The Effects of Corporate Governance on the Relationship between Innovative Efforts and Performance

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ABSTRACT The purpose of this study is to examine the effects of managerial share ownership, CEO duality and board independence on the relationship between innovative efforts and performance. The study is motivated by the observation that despite the widely held belief that innovative efforts are crucial to firms' survival, previous studies were unable to provide any evidence in support of this belief. It addresses this incongruity by focusing on the effects of corporate governance on the relationship between innovative efforts and performance. Specifically, this study predicts and finds that managerial share ownership has a positive effect on this relationship while CEO duality has a negative effect. Contrary to the hypothesis, this study finds that board independence also has a negative effect on the relationship between innovative efforts and performance. This contradictory result is, however, consistent with the managerial-incentive theory, which proposes that inside directors are in a better position than outside directors to motivate managers to undertake profitable projects because they have superior access to firms' specific information.

1. Introduction

The study presented in this paper investigates the effects of corporate governance on the relationship between innovative efforts and performance. Innovative efforts are measured based on expenditures for innovation or more specifically, research and development (R&D) expenditures. Building on agency theory,