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CORPORATE GOVERNANCE AND FINANCIAL PERFORMANCE - HOW MEASUREMENT AFFECTS THE OUTCOME

Abstract:

Given the increasing importance attached to Corporate Governance (CG) in global competition for capital and investors, my research goes back to the root cause of how the level of quality of Corporate Governance can be measured and if it has an impact on a firm's financial performance.

In a first step, I carry out a literature review and determine a set of eight (8) different rating approaches for CG quality that are frequently used in publications and literature. By making use of the Thompson Reuters Eikon Dataset, I recreate these eight (8) CG ratings over a period of five years (2012 to 2016) for the representative sample of 600 European firms included in the STOXX® EUROPE 600 index.

By carrying out a Principal Component Analysis with the recreated CG ratings, I find that they basically load on two main factors. Given the composition of the ratings, these factors can be defined as "internal" and "external" CG quality.

In a second step, I use these newly created variables for internal and external CG quality to carry out a fixed effects panel regression analysis that analyses the impact of CG quality on financial performance measured by Tobin's Q. The research outcome shows that external CG is positively related to Tobin's Q, whereas internal CG quality shows no significant impact. I therefore show that a general statement that CG positively impacts financial performance is not possible. It clearly depends on the choice of measurement approach and whether it focusses on measuring internal or external CG quality.

Keywords:

Corporate Governance

Governance Ratings

Financial Performance

JEL Classification: G18, G30, G34