Corporate Governance, Accounting Outcomes and Organizational Performance

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The purpose of this paper is to start the process of developing reliable and valid measures to assess how corporate governance affects corporate performance. This task is difficult because we are not aware of either a well-developed theory about the nature of corporate governance or a basis for choosing the relevant characteristics to include in an empirical study. As a result, it is important to stress that this analysis is exploratory only.

Investors, academics and policy makers are all interested in how corporate governance influences both how managers behave and enterprises perform. Assumptions and convictions about the importance of governance have driven discussions of regulatory change and the design of governance structures. But there is little conclusive evidence in the academic literature, perhaps because no one has yet identified which elements of governance matter most, and how.

In this study, we develop 14 multi-indicator indices from 39 individual governance indicators. These indices are the first step in a process to develop reliable and valid indicators for the complex idea that is known as corporate governance. We then study how well these indices can explain abnormal accruals, accounting restatements, future operating performance and future stock returns.

We find that our governance indices do have a relationship to future operating performance and excess stock returns. However, these indices have a very modest and mixed association with abnormal accruals and almost no relation with accounting restatements.