
Peru	1	0.41	-	76.48	-	0	0.192	4	16	2,056
Philippines	12	0.12	0.46	40.58	12.22	5	0.513	4	32	966
Poland	1	0.14	-	37.73	-	0	0.155	2	60	4,979
Singapore	18	0.14	0.30	67.42	6.74	5	1.608	4	20	22,027
South Africa	16	0.15	0.27	64.27	16.09	7	1.259	5	65	2,638
Taiwan	31	0.09	0.19	54.93	9.08	12	0.978	5	17	13,108
Thailand	6	0.18	0.17	54.64	15.34	2	0.286	4	20	1,808
Turkey	3	0.16	0.09	50.65	5.13	1	0.409	4	37	3,037
	205	0.15	0.36	55.82	14.70	66				

This table describes the sample by country. We report the median (MED) and standard deviation (SD) of firm life-cycle and corporate governance, respectively. Firm life-cycle is measured using the ratio of earned equity (retained earnings) to total assets (RE/TA). # CL is the number of firms cross-listed in the U.S. All information on cross-listed firms is sourced from the Bank of New York Mellon and Citibank. In the remaining columns, we report the country-level variables.

Table 2
Corporate Governance Provisions

Country	# Firms	Discipline (DIS)		Transparency (TPY)		Independence (IND)		Accountability (ACC)		Responsibility (RES)		Fairness (FAIR)	
		MED	SD	MED	SD	MED	SD	MED	SD	MED	SD	MED	SD
Argentina	1	66.70	-	70.00	-	78.60	-	62.50	-	50.00	-	72.20	-
Brazil	3	55.60	23.16	80.00	15.28	42.90	18.88	75.00	19.09	83.30	28.87	33.30	5.55
Chile	7	55.60	5.99	90.00	19.52	64.30	15.67	37.50	6.10	83.30	8.10	83.30	7.68
China	11	33.30	16.48	60.00	12.93	64.30	22.78	12.50	19.73	50.00	13.11	83.30	26.80
Colombia	1	55.60	-	50.00	-	35.70	-	50.00	-	50.00	-	77.80	-
Hong Kong	25	44.40	24.25	70.00	16.10	42.90	28.75	50.00	25.26	83.30	18.18	83.30	17.67
Hungary	1	22.20	-	60.00	-	57.10	-	12.50	-	66.70	-	72.20	-
India	13	66.70	16.90	50.00	14.81	64.30	29.41	50.00	18.40	50.00	16.13	83.30	24.37
Indonesia	12	33.30	18.02	60.00	13.79	14.30	19.83	18.75	8.36	33.30	19.41	66.70	32.95
Korea	13	33.30	9.99	50.00	7.51	35.70	13.87	62.50	17.22	33.30	10.67	33.30	23.30
Malaysia	22	55.60	18.86	65.00	17.66	78.60	21.63	31.25	19.88	50.00	14.23	80.55	22.05
Mexico	4	72.25	10.63	80.00	18.26	67.85	18.80	56.25	11.97	58.35	9.64	77.75	26.59
Pakistan	4	27.75	26.47	31.65	19.66	50.00	26.76	36.10	26.61	27.75	26.47	22.25	8.31
Peru	1	77.80	-	90.00	-	78.60	-	62.50	-	66.70	-	83.30	-
Philippines	12	33.30	17.41	45.00	12.67	53.60	26.26	25.00	13.55	33.30	16.66	33.30	27.84
Poland	1	11.10	-	20.00	-	78.60	78.60	100.0	-	16.70	-	0.00	-
Singapore	18	66.70	19.50	70.00	14.47	85.70	11.75	50.00	17.68	66.70	13.86	88.90	16.46
Sth Africa	16	55.60	13.76	50.00	18.97	71.40	25.59	75.00	23.48	66.70	21.08	80.55	23.20
Taiwan	31	55.60	17.75	50.00	25.00	85.70	11.75	50.00	25.16	50.00	19.71	50.00	26.11
Thailand	6	27.75	13.44	60.00	13.29	60.75	28.51	62.50	14.61	50.00	23.56	72.20	30.96
Turkey	3	77.80	29.42	40.00	20.82	71.40	24.71	62.50	14.43	66.70	9.64	22.20	5.55
	205	44.40	20.75	60.00	19.53	71.40	27.04	50.00	23.58	50.00	21.32	77.80	27.44

This table reports the country sample median (MED) and standard deviation (SD) of discipline, transparency, independence, accountability, responsibility, and fairness, respectively. Corporate governance data is from CLSA (2001).

Table 3

Life-Cycle Quartiles, Corporate Governance & Firm Characteristics

	Life-Cycle (RE/TA) Quartiles				
	Quartile 1 (Lowest)	Quartile 2	Quartile 3	Quartile 4 (Highest)	High - Low
# Firms	53	50	51	51	
Average RE/TA	(0.157)	0.080	0.211	0.466	0.623***
Median RE/TA	(0.003)	0.082	0.204	0.432	0.435***
Std. Deviation RE/TA	0.052	0.031	0.047	0.144	0.092***
	Life-Cycle Quartiles & Corporate Governance				
	Quartile 1 (Lowest)	Quartile 2	Quartile 3	Quartile 4 (Highest)	High - Low
Average Governance	51.71	55.00	54.14	59.25	7.54***
Median Governance	51.68	52.05	55.42	61.95	10.27***
Std. Dev. Governance	16.56	13.74	12.45	14.82	(1.74)
	Life-Cycle Quartiles & (Average) Individual Corporate Governance Provisions				
	Quartile 1 (Lowest)	Quartile 2	Quartile 3	Quartile 4 (Highest)	High - Low
Discipline	43.39	49.55	50.54	53.82	10.43***
Transparency	61.49	55.47	51.57	62.16	0.67
Independence	55.05	60.53	61.49	62.89	7.84***
Accountability	49.53	46.94	40.20	42.89	(6.64)***
Responsibility	47.48	50.11	53.92	61.44	13.96***
Fairness	53.03	67.44	67.10	72.32	19.29***

This table displays summary statistics by (RE/TA) quartile. The top panel displays the average, median, and standard deviation ratio of retained earnings to total assets, by quartile. The second panel displays the average, median, and standard deviation of corporate governance by ratio of earned equity (retained earnings) to total assets quartile. The third panel displays the average discipline, transparency, independence, accountability, responsibility, and fairness, also by ratio of retained earnings to total assets quartile. Corporate governance is from CLSA (2001). *** denotes significance at the 1% level.

Table 4
Corporate Governance and the Corporate Life-Cycle

	Dependent Variable is Corporate Governance						Ec. Sig
	Ordinary Least Squares						
	(1)	(2)	(3)	(4)	(5)	(6)	
Life-Cycle	4.259* (1.88)	2.971 (1.36)	4.630** (2.31)	3.724* (1.88)	4.785** (2.35)	5.686*** (2.97)	3.08
Size	-2.617*** (3.20)	-3.818*** (4.63)	-2.464*** (3.07)	-3.594*** (4.54)	-4.558*** (5.59)	-4.242*** (5.35)	10.53
Growth	7.926 (1.36)	6.352 (1.08)			7.001 (1.22)		2.40
Profitability	-4.514 (0.49)	3.673 (0.45)			5.113 (0.65)		1.01
Cash	12.424* (1.77)	2.278 (0.32)	17.763*** (2.31)	5.597 (0.70)	-0.594 (0.09)	3.345 (0.43)	1.88
Dependence on External Finance			0.547** (2.20)	0.181 (0.81)		0.197 (0.89)	3.22
U.S. Cross-Listing	6.814*** (2.81)	5.350*** (2.62)	6.258*** (2.64)	4.947** (2.40)	6.807*** (3.14)	6.251*** (2.81)	6.07
Stock Market Capitalization to GDP					-0.496 (0.31)	-0.472 (0.29)	0.97
Shareholder Rights					-1.459 (1.21)	-1.242 (1.04)	2.56
Culture					0.342*** (4.03)	0.337*** (3.94)	9.89
Economic Development					6.443*** (4.95)	6.027*** (4.58)	16.46
Industry Dummies	Included	Included	Included	Included	Included	Included	
Country Dummies	Excluded	Included	Excluded	Included	Excluded	Excluded	
# Firms	205	205	205	205	205	205	
R-Squared	0.218	0.546	0.242	0.544	0.412	0.408	
	Weighted Least Squares						
	(1)	(2)	(3)	(4)	(5)	(6)	Ec. Sig
Life-Cycle	7.504** (2.04)	3.391 (1.48)	8.033*** (2.59)	4.242** (2.14)	7.665** (2.44)	9.606*** (3.18)	4.79
Controls	Included	Included	Included	Included	Included	Included	
Industry Dummies	Included	Included	Included	Included	Included	Included	
Country Dummies	Excluded	Included	Excluded	Included	Excluded	Excluded	
# Firms	205	205	205	205	205	205	
R-Squared	0.306	0.659	0.351	0.669	0.421	0.426	

This table reports coefficient estimates from ordinary and weighted least squares regressions with heteroscedastic consistent t-stats (absolute value) presented underneath in parenthesis. The sample period is for the year 2001. The dependent variable is corporate governance. All other variables are defined in appendix 1. An intercept, and a full set of industry and country dummies are included (where indicated) but not reported. Ec. Sig refers to the change in corporate governance resulting from a two standard deviation change in each independent variable, holding all else equal. The economic significance is calculated based on the average absolute coefficient estimate of each variable. Bold refers to variables which are statistically significant in at least one of the six regressions. ***, **, and * denotes significance at the 1, 5, and 10% level, respectively.

Table 5
Individual Corporate Governance Provisions and the Corporate Life-Cycle

	Dependent Variable is					
	DIS	TPY	IND	ACC	RES	FAIR
Life-Cycle	20.707*** (3.75)	1.301 (0.31)	13.894** (1.98)	1.544 (0.24)	5.903 (1.58)	14.583** (1.98)
Size	-4.224* (1.98)	-3.759** (2.30)	-6.296*** (3.90)	-1.263 (0.61)	-4.372*** (3.13)	-4.092* (1.78)
Cash	-6.059 (0.35)	-2.698 (0.20)	16.355 (0.92)	6.677 (0.41)	14.921 (1.04)	10.147 (0.59)
Dependence on External Finance	1.021** (2.58)	0.664** (2.32)	0.620 (1.26)	0.247 (0.62)	0.501 (1.31)	0.482 (1.36)
U.S. Cross-Listing	11.003* (1.81)	12.027** (2.35)	4.281 (0.91)	2.207 (0.38)	8.788** (2.08)	16.411** (2.26)
Stock Market Capitalization to GDP	1.950 (0.58)	-3.354 (1.11)	-3.056 (0.92)	-10.219*** (2.71)	0.885 (0.33)	9.951** (2.51)
Shareholder Rights	3.304 (1.35)	-0.171 (0.07)	-1.877 (0.94)	1.341 (0.51)	2.463 (1.31)	-3.499 (1.17)
Culture	-0.060 (0.35)	-0.172 (1.15)	0.327*** (2.66)	0.461** (1.97)	0.127 (0.90)	-0.145 (0.63)
Economic Development	1.884 (0.72)	5.756*** (2.65)	9.127*** (4.10)	7.735*** (2.77)	5.132*** (2.62)	-0.107 (0.03)
Ec. Sig. (Life-Cycle)	20.71	0.92	9.86	1.10	4.19	10.35
Industry Dummies	Included	Included	Included	Included	Included	Included
Country Dummies	Excluded	Excluded	Excluded	Excluded	Excluded	Excluded
# Firms	205	205	205	205	205	205
R-Squared	0.269	0.355	0.368	0.323	0.387	0.397
	Dependent Variable is					
	DIS	TPY	IND	ACC	RES	FAIR
Life-Cycle	13.001*** (3.21)	-6.323 (1.00)	3.872 (0.67)	-2.606 (0.34)	7.143** (2.05)	10.601 (1.62)
Size	-2.403 (1.46)	-2.957** (2.24)	-4.622*** (2.73)	-1.862 (1.21)	-4.183*** (3.21)	-2.694 (1.33)
Cash	-0.686 (0.06)	8.447 (0.69)	23.301 (1.28)	13.845 (1.01)	19.930 (1.46)	26.062 (1.62)
Dependence on External Finance	0.553* (1.72)	0.686** (2.54)	0.403 (0.87)	0.802** (2.08)	0.309 (0.72)	0.360 (1.14)
U.S. Cross-Listing	2.016 (0.51)	5.304 (1.61)	0.897 (0.18)	3.294 (1.09)	4.364 (1.38)	7.985** (1.99)
Ec. Sig. (Life-Cycle)	9.23	(4.49)	2.75	(1.85)	5.07	7.53
Industry Dummies	Included	Included	Included	Included	Included	Included
Country Dummies	Included	Included	Included	Included	Included	Included
# Firms	205	205	205	205	205	205
R-Squared	0.643	0.648	0.552	0.691	0.619	0.663

This table reports coefficient estimates from weighted least squares regressions with heteroscedastic consistent t-stats presented underneath in parenthesis. In the weighted least squares regressions, the weight of each observation (firm) is the inverse of the number of observations (firms) in each country. The sample period is for the year 2001. The dependent variable is discipline (DIS), transparency (TPY), independence (IND), accountability (ACC), responsibility (RES), and fairness (FAIR), as indicated. Corporate governance measures are from CLSA (2001). All other variables are defined in appendix 1. An intercept, and a full set of industry and country dummies are included (where indicated) but not reported. Ec. Sig refers to the change in corporate governance resulting from a two standard deviation change in retained earnings, holding all else equal. The economic significance is calculated based on the average absolute coefficient estimate of retained earnings. Bold refers to variables which are statistically significant in at least one of the six regressions. ***, **, and * denotes significance at the 1, 5, and 10% level, respectively.

Table 6
Individual Corporate Governance Provisions and the Corporate Life-Cycle

	Corporate Governance	Dependent Variable is					
		DIS	TPY	IND	ACC	RES	FAIR
Life-Cycle Q2	0.448 (0.14)	-0.231 (0.04)	-6.700* (1.85)	6.956 (1.23)	-8.102* (1.91)	-3.389 (0.64)	14.364*** (3.04)
Life-Cycle Q3	0.770 (0.29)	7.993 (1.32)	-14.102*** (3.42)	4.964 (0.93)	-9.733** (2.39)	5.640 (1.24)	10.036* (1.87)
Life-Cycle Q4	2.016* (1.69)	8.850* (1.65)	-11.808*** (2.64)	10.566* (1.85)	-10.469** (2.57)	4.453 (0.95)	10.519 (1.57)
Size	-3.069*** (3.45)	-2.328 (1.51)	-2.100* (1.70)	-5.133*** (3.03)	-1.003 (0.62)	-3.966*** (3.07)	-3.837* (1.95)
Cash	16.021* (1.79)	-0.722 (0.06)	15.037 (1.18)	17.668 (0.95)	20.884 (1.52)	20.094 (1.47)	22.837 (1.44)
Dep. on Ext. Finance	0.525* (1.72)	0.547 (1.53)	0.841*** (2.73)	0.342 (0.74)	0.939** (2.39)	0.324 (0.71)	0.148 (0.45)
U.S. Cross-Listing	3.921* (1.84)	1.226 (0.32)	5.977* (1.94)	0.616 (0.12)	3.632 (1.22)	3.556 (1.19)	8.556** (2.25)
Industry Dummies	Included	Included	Included	Included	Included	Included	Included
Country Dummies	Included	Included	Included	Included	Included	Included	Included
# Firms	205	205	205	205	205	205	205
R-Squared	0.666	0.643	0.679	0.564	0.707	0.628	0.677

This table reports coefficient estimates from weighted least squares regressions with heteroscedastic consistent t-stats presented underneath in parenthesis. In the weighted least squares regressions, the weight of each observation (firm) is the inverse of the number of observations (firms) in each country. The sample period is for the year 2001. The dependent variable is corporate governance, or either of its components, as indicated. The reference group is Retained Earnings 1 (Quartile 1, the lowest quartile). All firm-level data is sourced from Worldscope. Corporate governance measures are from CLSA (2001). All other variables are defined in appendix 1. ***, **, and * denotes significance at the 1, 5, and 10% level, respectively. An intercept, and a full set of industry and country dummies are included (where indicated) but not reported.

Appendix 1
Variable Descriptions

Variable	Description	Source
Corporate Governance	Equally-weighted composite measure of six distinct governance categories, namely management discipline, transparency, independence, accountability, responsibility, and fairness.	All CLSA (2001)
Discipline (DIS)	Reflects public commitment to CG and financial discipline.	
Transparency (TPY)	Reflects the ability of outsiders to assess the true position of a company.	
Independence (IND)	Reflects whether the board is independent of controlling shareholders and is separate from senior management.	
Accountability (ACC)	Designed to capture the proper accountability of management to the board.	
Responsibility (RES)	Record of taking measures in case of mismanagement.	
Fairness (FAIR)	Records treatment of minorities.	
Life-Cycle	Earned Equity (Retained Earnings) to Total Assets	All Worldscope
Size	Log of book assets in US\$	
Growth	Logarithmic one-year asset growth	
Profitability	Earnings before interest and taxation (EBIT) to book assets	
Cash	Cash scaled by book assets	
Dep. On External Finance	Capital expenditure less cashflow from operation scaled by capital expenditure	
Dividend Payout	Dividends to Total Assets	
Cross-Listing	1 if the firm is cross-listed in the U.S.	Bank of New York, Citibank.
Shareholder Rights	From Spamann (2010) and Djankov et al. (DILLS) (2008) (for China, Hungary, and Poland where Spamann (2010 is unavailable). The index of DILLS (2008) ranges from 1 (weak shareholder rights) to 5 (strong shareholder rights). The Spamann (2010) index ranges from 2 to 5 (using 1997 values).	Spamann (2010) & Djankov et al. (2008)
Stock Market Capitalization	Stock Market Capitalization to GDP (in 2001)	Updated version of Beck et al. (2000)
Culture	“Individualism” from Hofstede (2001)	Hofstede (2001)
Economic Development	GDP per capita in US\$	World Bank and IMF
Industry Dummies	Industry dummies based on four-digit SIC codes.	Worldscope
Country Dummies	Country dummies. Argentina is the reference country	Author Calculations

