

IWH Research Seminar in Economics

Montag, 30. Januar 2017, 13:15–14:45 Uhr, Konferenzsaal im Erdgeschoss



A Corporate Governance Asset Pricing Model: Theory and some Evidence

Professor Dr. Ernst-Ludwig von Thadden, Universität Mannheim

This paper extends the classic risk-return tradeoff of asset pricing to a risk-effort tradeoff, by assuming that managerial effort is necessary to generate cash flows. Corporate governance standards influence the manager's return to effort, her exposure to corporate risk, and the dilution of shareholder value. In capital market equilibrium, this tradeoff has implications for the firm's cash flows and stock returns, and this in turn affects the endogenous choice of governance standards. Laxer governance standards decrease the stock's β , and in equilibrium systematic and idiosyncratic stock return risk are both negatively correlated with governance laxity. Various empirical tests with U.S. data using the corporate governance index of Gompers, Ishii, and Metrick (2003) are consistent with our predictions.

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