

Governance Mechanisms and Firm Characteristics

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Certificate

I certify that this thesis has not already been submitted for any degree and is not being submitted as part of candidature for any other degree.

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Abstract

Recent regulatory changes in developed economies have sought to apply uniform standards for corporate governance following a series of high profile corporate collapses between 2000 and 2002. The various regulatory responses raised questions in the governance literature on the appropriateness of a “one size fits all” approach. However, empirical outcomes in this literature do not provide a consistent picture on how, or even whether, governance choices vary with firm characteristics. This thesis addresses the lack in empirical direction by investigating the discriminatory power of a fundamental firm variable, the price-to-book ratio (P/B), that is often applied in Australian and other studies to predict governance outcomes. It evaluates how a joint price-to-book, price-to-earnings, firm classification (P/B, P/E) captures variations in governance choices by Australian firms and compares the results with those using a conventional P/B classification. Choices for two key mechanisms – the level of independence of the board of directors and the quality of its external auditors, are examined as they feature prominently in regulatory reforms. The results show that a joint P/B, P/E classification captures significant differences in the use of both mechanisms confirming that governance frameworks vary with firm characteristics. Consistent with expectations, these differences are recorded for board independence within high and within low P/B firms. Significant variations are also identified in the choice of auditor quality within both P/B classes of firms. By enabling a more parsimonious analysis of firm characteristics through the joint P/B, P/E framework, these results enhance our understanding of the choice of independent directors and high quality auditors. They also lend support to the general proposition that a “one size fits all” governance framework could lead to unnecessary costs for firms as they seek optimal governance arrangements that suit their specific information environments.

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