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Shock-Based Causal Inference in Corporate Finance and Accounting Research

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Abstract


We study shock-based methods for credible causal inference in corporate finance research. We focus on corporate governance research, survey 13,461 papers published between 2001 and 2011 in 22 major accounting, economics, finance, law, and management journals; and identify 863 empirical studies in which corporate governance is associated with firm value or other characteristics. We classify the methods used in these studies and assess whether they support a causal link between corporate governance and firm value or another outcome. Only a small minority of studies have convincing causal inference strategies. The convincing strategies largely rely on external shocks – usually from legal rules – often called “natural experiments”. We examine the 74 shock-based papers and provide a guide to shock-based research design, which stresses the common features across different designs and the value of using combined designs.

Keywords: causal inference, shock-based research design, natural experiments, legal shock, difference-in-differences, regression discontinuity, instrumental variables, event study, covariate balance

JEL Classification: K20, C10, C20

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194 References

1. ; Iliev , Bennedsen

is our good-practice RD paper and, for overall care with research design, our second favorite shock-based paper Posted: 2007

2. The SEC gave below-threshold firms until 2007 to comply; the exemption was later made permanent. Iliev limits his sample to firms with public float in 2004 between \$50 and \$100M. He assesses robustness with broader and narrower bandwidths, and also uses placebo thresholds at \$125M and \$150M. He verifies that the outcome variable (audit expense) is balanced near the threshold in 2002, during the preshock period. He uses a cubic in public float as his control for the forcing variable, along with other firm size controls. He first estimates a standard RD specification for audit fees in 2004 using a dummy for SOX §404 compliance. A concern with this design is that firms may manipulate their public float to stay below the \$75M threshold. The SEC rule was adopted in 2003.

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He studies the effect of SOX §404, which requires auditors to confirm the quality of firm internal controls for fiscal year 2004 and later Posted: 2002

3. A Abadie , A Diamond , J Hainmueller

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Journal of the American Statistical Association , volume 105 , p. 493 - 505 Posted: 2010

4. A Abadie , A Diamond , J Hainmueller
Comparative Politics and the Synthetic Control Method
American Journal of Political Science , volume 59 , issue 2 , p. 495 - 510 Posted: 2015
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