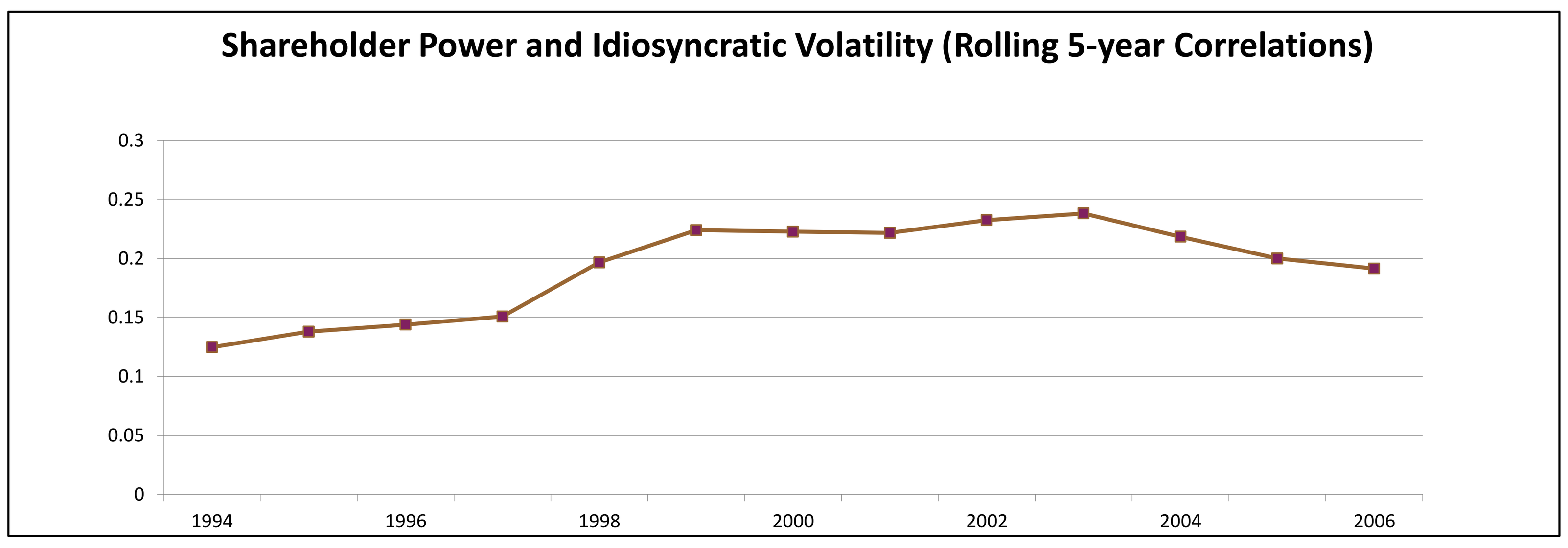
Corporate Governance and Corporate Volatility

- Most observers agree that the recent financial crisis was caused, in large part, by excessive corporate risk-taking.
- Policy response → calls for increased managerial accountability by empowering shareholders.
- But this policy response may be misguided.

<u>Hypothesis: empowering shareholders increases firm-specific risks.</u>

Findings:

- From 1990-2006, shareholder power (measured by G-Index – Gompers, Ishii & Metrick 2003) is positively correlated with idiosyncratic stock price volatility, volatility of cash flows and volatility of return on assets.
- Magnitude of correlation varies over time.



Future Investigation:

- Are shareholders adequately compensated for these increased risks?
- Why does the relationship between shareholder power and firm risk change over time?

Jay B Kesten, Assistant Professor
Florida State University College of Law
jkesten@law.fsu.edu // (850) 644-1596