NO13070

Firm Characteristics of Companies That Adopt A Formal Corporate Governance Policy

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NO13070

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ABSTRACT

The main purpose of this study is to investigate the determinants of formal governance policy. Many firms have a formal governance policy. Others, however, have no such policy. This study examines what kind of firm's characteristics that encourage companies to adopt a formal governance policy.

Data were collected from Corporate Library. A sample of 3068 firms from the database of 2010 Corporate Library was analyzed. Our results show that when firms have a better financial performance and better corporate policies, they are more likely to have a formal governance policy. Specifically, when firms have a better board rating, compensation policy, takeover defense strategy, and accounting practice, firms are more likely to have a formal governance policy.

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INTRODUCTION

Prior research has attempted to investigate the relationship between governance mechanisms and the market valuation of publicly traded firms (Bai et al.) In general, the research has documented the importance of corporate governance to protect the shareholders and to enhance the firm's value. Many firms have a formal governance policy to guide their financial decisions and corporate strategies. Others, however, have no such a policy. The main purpose of this study is to investigate the determinants of formal governance policy. This study examines the firm's characteristics that encourage companies to adopt a formal governance policy. This study is organized as follows: Section II provides the literature review; Section III provides the data collection; Section IV provides the data analysis and results; Section V provides the conclusion.

LITERATURE REVIEW

Prior studies, in general, have documented that the adoption of a formal corporate governance policy has a positive impact on the firm's value. Having a formal corporate governance also enhances shareholders' value. Ashbaugh-Skaife et al. (2006) investigated whether firms with strong corporate governance will result in higher credit ratings relative to firms with weaker governance. They documented, after controlling for firm-specific risk characteristics, that credit

ratings are negatively related to the quality of corporate governance, proxied by the number of block holders and CEO power, and positively related to takeover defenses, accrual quality, earnings timeliness, board independence, board stock ownership, and board expertise. They also provided evidence that CEOs of firms with speculative-grade credit ratings are overcompensated than their counterparts at firms with investment-grade ratings.

Bai et al. (2004) investigated the relationship between governance mechanisms and the market valuation of publicly listed firms in China. They examine the effect of corporate governance variables on market valuation after controlling for factors commonly used in market-valuation analysis. Their results indicated that both high concentration of non-controlling shareholding and issuing shares to foreign investors have positive impact on the firm's market valuation, while a large holding by the largest shareholder, the CEO being the chairman or vice chairman of the board of directors, and the largest shareholder being the government have negative effects.

Black et. al. (2006) provide evidence that an overall corporate governance index is an important and likely causal factor in explaining the market value of Korean public companies.

Bebchuk, et al. put forward an entrenchment index based on six provisions: staggered boards, limits to shareholder bylaw amendments, poison pills, golden parachutes, and supermajority requirements for mergers and charter amendments. They find that increases in the index level are associated with economically significant reductions in firm valuation as well as large negative abnormal returns.

Gompers et al. (2003) used the incidence of 24 governance rules and constructed a "Governance Index" to proxy for the level of shareholder rights at about 1500 large firms during

the 1990s. They find that firms with stronger shareholder rights had higher firm value, higher profits, higher sales growth, lower capital expenditures, and made fewer corporate acquisitions.

Bauer et al. (2003) analyzed whether good corporate governance leads to higher common stock returns and improves firm value in Europe. Surprisingly, and contrary to Gompers, et al., Ishii and Metrick (2003), they find a negative relationship between governance standards and these earnings based performance ratios.

Core et al. (1999) find that measures of board and ownership structure explain a significant amount of cross-sectional variation in CEO compensation, after controlling for standard economic determinants of pay. Moreover, the signs of the coefficients on the board and ownership structure variables suggest that CEOs earn greater compensation when governance structures are less effective. They also find that the predicted component of compensation arising from these characteristics of board and ownership structure has a statistically significant negative relation with subsequent firm operating and stock return performance. Overall, their results suggest that firms with weaker governance structures have greater agency problems; that CEOs at firms with greater agency problems receive greater compensation; and that firms with greater agency problems perform worse.

Larcker et al. (2007) examined the association between typical measures of corporate governance and various accounting and economic outcomes. Their study did not produced a consistent set of results. They believe that these mixed results are partially attributable to the difficulty in generating reliable and valid measures for the complex construct that is termed

corporate governance. Using a sample of 2,106 firms and 39 structural measures of corporate their exploratory principal component analysis suggests that there are 14 dimensions to corporate governance. They find that these indices have a mixed association with abnormal accruals, little relation to accounting restatements, but some ability to explain future operating performance and future excess stock returns.

Joh (2003) studied how ownership structure and conflicts of interest among shareholders under a poor corporate governance system affected firm performance before the Asian financial crisis. His research finds that firms with low ownership concentration show low firm profitability, while firms with a high disparity between control rights and ownership rights showed low profitability.

Klapper and Love (2002) study shows that better corporate governance is highly correlated with better operating performance and market valuation. More important, they provide evidence showing that firm-level corporate governance provisions matter more in countries with weak legal environments. These results suggest that firms can partially compensate for ineffective laws and enforcement by establishing good corporate governance and providing credible investor protection. The authors' empirical evidence also show that firm-level governance and performance is lower in countries with weak legal environments, suggesting that improving the legal system should remain a priority for policymakers.

In general, the prior research has documented the importance of corporate governance to protect the shareholders and to enhance the firm's value. One would reasonably assume that all firms should adopt a formal corporate governance policy to maximize the shareholders' value

and the firm's value. What is unclear is that why some firms do not have a formal governance policy. This paper is designed to shed some light on what firm characteristics tend to encourage firms to adopt a formal governance policy.

DATA COLLECTION

Data was collected from Corporate Library of 2010. A total sample of 3,068 firms was collected. The Corporate Library reported whether the firm has a formal governance policy. In this study, it is used as the dependent variable. It is coded one if the firm has a formal governance policy and zero if it does not have one. Furthermore, the database reported the quality of firm's governance policies, including board rating (BR), compensation policy (CO), takeover defense policy (TK), and accounting practice (ACCT). In this study, all four independent variables of quality of corporate governance are a dummy variable. If the variable is classified by Corporate library as low concern or moderate concern, it is coded as one. If it is classified as high concern or very high concern, it is coded as zero. We also collected the firm's financial performance. Firm's stock returns relative to the SP 500 index and industry are utilized as the proxy for firm's financial performance. If the firm outperforms the SP 500 index or the industry, it is coded one, it is coded zero otherwise. Stock returns for one year, three years, and five years were collected and analyzed.

METHODOLOGY

The logistic model was performed to detect the effects of the quality of corporate governance policies on the firm's formal governance policy. The dependent variable is whether the firm has a formal governance policy. It is coded zero if the firm does not have a formal

governance policy and one if the firm has a formal governance policy.

Logistic regression model is appropriate for this study because the dependent variable is binary and the assumptions of multivariate normality are violated for independent variables. The probability of having a formal governance policy can be modeled as follows:

$$P(\text{Governance Policy}=1) = 1/\{1+e^{-y}\}$$

$$\text{Where } y= \alpha_0+ ß_1*FP+ ß_2*BR +ß_3*CO +ß_4* TK +ß_5*ACCT$$

Where FP: Financial performance. If the firm outperforms the SP 500 index or industry, it is coded one, it is zero otherwise.
GOV_POL: Formal Governance policy availability. If it is available, it is coded one, it's coded 0 otherwise
BR: The quality of board Rating. It is a dummy variable. If it is rated low concern or moderate concern, it is coded one. If it is rated as high or very high concern, it is coded 0.
CO: The quality of compensation policy. It is a dummy variable. If it is rated low concern or moderate concern, it is coded one. If it is rated as high or very high concern, it is coded 0.
TK: The quality of takeover defense policy. It is a dummy variable. If it is rated low concern or moderate concern, it is coded one. If it is rated as high or very high concern, it is coded 0.
ACCT: The quality of accounting practice. It is a dummy variable. If it is rated low concern or moderate concern, it is coded one. If it is rated as high or very high concern, it is coded 0

While a positive coefficient increases the probability of having a formal governance policy, a negative value decreases the predicted probability.

DATA ANALYSIS AND RESULT

Table one presents the descriptive statistics of dependent variable, whether the firm has a formal governance policy, and independent variables, including proxies for the quality of governance and financial performance. Our sample includes 3,068 firms collected from the Corporate Library database. All variables are classified as a dummy variable that takes a value of

either one or zero. For example, according to Table one, 72.87% of firms in the sample have a formal governance policy.

TABLE 1

Descriptive Statistics of Variables in the Study

This Table provides the statistics of variables in the study. Corporate governance is the dependent variable in the logistic model. The rest are the independent variables. All are dummy variables.

Descriptive Statistics

Variables	N	Minimum	Maximum	Mean	Std. Deviation
GOV_POL	2875	.00	1.00	.7287	.44471
BR	3067	.00	1.00	.8138	.38931
CO	3067	.00	1.00	.7463	.43518
TK	2462	.00	1.00	.7124	.45272
ACCT	3061	.00	1.00	.9624	.19018
OneSP	3068	.00	1.00	.5678	.49546
OneInd	3068	.00	1.00	.3527	.47788
ThreeSP	3068	.00	1.00	.5639	.49598
ThreeInd	3068	.00	1.00	.4694	.49914
FiveSP	3068	.00	1.00	.4371	.49611
FiveInd	3068	.00	1.00	.3651	.48153
Valid N (listwise)	2307				

GOV_POL: Formal Governance policy availability. If it is available, it is coded one, it is coded 0 otherwise.
BR: The quality of board Rating. It is a dummy variable. If it is rated low concern or moderate concern, it is coded one. If it is rated as high or very high concern, it is coded 0.
CO: The quality of compensation policy. It is a dummy variable. If it is rated low concern or moderate concern, it is coded one. If it is rated as high or very high concern, it is coded 0.
TK: The quality of takeover defense policy. It is a dummy variable. If it is rated low concern or moderate concern, it is coded one. If it is rated as high or very high concern, it is coded 0.

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ACCT: The quality of accounting practice. It is a dummy variable. If it is rated low concern or moderate concern, it is coded one. If it is rated as high or very high concern, it is coded 0.
OneSP: One year stock return vs. SP 500 Index. It is a dummy variable. If it outperforms the index, it is coded one. If it underperforms the index it is coded 0.
ThreeSP: Three year stock return vs. SP 500 index. It is a dummy variable. If it outperforms the index, it is coded one. If it underperforms the index it is coded 0.
FiveSP: Five year stock return vs. SP 500 index. It is a dummy variable. If it outperforms the index, it is coded one. If it underperforms the index it is coded 0.
OneInd: One year stock return vs. industry. It is a dummy variable. If it outperforms the industry, it is coded one. If it underperforms the industry it is coded 0.
ThreeInd: Three year stock return vs. industry. It is a dummy variable. If it outperforms the industry, it is coded one. If it underperforms the industry it is coded 0.
FiveInd: Five year stock return vs. industry. It is a dummy variable. If it outperforms the industry, it is coded one. If it underperforms the industry it is coded 0.

Table 2 presents the correlation coefficients of the independent variables. Results suggest statistically significant positive relationships between financial performance, measured by stock returns, and the quality of corporate governance, proxied by board rating, compensation policy, take over defense strategy, and accounting practice. For example, accounting practice is positively correlated with one, three, and five year stock returns.

Table 2

Correlation coefficients among independent variables

This Table presents the correlation coefficients among independent variables. Sample size is 3,068 firms. For each correlation coefficient, the significance level is presented below the correlation coefficient.

	BR	CO	TK	ACCT	ONE_SP	ONE_ IND	THREE_ SP	THREE_ IND	FIVE_ SP	FIVE_ IND
BR	1.00	-.042* .02	.052* .01	.016 .387	.026 .152	.045* .014	-.015 .395	-.017 .348	-.006 .755	-.03 .092
CO	-.042* .02	1.00	-.021 .306	-.032 .075	-.039* .029	.01 .574	-.02 .262	-.006 .741	.065** .000	-.045* .013

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TK	.052* .010	-.021 .306	1.00	-.01 .636	-.07** .001	-.064** .001	.027 .179	.002 .92	.033 .104	.007 .726
ACCT	.016 .387	-.032 .075	-.01 .636	1.00	.004 .804	-.009 .635	.041* .024	.045* .014	.063** .000	.039* .03
ONE_SP	.026 .152	-.039* .029	-.07** .001	.004 .804	1.00	.588** .000	.074** .000	.095** .000	.038* .036	.034 .058
ONE_IND	.045* .014	.01 .574	.064** .001	-.009 .635	.588** .000	1.00	.037* .041	.071** .000	-.034 .058	-.007 .695
THREE_SP	-.015 .395	-.02 .262	.027 .179	.041* .024	.074** .000	.037* .041	1.00	.752** .000	.348** .000	.327** .000
THREE_IND	-.017 .348	-.006 .741	.002 .92	.045* .014	.095** .000	.071** .000	.752** .000	1.00	.340** .000	.410** .000
FIVE_SP	-.006 .755	.065* ..000	.033 .104	.063** .000	.038* .036	-.034 .058	.348** .000	.340** .000	1.00	.628** .000
FIVE_IND	-.03 .092	-.045* .013	.007 .726	.039* .03	.034 .058	-.007 .695	.327** .000	.410* .000	.628** .000	1.00

* Correlation is significant at the 0.05 level (2-tailed).
** Correlation is significant at the 0.01 level (2-tailed).

BR: The quality of board Rating. It is a dummy variable. If it is rated low concern or moderate concern, it is coded one. If it is rated as high or very high concern, it is coded 0.
CO: The quality of compensation policy. It is a dummy variable. If it is rated low concern or moderate concern, it is coded one. If it is rated as high or very high concern, it is coded 0.
TK: The quality of takeover defense policy. It is a dummy variable. If it is rated low concern or moderate concern, it is coded one. If it is rated as high or very high concern, it is coded 0.
ACCT: The quality of accounting practice. It is a dummy variable. If it is rated low concern or moderate concern, it is coded one. If it is rated as high or very high concern, it is coded 0.
OneSP: One year stock return vs. SP 500 Index. It is a dummy variable. If it outperforms the index, it is coded one. If it underperforms the index it is coded 0.
ThreeSP: Three year stock return vs. SP 500 index. It is a dummy variable. If it outperforms the index, it is coded one. If it underperforms the index it is coded 0.
FiveSP: Five year stock return vs. SP 500 index. It is a dummy variable. If it outperforms the index, it is coded one. If it underperforms the index it is coded 0.
OneInd: One year stock return vs. industry. It is a dummy variable. If it outperforms the industry, it is coded one. If it underperforms the industry it is coded 0.
ThreeInd: Three year stock return vs. industry. It is a dummy variable. If it outperforms the industry, it is coded one. If it underperforms the industry it is coded 0.
FiveInd: Five year stock return vs. industry. It is a dummy variable. If it outperforms the industry, it is coded one. If it underperforms the industry it is coded 0.

Results from Table three indicate that the quality of governance policies and financial

performance have a significant impact on the firm's governance policy. Board rating, compensation policy, accounting practice, and three year stock return relative to industry have a positive impact on firm's governance policy. Specifically, when the firm has a higher board rating, better compensation policy, and better accounting practice, the firm is more likely to have a formal governance policy. All those variables are statistically significant at least 10% level. The model is statistically significant at 1% based on the chi square

Table 3
Results of Logistic Regression Based on the quality of corporate policies and corporate financial performance (relative to industry)
Dependent Variable: Corporate Governance Policy (GOV_POL)
P(GOV_POL, Governance Policy =1) = $1/\{1+e^{-y}\}$

Where $y= \alpha_0 + ß_1*BR + ß_2*CO + ß_3*TK + ß_4* ACCT + ß_5*oneInd + ß_6 * threeInd + ß_7 * fiveInd$

This Table presents the results of the impact of the quality of corporate policies and corporate financial performance relative to industry on corporate governance. Four different proxies for quality of corporate governance are used: Board Rating, Compensation Policy, Takeover Defense Strategy, and Accounting Practice

	2 log likelihood	Chi Square	Wald Statistic	Sign.
Intercept	328.838(a)	.000	94.20	
BR	349.402	20.564	21.15***	.000
CO	390.552	61.715	54.53***	.000
TK_	331.203	2.366	2.385	.124
ACCT	331.651	2.813	2.92*	.093
OneInd	330.196	1.358	1.351	.244
ThreeInd	338.171	9.333	9.23***	.002
FiveInd	330.687	1.849	1.854	.174
Model	328.838	101.687		.00***

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Where:

GOV_POL: Formal Governance policy availability. If it is available, it is coded one, it is coded 0 otherwise
BR: The quality of board Rating. It is a dummy variable. If it is rated low concern or moderate concern, it is coded one. If it is rated as high or very high concern, it is coded 0.
CO: The quality of compensation policy. It is a dummy variable. If it is rated low concern or moderate concern, it is coded one. If it is rated as high or very high concern, it is coded 0.
TK: The quality of takeover defense policy. It is a dummy variable. If it is rated low concern or moderate concern, it is coded one. If it is rated as high or very high concern, it is coded 0.
ACCT: The quality of accounting practice. It is a dummy variable. If it is rated low concern or moderate concern, it is coded one. If it is rated as high or very high concern, it is coded 0.
OneInd: One year return vs. industry. It is a dummy variable. If it outperforms the industry, it is coded one. If it underperforms the industry it is coded 0.
ThreeInd: Three year return vs. industry. It is a dummy variable. If it outperforms the industry, it is coded one. If it underperforms the industry it is coded 0.
FiveInd: Five year return vs. industry. It is a dummy variable. If it outperforms the industry, it is coded one. If it underperforms the industry it is coded 0.

Results from Table four indicate that the quality of governance policies and financial performance have a significant impact on the firm's governance policy. Board rating, compensation policy, accounting practice, takeover defense strategy, one and three years stock returns relative to SP 500 index have a positive impact on firm's governance policy. Specifically, when the firm has a higher board rating, better compensation policy, better accounting practice, and better financial performance, the firm is more likely to have a formal governance policy. All those variables are statistically significant at least 10% level. The model is statistically significant at 1% based on the chi square

Table 4

Results of Logistic Regression Based on the quality of corporate policies corporate and financial performance (relative to SP 500 Index) Dependent Variable: Corporate Governance Policy (GOV_POL)

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P(GOV_POL, Governance policy=1) = $1/\{1+e^{-y}\}$

Where $y= \alpha_0+ ß_1*BR+ ß_2*CO +ß_3*TK +ß_4* ACCT +ß_5*oneSP + ß_6 * threeSP + ß_7 * fiveSP$

This Table presents the results of the impact of the quality of corporate policies and corporate financial performance relative to the SP 500 index on corporate governance. Four different proxies for quality of corporate governance are used: Board Rating, Compensation Policy, Takeover Defense Strategy, and Accounting Practice

	2 log likelihood	Chi Square	Wald Statistic	Sign.
Intercept	329.824(a)	.000	166.41	
BR	350.804	20.979	21.58***	.000
CO	385.953	56.129	49.95***	.000
TK	332.560	2.735	2.75*	.098
ACCT	331.916	2.092	2.920	.148
OneSP	341.029	11.205	11.21***	.001
ThreeSP	335.127	5.303	5.30**	.021
FiveSP	331.923	2.098	2.093	.147
Model	329.824	114.234		.00**

. **Where:** *, **, ***: significant at the 10%, 5%, and 1% levels
GOV_POL: Formal Governance policy availability. If it is available, it is coded one, it is coded 0 otherwise
BR: The quality of board Rating. It is a dummy variable. If it is rated low concern or moderate concern, it is coded one. If it is rated as high or very high concern, it is coded 0.
CO: The quality of compensation policy. It is a dummy variable. If it is rated low concern or moderate concern, it is coded one. If it is rated as high or very high concern, it is coded 0.
TK: The quality of takeover defense policy. It is a dummy variable. If it is rated low concern or moderate concern, it is coded one. If it is rated as high or very high concern, it is coded 0.
ACCT: The quality of accounting practice. It is a dummy variable. If it is rated low concern or moderate concern, it is coded one. If it is rated as high or very high concern, it is coded 0.
OneSP: One year return vs. SP 500 Index. It is a dummy variable. If it outperforms the index, it is coded one. If it underperforms the index it is coded 0.
ThreeSP: Three year return vs. SP 500 index. It is a dummy variable. If it outperforms the index, it is coded one. If it underperforms the index it is coded 0.
FiveSP: Five year return vs. SP 500 index. It is a dummy variable. If it outperforms the index, it is coded one. If it underperforms the index it is coded 0.

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Table 5 reports the results of the impact of firm's financial performance on governance policy. Results indicated that the better the firm's financial performance, the more likelihood that the firm will have a formal governance policy. When stock returns relative to SP 500 were used, the model, statistically significant at 1% level, showed that one year and three year stock returns have a positive impact on the governance policy. Both are statistically significant at least 5% level. When stock returns relative to industry, the model, statistically significant at 5% level, showed that one year and three stock returns have a positive impact on the governance policy. Both are statistically significant at least 10% level.

Table 5
Results of Logistic Regression Based on corporate financial Performance relative to SP 500 Index and relative to industry
Dependent Variable: Corporate Governance Policy (GOV_POL)
P(GOVE_POL, Governance policy=1) = $1/\{1+e^{-y}\}$

Where y= α_0+ ß1*oneSP + ß2 * threeSP + ß3 * fiveSP
Where y= α_0+ ß1*oneInd +ß2 * threeInd + ß3 * fiveInd

This Table presents the results of the impact of corporate financial performance on the corporate governance. Two models are estimated: first model uses financial performance relative to SP 500 index; second model uses financial performance relative to the industry (presented in bold and italicized),

	2 log likelihood	Chi Square	Wald Statistic	Sign.
Intercept: SP	64.426)	.000	281.29	
Intercept: Industry	***55.158***	***.000***	***153.49***	
OneSP	81.437	11.205	17.03***	.001
OneInd	***58.616***	***3.458***	***3.42****	***.064***
ThreeSP	66.679	5.303	2.25**	.021
ThreeInd	***60.439***	***5.281***	***5.25****	***.022***
FiveSP	69.807	2.098	5.35	.147

FiveInd	***55.523***	***.365***	***.366***	***.545***
Model : relative to SP	64.426	30.262		.00***
Model: Industry	**55.158**	***9.593***		***.020****

Where: *, **, ***: significant at the 10%, 5%, and 1% levels
GOV_POL: Formal Governance policy availability. If it is available, it is coded one, it is coded 0 otherwise
OneSP: One year return vs. SP 500 Index. It is a dummy variable. If it outperforms the index, it is coded one. If it underperforms the index it is coded 0.
ThreeSP: Three year return vs. SP 500 index. It is a dummy variable. If it outperforms the index, it is coded one. If it underperforms the index it is coded 0.
FiveSP: Five year return vs. SP 500 index. It is a dummy variable. If it outperforms the index, it is coded one. If it underperforms the index it is coded 0.
OneInd: One year return vs. industry. It is a dummy variable. If it outperforms the industry, it is coded one. If it underperforms the industry it is coded 0.
ThreeInd: Three year return vs. industry. It is a dummy variable. If it outperforms the industry, it is coded one. If it underperforms the industry it is coded 0.
FiveInd: Five year return vs. industry. It is a dummy variable. If it outperforms the industry, it is coded one. If it underperforms the industry it is coded 0.

Table 6 reports the results for the impact of corporate polices on governance policy. Results indicated that board rating, compensation policy and accounting practice have statistically significant impact on the firm's governance policy. Specifically, the better the firm's board rating, the better the firm's compensation policy, and the higher quality of accounting practice, the more likely the firm will have a formal governance policy. Both board rating and compensation policy are statistically significant at 1% level and accounting is statistically significant at 1% level. The model, according to chi square, is statistically significant at 1% level

Table 6
Results of Logistic Regression Based on the quality of corporate policies
Dependent Variable: Corporate Governance Policy (GOC_POL)
$P(GOV\_POL=1) = 1/\{1+e^{-y}\}$

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Where $y = \alpha_0 + \beta_1 * BR + \beta_2 * CO + \beta_3 * TK + \beta_4 * ACCT$

This Table presents the results of the impact of the quality of corporate policies on corporate governance. Four different proxies for quality of corporate governance are used: Board Rating, Compensation Policy, Takeover Defense Strategy, and Accounting Practice

	2 log likelihood	Chi Square	Wald Statistic	Sign.
Intercept	75.222(a)	.000	218.90	
BR	96.602	21.380	22.02***	.000
CO	136.247	61.025	53.92***	.000
TK	77.346	2.124	2.14	.145
ACCT	78.181	2.959	3.07*	.085
Model	75.222	90.235		.000

Where: *, **, ***: significant at the 10%, 5%, and 1% levels

GOV_POL: Formal Governance policy availability. If it is available, it is coded one, it is coded 0 otherwise

BR: The quality of board Rating. It is a dummy variable. If it is rated low concern or moderate concern, it is coded one. If it is rated as high or very high concern, it is coded 0.

CO: The quality of compensation policy. It is a dummy variable. If it is rated low concern or moderate concern, it is coded one. If it is rated as high or very high concern, it is coded 0.

TK: The quality of takeover defense policy. It is a dummy variable. If it is rated low concern or moderate concern, it is coded one. If it is rated as high or very high concern, it is coded 0.

ACCT: The quality of accounting practice. It is a dummy variable. If it is rated low concern or moderate concern, it is coded one. If it is rated as high or very high concern, it is coded 0.

Conclusion:

The main purpose of this study is to investigate the firm characteristics of companies that adopt a formal governance policy. Prior studies have documented that the adoption of a formal corporate governance policy has a positive impact on the firm's value. Having a formal corporate governance also enhances shareholders' value. Many firms have a formal governance policy. Others, however, have no such policy. This study examines what kind of firm's characteristics that encourage companies to adopt a formal governance policy.

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Data were collected from Corporate Library. A sample of 3068 firms was analyzed. Results show that when firms have a better financial performance and better corporate policies, they are more likely to have a formal governance policy. Specifically, when firms have a better board rating, compensation policy, takeover defense strategy, and accounting practice, firms are more likely to have a formal governance policy.

The results presented in this study are consistent with the empirical evidence from prior studies. Firms that have better governance mechanisms tend to perform better than their counterparts. Similarly, firms that perform better also are more likely to adopt a formal governance policy. Moreover, when firms have better governance mechanisms, proxied by board rating, compensation policy, take over defense strategy, and accounting practice, they are more likely to adopt a formal governance policy.

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