

Corporate Governance, Financial Reporting Quality, and the Cost of Capital: A Synthesis of Evidence from Developed and Emerging Markets

Oreoluwa Bello*

Department of Management and Accounting, Ladoke Akintola University of Technology (LAUTECH),
Ogbomoso, Oyo State, Nigeria

*Corresponding Author

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ABSTRACT

The relationship between corporate governance, financial reporting quality and the cost of capital has generated a substantial body of empirical accounting and finance research over five decades, yet the evidence remains fragmented across theoretical traditions, measurement approaches and institutional settings. This paper presents an integrative review of 66 studies published between 1976 and 2023 in leading accounting, finance and management journals, synthesising what is known about how monitoring structures and disclosure credibility shape the risk premium demanded by providers of equity and debt capital. Adopting a structured narrative review methodology, the paper organises the literature into seven thematic clusters and evaluates the convergence and divergence of findings within each. Four principal conclusions emerge. First, the theoretical claim that information risk is priced remains contested: analytical models disagree over whether information asymmetry is diversifiable in large economies, and the corresponding empirical evidence on accruals quality as a priced risk factor does not survive alternative asset-pricing specifications. Second, the evidence is markedly more consistent in debt than in equity markets, where auditor credibility, internal control integrity and disclosure quality demonstrably influence bond yields, credit ratings and private loan covenant structures. Third, firm-level governance and country-level institutional protection appear to operate as partial substitutes, with the marginal valuation benefit of firm-level transparency greatest where legal enforcement is weakest; this third conclusion rests on a markedly thinner evidence base than the first two and is advanced as provisional. Fourth, the corpus displays a pronounced geographic imbalance, with emerging market evidence accounting for under a tenth of empirical studies and sub-Saharan African evidence almost absent. The paper concludes by specifying a research agenda addressing this deficit, the methodological treatment of endogeneity in governance research, and the implications of artificial-intelligence-enabled assurance for information risk.

Keywords: corporate governance, financial reporting quality, cost of capital, information asymmetry, emerging markets

INTRODUCTION

Background and motivation

The cost of capital is simultaneously the price a firm pays for external finance and the rate at which the market capitalises its expected future cash flows. It follows that any firm attribute which alters investors' assessment of the uncertainty surrounding those cash flows, or their confidence in the reported figures from which expectations are formed, must in principle be reflected in the required return. Two such attributes have dominated accounting and finance scholarship: the architecture of corporate governance, understood as the set of internal and external mechanisms that constrain managerial discretion, and the quality of financial reporting, understood as the fidelity with which accounting numbers map into underlying economic performance.

The intuition connecting the two to financing cost is straightforward and has proved durable. Where monitoring is weak, managers may divert resources or pursue private benefits, and rational investors price that expropriation risk *ex ante*. Where reporting is opaque, outside capital providers cannot distinguish good projects from bad, demand compensation for adverse selection, and may ration capital altogether. Improving either dimension should therefore compress the risk premium.

The empirical record, however, has proved considerably less tidy than the intuition. Foundational analytical work disputes whether information risk is a priced risk factor at all in large, well-diversified economies. Results obtained in equity markets have frequently failed to replicate under alternative asset-pricing specifications, while broadly parallel tests in debt markets have produced far more stable findings. Cross-country evidence suggests that the entire relationship is conditioned by the legal and regulatory environment in which a firm operates, which raises the question of whether results estimated on United States data travel at all to the institutional settings where the stakes are arguably highest.

That question carries particular weight for sub-Saharan Africa. Nigerian listed firms operate under a corporate governance code, an accounting standards regime aligned with International Financial Reporting Standards, and a capital market that has repeatedly identified the cost and availability of long-term finance as a binding constraint on corporate investment.

If firm-level transparency can substitute for weak sovereign enforcement, the policy implication is that voluntary governance investment is a high-return activity for individual firms. If, conversely, firm-level mechanisms are only effective where institutional infrastructure already supports them, the binding constraint lies at the level of the state rather than the firm, and corporate governance reform pursued in isolation will disappoint. The literature contains the ingredients for adjudicating between these positions but has not, to date, assembled them.

Objectives of the review

This review pursues four objectives:

- To trace the theoretical foundations linking governance, disclosure and financing frictions, and to characterise the unresolved analytical dispute over whether information risk is priced.
- To synthesise the empirical evidence separately for equity and debt markets, and to explain why the two literatures have converged on different degrees of confidence.
- To evaluate how the institutional environment moderates firm-level relationships, with particular attention to the substitution-versus-complementarity question in emerging markets.
- To appraise the methodological apparatus of the field, identify substantive and geographic gaps, and articulate a research agenda responsive to them.

Contribution and structure

The paper contributes to the literature in three respects. It integrates four research streams that are ordinarily reviewed in isolation, namely disclosure economics, audit quality, corporate governance and comparative institutional analysis, within a single transmission framework. It documents quantitatively the geographic and temporal composition of the evidence base, making the imbalance in that base an object of analysis rather than an unstated background condition. And it translates the resulting synthesis into a research agenda specified at a level of detail sufficient to guide doctoral and early-career work in African finance and accounting departments.

The remainder of the paper is organised as follows. The next section sets out the review methodology and describes the corpus. The paper then develops the theoretical foundations and presents the integrating conceptual framework, before synthesising the evidence on reporting quality and equity costs, on assurance and debt contracting, and on governance mechanisms in turn. Later sections examine institutional moderation and the emerging market evidence, consider ESG disclosure and technological change in assurance, appraise estimation and identification methods, and specify research gaps and a forward agenda before the conclusion.

REVIEW METHODOLOGY

Review type and justification

This paper adopts a structured narrative synthesis rather than a statistical meta-analysis. The choice is dictated by the heterogeneity of the underlying evidence. Studies in this domain operationalise the dependent variable in at least four incompatible ways, including implied cost of equity derived from analyst forecasts, realised returns, bond yield spreads and loan interest rates. They operationalise the independent construct in ways that are equally diverse, ranging from analyst-rated disclosure scores through accruals-based quality proxies to composite governance indices whose components differ across studies. Pooling standardised effect sizes across such disparate constructs would produce an artefact of aggregation rather than a meaningful summary statistic. A structured narrative approach retains the interpretive nuance that the domain requires while imposing explicit and reproducible selection rules.

Search strategy and selection criteria

Eligibility was governed by a set of criteria fixed before screening began. Table 1 sets out those criteria and the corresponding grounds for exclusion, which were applied unchanged at both the title-and-abstract and full-text stages.

Table 1: Inclusion and exclusion criteria applied at full-text review

Dimension	Included	Excluded
Publication type	Peer-reviewed journal articles; analytical papers published in ranked outlets	Conference abstracts, theses, working papers superseded by published versions, practitioner commentary
Outcome variable	Cost of equity (implied or realised), cost of debt, bond yield spreads, credit ratings, loan pricing or covenant structure, capital constraints	Studies whose only outcome is accounting profitability, Tobin's Q or firm value without a financing-cost channel
Explanatory construct	Governance mechanisms, reporting quality, disclosure level, audit or assurance quality, internal control quality, institutional or legal environment	Studies of capital structure determinants unrelated to information or monitoring
Theoretical papers	Analytical models directly addressing the disclosure-cost of capital link and reviews establishing the state of the field	General agency or contracting theory without a capital-cost implication
Language and period	English language; 1976 to 2023	Non-English publications; pre-1976 material

Three electronic databases were searched: Scopus, Web of Science Core Collection and Google Scholar. The search window ran from 1976, the year of the foundational agency-theoretic statement in the field, to December 2023. All searches were executed within a single two-week window so that database contents were held effectively constant across sources. The search logic paired a capital-cost concept block with a governance and reporting-quality concept block using the Boolean operator AND, with terms within each block combined using OR. Table 2 reproduces the complete search string as entered in each database, together with the database-specific field codes, the filters applied and the number of records returned.

Table 2: Database-specific search strings, filters and records returned

Database	Search string as entered	Filters applied	Records
Scopus	TITLE-ABS-KEY(("cost of capital" OR "cost of equity" OR "cost of debt" OR "bond yield" OR "loan spread" OR "credit rating") AND ("corporate governance" OR "financial reporting quality" OR "earnings quality" OR "disclosure quality" OR "audit quality" OR "internal control" OR "information asymmetry" OR "investor protection"))	PUBYEAR > 1975 AND PUBYEAR < 2024; DOCTYPE = ar; LANGUAGE = English; SUBJAREA = BUSI OR ECON	186
Web of Science Core Collection	TS=(("cost of capital" OR "cost of equity" OR "cost of debt" OR "bond yield*" OR "loan spread*" OR "credit rating*") AND ("corporate governance" OR "financial reporting quality" OR "earnings quality" OR "disclosure quality" OR "audit quality" OR "internal control*" OR "information asymmetry" OR "investor protection"))	Timespan 1976-2023; Document Type = Article; Language = English; Web of Science Categories = Business, Finance OR Economics OR Management	141
Google Scholar	("cost of equity" OR "cost of debt" OR "cost of capital") AND ("corporate governance" OR "reporting quality" OR "earnings quality" OR "audit quality") -patent -citation	Custom range 1976-2023; articles only; patents and citations excluded; first 200 relevance-ranked results screened	85
Citation chaining	Backward reference-list screening and forward citation screening of the 12 most highly cited records identified above	Applied after database searching; restricted to peer-reviewed articles meeting the criteria in Table 1	Included within the totals above

Note: Google Scholar does not support the field-code syntax available in Scopus and Web of Science and returns results ranked by relevance rather than as a closed set; it was therefore used as a supplementary rather than a primary source, with screening capped at the first 200 results, beyond which no additional eligible records were identified.

Records from the three databases were combined and de-duplicated on digital object identifier and, where no identifier was present, on the combination of first author, year and title. Screening then proceeded in two stages. At the first stage, titles and abstracts were assessed against the criteria in Table 1, with records retained where eligibility could not be determined from the abstract alone. At the second stage, full texts were retrieved and assessed. Screening at both stages was conducted by the sole author, which is a limitation addressed in the discussion of limitations below. Table 3 records the reasons for exclusion at full-text review, and Figure 1 documents the complete screening sequence.

Table 3: Reasons for exclusion at full-text review

Reason for exclusion	Records	Explanation
No capital-cost outcome variable	21	Study examined governance or reporting quality against profitability, Tobin's Q or firm value with no financing-cost channel
Explanatory construct out of scope	10	Study addressed capital structure determinants unrelated to information or monitoring
Superseded or overlapping sample	9	Working paper subsequently published, or a later article by the same authors using substantially the same sample and design
Not peer-reviewed or non-ranked outlet	8	Conference abstracts, dissertations and practitioner commentary
Full text not retrievable	7	No accessible full text through institutional subscription or open-access repository
Total excluded at full-text review	55	

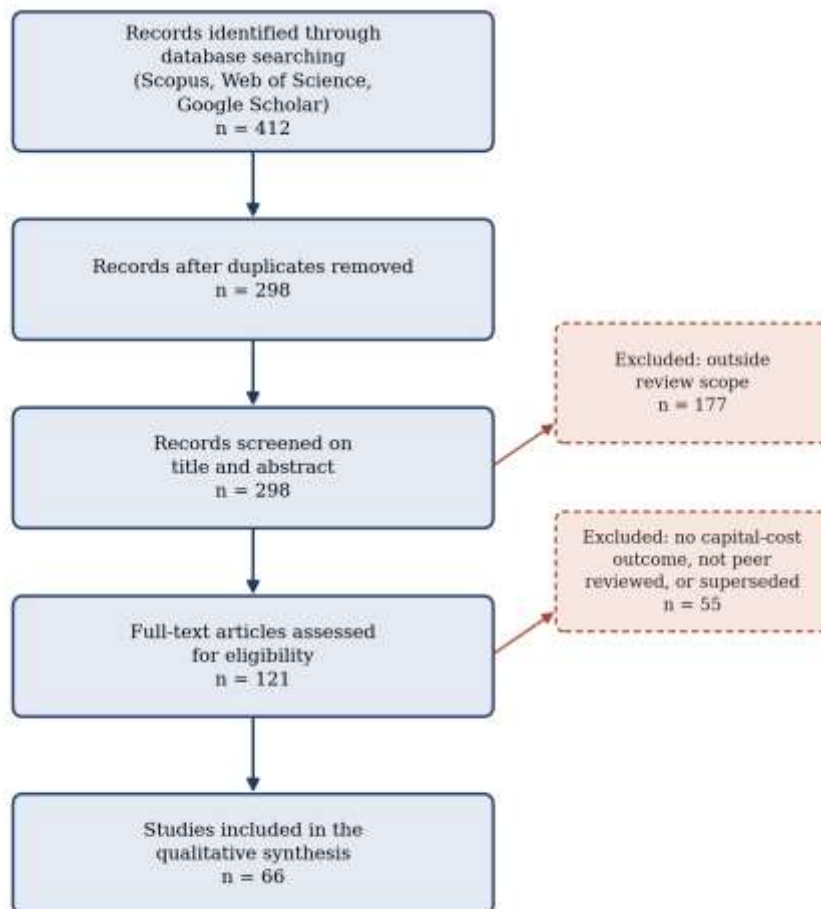


Figure 1: Identification, screening and inclusion of studies

Composition of the corpus

The final corpus comprises 66 studies. Two considerations governed the decision to close selection at this point. The first is thematic saturation: by the final round of screening, additional eligible records were returning findings already represented within one of the seven thematic clusters, and no record introduced a construct, mechanism or institutional setting not already covered. The second is canonical coverage: the corpus contains the contributions that the field itself treats as foundational, verified by confirming that the most frequently cited works in the reference lists of the included reviews were themselves captured. Saturation of this kind is a weaker criterion than the exhaustive enumeration a systematic review would require, and the implications are discussed below.

Figure 2 reports the distribution across the seven thematic clusters used to organise the synthesis. Theoretical and disclosure-model contributions constitute the largest single group, reflecting the unusual extent to which this literature has been driven by formal analytical argument rather than by inductive empirical work alone. Reporting quality and equity costs, and assurance and debt contracting, together account for close to a third of the corpus.

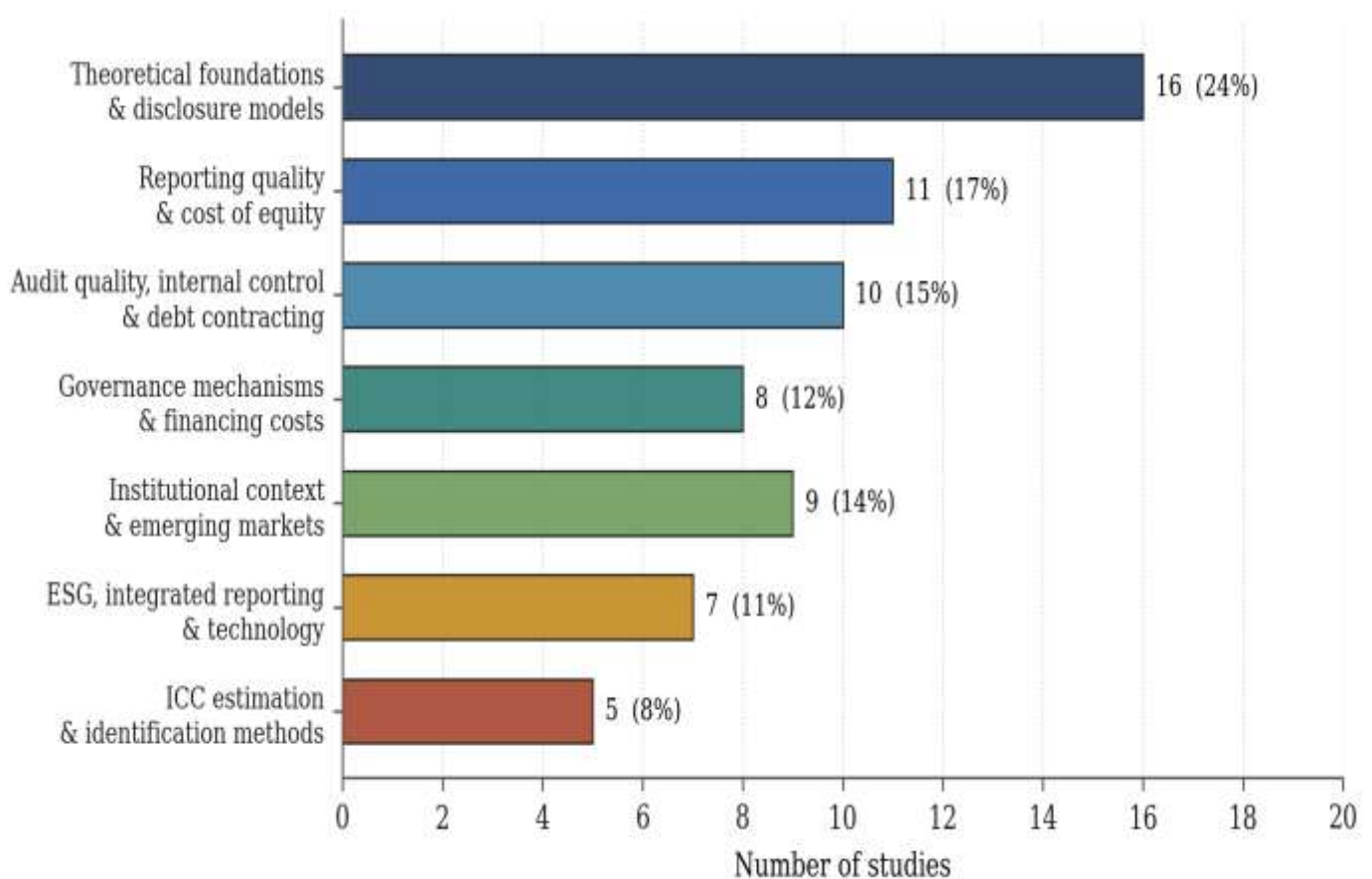


Figure 2: Distribution of reviewed studies across thematic clusters (n = 66)

Figure 3 disaggregates the corpus simultaneously by publication period and by empirical setting. Two patterns warrant emphasis. The first is the pronounced concentration of activity in the decade from 2000 to 2009, which followed both the Sarbanes-Oxley reforms and the maturation of implied cost of capital estimation techniques, and which supplied the field with the majority of its canonical empirical results. The second, and analytically more consequential, is the distribution across settings. Of the 43 empirical studies in the corpus, 28 are conducted on a single developed market, overwhelmingly the United States; 11 are cross-country; and only four focus principally on emerging markets. A single study in the corpus takes sub-Saharan Africa as its primary setting. This imbalance is not an artefact of the selection criteria but a property of the published literature itself, and the discussion of research gaps returns to its implications.

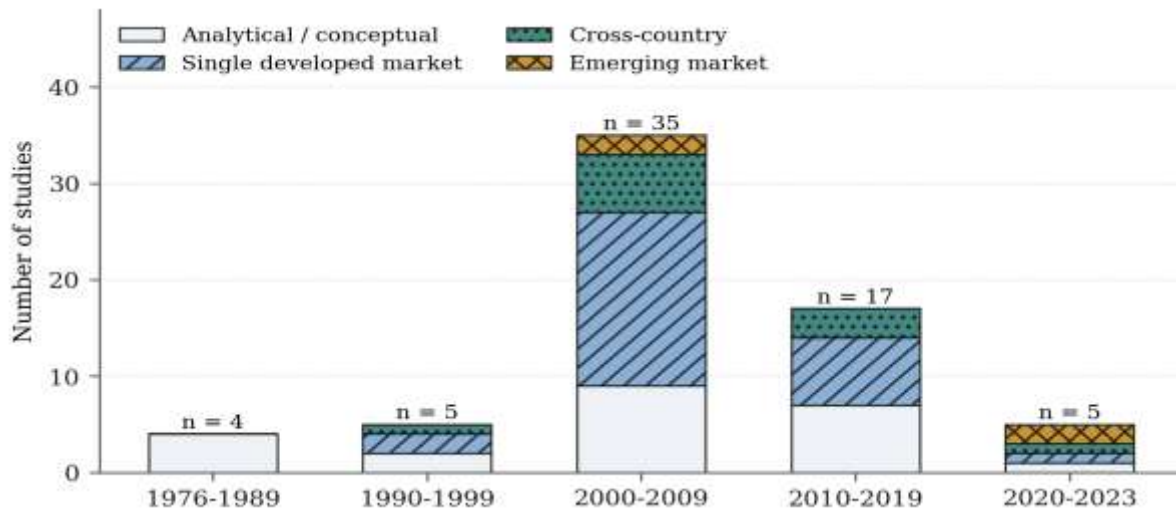


Figure 3: Reviewed studies by publication period and empirical setting

Analytical approach and limitations

Within each cluster, studies were coded for the direction and statistical strength of the reported association, the proxies employed, the identification strategy and the institutional setting. Findings were then assessed for convergence, defined as consistent sign and significance across independent samples and specifications, or divergence, where results reverse or attenuate under alternative treatments.

Limitations of the review protocol

Four limitations qualify what this protocol can support, and they bear directly on how the conclusions that follow should be read.

First, and most consequentially, selection was purposive rather than exhaustive. The corpus was closed on the saturation and canonical-coverage criteria described above rather than by enumerating every record meeting the inclusion criteria. Purposive selection carries a specific risk that should be stated plainly: because the reviewer decides when coverage is sufficient, judgements about sufficiency may be influenced by the conclusions already forming, so that studies confirming an emerging synthesis are more readily judged representative than those complicating it. The risk is greatest for the clusters with the fewest included studies, where a small number of additional records could shift the balance of evidence, and it is smallest for the theoretical and equity-market clusters, where the canonical works are well-defined and comprehensively covered. This review should therefore be read as a structured interpretation of a defensible corpus, not as an unbiased estimate of the population of findings, and its cluster-level conclusions carry correspondingly different weight.

Second, screening and coding were performed by a single reviewer. No independent second screener assessed eligibility and no inter-rater agreement statistic can therefore be reported, which is a departure from systematic review practice and leaves scope for inconsistent application of the inclusion criteria at the margins.

Third, restriction to English-language, peer-reviewed outlets introduces a recognised bias against work published in regional and non-English journals. This restriction bears asymmetrically on the present subject, since African and other emerging-market scholarship is disproportionately published in regional outlets not indexed in Scopus or Web of Science. The review may therefore understate the absolute volume of African research, although the relative scarcity documented below is corroborated by the composition of the indexed literature itself.

Fourth, the publication process favours statistically significant findings, so the synthesis characterises the published record rather than the full distribution of estimates. Because a structured narrative review cannot apply

the funnel-plot and trim-and-fill diagnostics available to meta-analysis, the magnitude of any such bias cannot be assessed here.

Theoretical Foundations

Agency theory and the monitoring rationale

The intellectual foundation of the field is the separation of ownership from control and the residual loss it generates. Jensen and Meckling (1976) formalised the firm as a nexus of contracts in which managers holding less than the full residual claim have incentives to consume perquisites and to under-supply effort, with rational principals anticipating this behaviour and discounting the price they will pay for the claim. Two implications follow directly for financing cost. Agency costs are borne ultimately by the manager through a lower price for the firm's securities, which supplies the private incentive to bond against opportunism. And expenditure on monitoring is economically justified only up to the point where marginal monitoring cost equals the marginal reduction in residual loss, which is why observed governance quality varies across firms rather than converging on a single optimum.

Shleifer and Vishny (1997) extended this logic into a comparative institutional survey, arguing that governance is fundamentally about how suppliers of finance assure themselves of a return, and that the mechanisms available for doing so differ systematically across legal systems. Bushman and Smith (2001) subsequently articulated the specific role of financial accounting information within governance, distinguishing its use in contracting, in disciplining managers through the market for corporate control, and in reducing the information risk borne by investors. This third channel provides the direct analytical bridge from reporting quality to the cost of capital.

Information asymmetry and adverse selection

Myers and Majluf (1984) supplied the second theoretical pillar. Where managers are better informed than investors about asset value, an equity issue conveys unfavourable information, since managers issue when they believe the stock overvalued. Rational investors discount new issues accordingly, which can cause firms to forgo positive net present value projects and generates the financing hierarchy in which internal funds are preferred to debt and debt to external equity. The framework establishes that information asymmetry is costly independent of any agency conflict over effort, and that the cost manifests both in the price of external finance and in the quantity of investment forgone.

Analytical disclosure models

A distinct analytical tradition examines the firm's disclosure choice as an equilibrium outcome. Verrecchia (1983) demonstrated that proprietary disclosure costs generate partial rather than full disclosure, with managers withholding information below a threshold, and that the market rationally discounts non-disclosure while being unable to unravel it completely. Diamond and Verrecchia (1991) linked disclosure to liquidity, showing that improved disclosure reduces information asymmetry among traders, attracts uninformed liquidity and lowers the cost of capital by reducing the price concession required to execute large trades. Healy and Palepu (2001) and Verrecchia (2001) synthesised the resulting body of work, with the latter distinguishing association-based, discretionary-based and efficiency-based disclosure research and observing that the field lacked a unifying theory capable of generating comparative statics across the three. Beyer, Cohen, Lys and Walther (2010) and Leuz and Wysocki (2016) subsequently extended this stocktaking, the latter emphasising how weak identification has limited what can be concluded about the real effects of disclosure regulation.

The information risk pricing debate

The most consequential unresolved question in the theoretical literature concerns whether information risk is priced in equilibrium. Easley and O'Hara (2004) modelled a setting in which the composition of public and private information affects the required return, because uninformed investors bear systematic risk arising from their disadvantage in portfolio formation, which cannot be diversified away. Lambert, Leuz and Verrecchia

(2007) reached a materially different conclusion. Working within a standard CAPM framework, they showed that disclosure affects the cost of capital through its effect on assessed covariances of cash flows rather than through asymmetry as such, and that in a large economy the effect of information asymmetry per se is diversifiable. Their subsequent contribution (Lambert, Leuz and Verrecchia, 2012) clarified that asymmetry can nonetheless affect the cost of capital in imperfectly competitive markets, where informed investors' trading moves prices. Gao (2010) demonstrated a further complication, namely that disclosure affects real investment decisions as well as the discount rate, so that improvements in disclosure quality need not raise investor welfare monotonically. Armstrong, Core, Taylor and Verrecchia (2011) supplied corresponding empirical evidence, finding that information asymmetry affects the cost of capital in the presence of imperfect competition but not otherwise, which is precisely the conditional prediction the analytical literature implies. Table 4 summarises the competing positions.

Table 4: Competing theoretical positions on the pricing of information risk

Position	Principal proponents	Core mechanism	Prediction for firm-level disclosure
Information risk is a priced, non-diversifiable factor	Easley and O'Hara (2004)	Uninformed investors cannot hold the efficient portfolio; the informed/uninformed composition of information affects systematic risk	Firms with more public and less private information face a lower required return
Asymmetry is diversifiable; only assessed covariance matters	Lambert, Leuz and Verrecchia (2007)	Disclosure alters investors' assessment of the covariance of the firm's cash flows with aggregate cash flows; asymmetry itself washes out in a large economy	Disclosure lowers the cost of capital only where it changes assessed covariance, not merely because it reduces asymmetry
Conditional pricing under imperfect competition	Lambert, Leuz and Verrecchia (2012); Armstrong, Core, Taylor and Verrecchia (2011)	Where markets are imperfectly competitive, informed trading moves prices and asymmetry is not fully diversified	A disclosure effect should be detectable only in less competitive market segments
Welfare effects are non-monotonic	Gao (2010)	Disclosure alters real investment as well as the discount rate; the two effects can move in opposite directions	Higher disclosure quality does not necessarily improve investor welfare even if it lowers the discount rate

An integrating framework

Figure 4 consolidates these strands into the framework that organises the remainder of the review. Firm-level antecedents, comprising governance mechanisms and reporting and assurance quality, operate on financing cost through two analytically distinct channels. The adverse selection channel runs through information asymmetry and market liquidity and is the mechanism emphasised by the disclosure literature. The agency and estimation risk channel runs through monitoring cost and residual uncertainty about the distribution of future cash flows, and is the mechanism emphasised by the governance literature. Both channels feed into equity and debt pricing, but the framework anticipates that they do so with different intensity for the two classes of capital provider, a prediction taken up in the discussion of governance mechanisms below. The institutional environment is

modelled as a moderator acting on both the channels themselves and the strength of their translation into observed pricing.

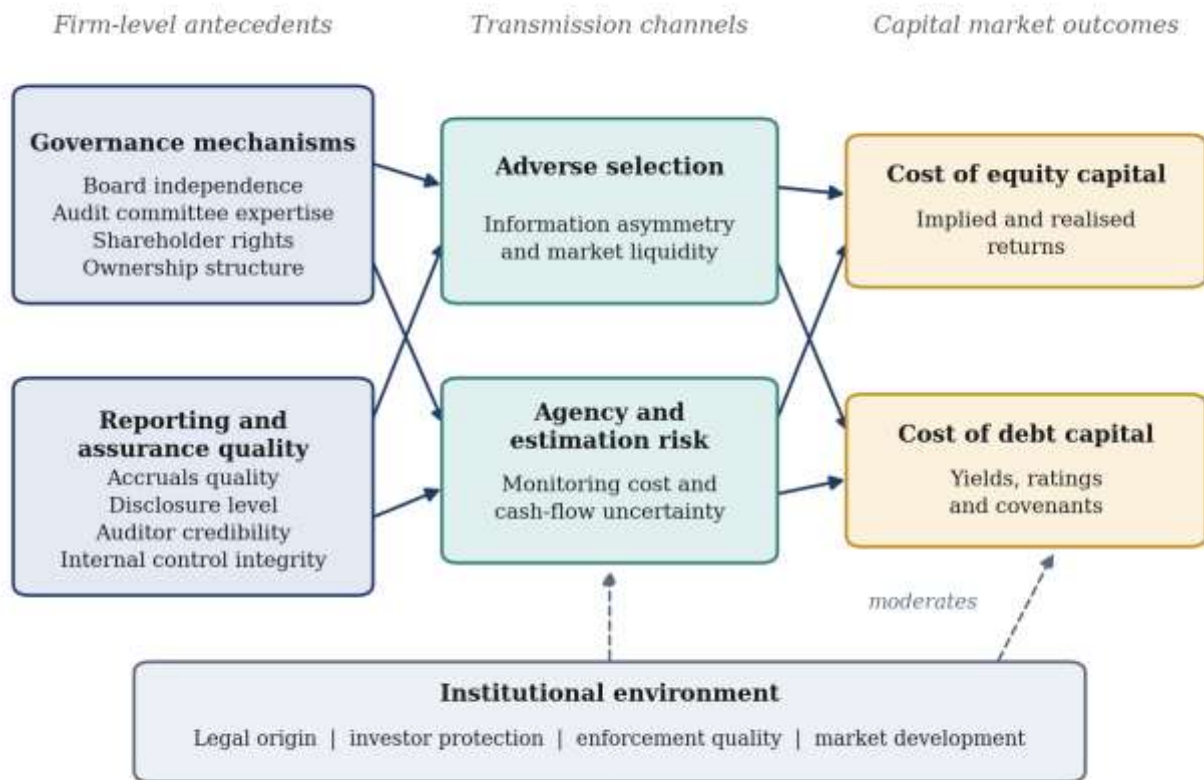


Figure 4: Integrating framework linking governance and reporting quality to financing costs

Financial Reporting Quality And The Cost Of Equity

Operationalising reporting quality

Empirical progress in this area has depended on the construction of tractable proxies for an inherently unobservable construct. Dechow and Dichev (2002) provided the most influential, modelling working capital accruals as a function of past, present and future operating cash flows and interpreting the residual standard deviation as accrual estimation error. The measure has the analytical virtue of capturing the mapping quality of accruals into cash flows without requiring the researcher to distinguish intentional manipulation from honest estimation difficulty, a distinction which subsequent work has shown to matter substantially. Kothari, Leone and Wasley (2005) addressed a serious specification problem in the discretionary accruals literature by demonstrating that conventional Jones-type models are misspecified for firms with extreme performance, and proposing performance matching as a correction. Dechow, Ge and Schrand (2010) surveyed the resulting proliferation of proxies and concluded that no single measure dominates, since each captures a different aspect of a multidimensional construct, and that proxy choice should therefore be governed by the specific decision context under study.

A parallel measurement tradition works from disclosure rather than accruals. Botosan (1997) constructed a disclosure index from annual report content, while later cross-country work has relied on analyst ratings and on aggregate earnings opacity measures. Barth, Konchitchki and Landsman (2013) introduced earnings transparency, defined by the extent to which earnings and changes in earnings explain returns, as a measure with the useful property of being estimated directly from the association the theory posits.

Evidence on disclosure level and equity cost

Botosan (1997) reported the finding that framed the subsequent literature: greater disclosure is associated with a lower cost of equity, but only for firms with low analyst following. The conditionality was not incidental. It indicated that voluntary disclosure substitutes for information that intermediaries supply where they are active, which limits the marginal benefit of disclosure precisely among the large, visible firms that dominate most samples. Botosan and Plumlee (2002) re-examined the question using AIMR disclosure ratings across three disclosure types and obtained a more nuanced result: annual report disclosure was negatively associated with the cost of equity, but timely disclosure was positively associated with it, a finding they attributed to increased return volatility induced by more frequent disclosure. The literature has never fully resolved this tension, and it constitutes an early indication that “more disclosure” and “lower cost of capital” are not related by a simple monotonic function.

Earnings attributes, accruals quality and the priced-risk dispute

Francis, LaFond, Olsson and Schipper (2004) evaluated seven earnings attributes and found accruals quality to be the attribute most strongly associated with the cost of equity, with accounting-based attributes generally exhibiting stronger associations than market-based ones. Francis, LaFond, Olsson and Schipper (2005) sharpened the claim considerably by interpreting accruals quality as a priced risk factor, constructing a factor-mimicking portfolio and reporting a significant loading. This interpretation, which would have established information risk as a systematic risk factor comparable in status to size or book-to-market, proved to be the field’s most consequential contested claim.

Core, Guay and Verdi (2008) subjected it to the appropriate asset-pricing test and rejected it. Their central methodological point is that a contemporaneous regression of excess returns on factor returns establishes only that the factor covaries with returns, not that it commands a risk premium in expected returns. Conducting two-stage cross-sectional tests of the kind required to identify a priced factor, they found no evidence that accruals quality is priced. The exchange is instructive well beyond its immediate subject, since it demonstrates how a widely-cited empirical regularity can rest on an inferential step that does not test the hypothesis of interest. Bhattacharya, Ecker, Olsson and Schipper (2012) subsequently reframed the question productively by modelling the relationship as partly mediated, finding that earnings quality affects the cost of equity both directly and indirectly through information asymmetry, which helps reconcile results obtained using different intermediating variables.

At the cross-country level the evidence is more stable. Bhattacharya, Daouk and Welker (2003) documented that aggregate earnings opacity at country level is associated with higher costs of equity and lower trading volume, a result estimated across a sufficiently wide institutional range to generate variation that within-country designs cannot access. Table 5 summarises the principal evidence in this cluster.

Table 5: Synthesis of evidence on reporting quality and the cost of equity

Study	Setting	Construct and proxy	Principal finding	Status of finding
Botosan (1997)	US manufacturing firms	Self-constructed annual report disclosure index	Higher disclosure associated with lower cost of equity, but only for low-analyst-following firms	Conditionally supported; widely replicated with the same conditionality
Botosan and Plumlee (2002)	US, AIMR-rated firms	Analyst-rated disclosure by type	Annual report disclosure lowers cost of equity; timely disclosure raises it	Mixed; the divergence by disclosure type remains unresolved

Francis et al. (2004)	US listed firms	Seven earnings attributes including accruals quality	Accruals quality most strongly associated with cost of equity	Association robust; causal interpretation contested
Francis et al. (2005)	US listed firms	Accruals quality factor-mimicking portfolio	Accruals quality interpreted as a priced risk factor	Rejected by Core et al. (2008) on asset-pricing test grounds
Core, Guay and Verdi (2008)	US listed firms	Two-stage cross-sectional asset-pricing tests	No evidence that accruals quality is a priced risk factor	Widely accepted as the methodologically decisive treatment
Bhattacharya, Daouk and Welker (2003)	34 countries	Country-level aggregate earnings opacity	Higher opacity associated with higher cost of equity and lower trading volume	Supported; institutional variation aids identification
Barth, Konchitchki and Landsman (2013)	US listed firms	Earnings transparency (return-earnings mapping)	Greater transparency associated with lower cost of capital	Supported; measure constructed directly from the posited association
Bhattacharya, Ecker, Olsson and Schipper (2012)	US listed firms	Earnings quality, information asymmetry, cost of equity	Effect operates both directly and through information asymmetry as mediator	Supported; reconciles otherwise divergent specifications

Note: “Status of finding” reflects the assessment of convergence or divergence described in the analytical approach above and is the present author’s appraisal of the weight of subsequent evidence.

Interpretation

The equity evidence supports a weaker conclusion than is often attributed to it. There is a reliable negative association between reporting quality and the implied cost of equity across many samples and proxies. There is not, on present evidence, a demonstrated risk-based explanation for that association within a standard asset-pricing framework. The gap between these two statements is where the analytical dispute over the pricing of information risk becomes empirically live, and it is compounded by well-documented measurement problems in the implied cost of capital estimates that serve as the dependent variable, discussed in the methodological synthesis below. Sensitivity to analyst forecast bias in particular means that a portion of the observed association may reflect the correlation of reporting quality with forecast optimism rather than with expected returns.

Audit Quality, Internal Control And Debt Contracting

Auditor credibility as a signal

DeAngelo (1981) established the analytical basis for treating auditor size as a proxy for quality. Audit quality is the joint probability that the auditor detects a breach and reports it; larger auditors possess greater quasi-rents from their existing client portfolio and therefore more to lose from a reputation-damaging audit failure, giving them stronger incentives to report detected breaches. The argument is about incentives rather than technical competence, and it supports the extensive use of Big N status as an audit quality indicator. Causholli and Knechel (2012) complicated this literature productively by characterising the audit as a credence good whose quality cannot be directly observed even by the purchasing client, since the outcome of an audit is unobservable and only the auditor knows the effort expended. The implication is that reputational proxies capture perceived rather

than delivered quality, which is a limitation for the audit quality literature but is precisely appropriate for research on capital costs, where market perception is the operative variable.

Public debt markets

Sengupta (1998) reported that firms with consistently high disclosure quality ratings enjoy lower effective interest costs on new debt issues, and that the effect is stronger where market uncertainty about the firm is greater. Mansi, Maxwell and Miller (2004) extended the analysis to auditor characteristics, finding that both auditor quality and auditor tenure are negatively associated with the cost of debt, and that the effects are concentrated in non-investment grade issues where information risk is most acute. Pittman and Fortin (2004) exploited the newly-public firm setting, where information asymmetry is at its maximum and reputational capital has not yet accumulated, and found that retaining a Big Six auditor lowers the cost of debt for young public firms, with the benefit declining as the firm establishes a track record. The convergence across these designs is notable: three different samples, three different identification strategies and a consistent direction of effect.

Private loan contracting

Private debt provides an unusually informative setting because contracts specify not only price but also covenant structure, security and maturity, allowing the researcher to observe how lenders substitute among monitoring technologies. Bharath, Sunder and Sunder (2008) found that borrowers with poorer accounting quality face higher spreads, shorter maturities and more intensive collateral requirements in both public and private debt markets, but that the adjustment operates more through non-price terms in private markets, consistent with banks' comparative advantage in monitoring. Costello and Wittenberg-Moerman (2011) used the disclosure of material internal control weaknesses under Sarbanes-Oxley as a shock to reporting credibility and documented a striking substitution: following a weakness disclosure, lenders reduce their reliance on financial covenants and financial-ratio-based performance pricing and shift towards price protection, security and credit-rating-based provisions. Lenders do not simply charge more when accounting numbers become unreliable; they stop contracting on those numbers. Kim, Song and Tsui (2013) confirmed that both auditor size and auditor tenure reduce bank loan interest rates, with effects concentrated in the post-Sarbanes-Oxley period and in transaction-based term loans rather than relationship-based revolving facilities.

Internal control integrity

Ashbaugh-Skaife, Collins and Kinney (2007) examined the determinants of internal control deficiencies disclosed voluntarily before the Section 404 mandate took effect, finding them associated with operating complexity, recent organisational change and constrained resources for internal control investment. Ashbaugh-Skaife, Collins, Kinney and LaFond (2009) then addressed the pricing question directly, reporting that firms disclosing internal control deficiencies exhibit significantly higher idiosyncratic risk, systematic risk and cost of equity, and, importantly, that firms subsequently remediating those deficiencies experience a decline in the cost of equity. The remediation result is valuable precisely because it uses within-firm variation and therefore addresses the objection that deficiency-disclosing firms simply differ in unobserved ways. Graham, Harvey and Rajgopal (2005) supplied complementary evidence of a different character, surveying more than 400 executives and finding that a large majority would sacrifice economic value to meet an earnings benchmark, and that the stated motivation is the perceived capital-market cost of missing it. Table 6 summarises the cluster.

Table 6: Synthesis of evidence on assurance, internal control and the cost of debt

Study	Setting	Mechanism examined	Principal finding
Sengupta (1998)	US public debt issues	Disclosure quality ratings	Higher disclosure quality lowers effective interest cost; effect strongest under greater market uncertainty

Mansi, Maxwell and Miller (2004)	US bond market	Auditor quality and tenure	Both reduce the cost of debt; effects concentrated in non-investment-grade issues
Pittman and Fortin (2004)	US newly public firms	Auditor choice	Big Six auditor lowers debt cost for young public firms; benefit declines with firm age
Bharath, Sunder and Sunder (2008)	US public and private debt	Accounting quality	Poorer quality raises spreads and tightens non-price terms; private lenders adjust non-price terms more
Costello and Wittenberg-Moerman (2011)	US private loans	SOX internal control weakness disclosure	Lenders substitute away from financial covenants towards price, security and rating-based provisions
Kim, Song and Tsui (2013)	US bank loans, 1996-2008	Auditor size and tenure	Both lower loan interest rates; effects driven by the post-SOX period and term loans
Ashbaugh-Skaife et al. (2009)	US firms under SOX	Internal control deficiencies and remediation	Deficiencies raise the cost of equity; remediation lowers it, using within-firm variation
Graham, Harvey and Rajgopal (2005)	US executives (survey)	Reporting incentives	Executives report willingness to sacrifice economic value to meet benchmarks, citing capital-market consequences

Why the debt evidence is more consistent

The contrast between the debt and equity literatures is one of the more informative regularities in this field, and three explanations for it are worth distinguishing. The first is measurement. The cost of debt is directly observable as a contracted yield or spread, whereas the cost of equity must be inferred from a valuation model requiring assumptions about growth and terminal value, introducing estimation error that attenuates coefficients and inflates standard errors. The second is economic and concerns payoff asymmetry. Debt holders hold a concave claim and are therefore disproportionately exposed to downside outcomes, which are exactly what poor reporting quality and weak internal control tend to conceal; equity holders' convex claim gives them some offsetting benefit from the volatility that opacity generates. The third is contractual: lenders write covenants directly on accounting numbers, so reporting quality enters their decision problem mechanically and not merely through beliefs about firm value. These explanations are complementary rather than competing, and together they suggest that the debt market provides the more powerful setting for testing information-risk propositions, a methodological implication developed in the research agenda below.

Governance Mechanisms As Mitigating Channels

Boards, audit committees and reporting credibility

Klein (2002) established the link between board structure and reporting outcomes, reporting a negative association between board and audit committee independence and abnormal accruals, and showing that reductions in board independence are followed by increases in earnings management. The directional evidence is valuable because it partially addresses the concern that structure and behaviour are jointly determined. Anderson, Mansi and Reeb (2004) carried the argument into debt markets, finding that fully independent boards and, in particular, wholly independent audit committees with financial expertise and frequent meetings are associated with significantly lower debt financing costs. Their interpretation is that bondholders value board independence specifically for its contribution to accounting integrity rather than for its contribution to shareholder value maximisation, which are distinct and occasionally opposing objectives.

Shareholder rights and managerial entrenchment

Gompers, Ishii and Metrick (2003) constructed a governance index from 24 anti-takeover and shareholder-rights provisions and documented that a strategy long in strong-shareholder-rights firms and short in weak-rights firms

would have earned substantial abnormal returns over the 1990s, with weak-rights firms also exhibiting lower valuations and worse operating performance. Bebchuk, Cohen and Ferrell (2009) refined this by showing that six of the 24 provisions drive essentially the whole result, constructing the entrenchment index and finding that the remaining eighteen provisions are uncorrelated with valuation. The refinement matters for interpretation: governance quality is not well captured by counting provisions, and composite indices whose components are not individually validated risk aggregating signal with noise. This caution applies with particular force to the self-constructed governance indices common in emerging market research.

The bondholder-shareholder trade-off

A governance mechanism that serves shareholders does not automatically serve creditors, and the literature contains an instructive divergence on this point. Bhojraj and Sengupta (2003) found that greater institutional ownership and greater outside director representation are associated with higher bond ratings and lower yields, consistent with monitoring benefits accruing to all capital providers. Klock, Mansi and Maxwell (2005) reported an apparently contradictory result: firms with strong anti-takeover provisions, which the shareholder-rights literature codes as poor governance, enjoy a lower cost of debt. The results are reconcilable once the claim structure is taken into account. Anti-takeover protection insulates bondholders from the leveraging and asset substitution that hostile acquisitions typically bring, so a provision that entrenches management at shareholders' expense may simultaneously protect creditors. Governance quality is therefore not a scalar, and studies employing a single composite index against a single class of capital provider risk mis-specifying the underlying economics.

Comprehensive cross-market evidence

Zhu (2014) provides the most integrated treatment in the corpus, examining both the cost of equity and the cost of debt across an international sample and finding that good governance is associated with lower costs of both. The critical result is the conditionality. The governance-equity relationship is more pronounced in countries with strong legal systems, extensive disclosure and good government quality, whereas the governance-debt relationship is stronger in countries with weak legal protection, low transparency and poor government quality. This asymmetry is not an anomaly but follows directly from the payoff structures discussed in the preceding section. Where institutions are weak, creditors face severe difficulties enforcing claims and therefore place high value on firm-level governance as a substitute; equity holders in such settings may discount firm-level governance because they doubt it can be enforced against a controlling owner. Figure 5 renders this schematically, and Table 7 summarises the cluster.

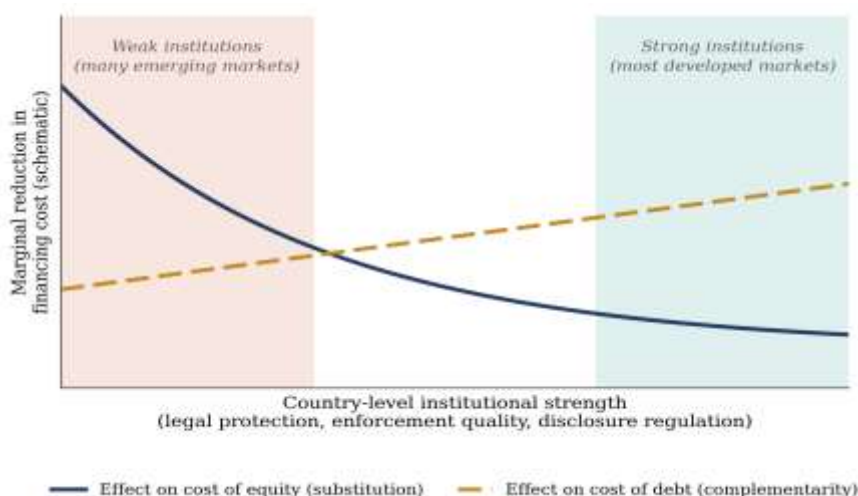


Figure 5: Schematic representation of the substitution and complementarity hypotheses

Figure 5 is a schematic device rather than an estimated relationship. Its purpose is to make explicit the two competing predictions that the emerging market literature is attempting to adjudicate, so that the empirical evidence reviewed in the following section can be read against them.

Table 7: Synthesis of evidence on governance mechanisms and financing costs

Study	Governance construct	Capital market examined	Principal finding
Klein (2002)	Board and audit committee independence	Reporting outcomes (indirect)	Independence negatively associated with abnormal accruals; reductions in independence followed by increased earnings management
Anderson, Mansi and Reeb (2004)	Board and audit committee characteristics	Debt	Independent boards and fully independent, expert audit committees associated with lower debt cost
Gompers, Ishii and Metrick (2003)	G-Index (24 provisions)	Equity	Weak shareholder rights associated with lower valuations and inferior returns
Bebchuk, Cohen and Ferrell (2009)	E-Index (6 provisions)	Equity	Six provisions drive the entire G-Index result; remaining eighteen uncorrelated with valuation
Bhojraj and Sengupta (2003)	Institutional ownership; outside directors	Debt	Both associated with higher bond ratings and lower yields
Klock, Mansi and Maxwell (2005)	Anti-takeover provisions	Debt	Strong anti-takeover protection associated with a lower cost of debt, opposite in sign to the equity result
Zhu (2014)	Composite governance score	Equity and debt, international	Good governance lowers both; equity effect stronger in strong institutions, debt effect stronger in weak institutions
Chen, Chen and Wei (2009)	Firm-level governance and disclosure	Equity, Asian markets	Governance reduces the cost of equity more where country-level investor protection is weaker

Institutional Context: Emerging Versus Developed Markets

Legal origin and investor protection

La Porta, Lopez-de-Silanes, Shleifer and Vishny (1998) established that legal origin predicts the content of investor protection law and the quality of its enforcement, with common law countries affording stronger protection to both shareholders and creditors than French civil law countries, and with ownership concentration emerging as an adaptive response to weak protection. La Porta et al. (2000) developed the implications for corporate governance, arguing that the central agency problem in most of the world is not the dispersed-ownership conflict between managers and shareholders but the expropriation of minority shareholders by controlling ones. This reorientation is essential for reading the emerging market evidence, since governance mechanisms designed for the first problem, such as board independence and takeover markets, may be poorly matched to the second.

Doidge, Karolyi and Stulz (2007) quantified the relative importance of country and firm characteristics, finding that country characteristics explain far more of the variation in governance ratings than observable firm characteristics do, and that firm-level governance is almost irrelevant in the least developed countries. Their explanation is economic rather than merely statistical: in poor institutional environments the cost to a firm of adopting strong governance is high while the benefit, which accrues through access to external finance in markets that are themselves underdeveloped, is low. Firms therefore rationally decline to invest in governance. This is a materially different claim from the substitution hypothesis and stands in some tension with it.

Cross-country reporting disparities and the IFRS transition

Leuz, Nanda and Wysocki (2003) documented systematic cross-country variation in earnings management, showing it to be inversely related to the strength of investor protection and interpreting managed earnings as a mechanism by which insiders conceal private control benefits. Hail and Leuz (2006) connected institutional quality directly to financing cost, finding that firms in countries with more effective securities regulation and stronger legal institutions face a significantly lower cost of equity, with differences of economically meaningful magnitude that persist after controlling for firm characteristics and risk. Daske, Hail, Leuz and Verdi (2008) examined the mandatory IFRS transition and reported modest average increases in market liquidity and modest decreases in the cost of capital, but with the essential qualification that benefits accrue only in countries with strong enforcement regimes and only for firms with prior incentives toward transparency. The finding is among the most policy-relevant in the corpus: standards adoption without enforcement capacity does not deliver capital-market benefits, a conclusion of direct relevance to jurisdictions that have adopted IFRS as a matter of formal compliance.

Lang, Lins and Maffett (2012) added a state-dependence dimension, finding that transparency is associated with greater liquidity and higher valuation generally, but that the association strengthens markedly during periods of market stress and in countries with weaker institutions. Transparency, in other words, is most valuable when it is scarcest and when uncertainty is highest, which implies that studies estimated over calm periods in developed markets will systematically understate its value elsewhere.

Emerging market evidence and the substitution question

Klapper and Love (2004) provided the foundational emerging market result, using firm-level governance rankings across 14 emerging economies to show that better governance is associated with higher operating performance and market valuation, and that the association is stronger in countries with weaker legal environments. Their interpretation, that firm-level governance matters more where the legal system does not provide it, is the substitution hypothesis in its clearest form. Chen, Chen and Wei (2009) confirmed the pattern for the cost of equity specifically across Asian emerging markets, finding that firm-level governance and disclosure reduce the cost of equity, with the effect concentrated in countries with weaker investor protection. Khan, Javeed, Cuong and Pham (2020) provided more recent evidence from Pakistan, constructing a governance index based on compliance with the 2002 Code of Corporate Governance and reporting a negative association with the firm-level cost of capital.

Three qualifications should be attached to these results before they are carried forward. The emerging-market evidence in this corpus rests on four studies, of which one addresses sub-Saharan Africa; the settings are predominantly Asian and Latin American, with corporate ownership structures and banking systems that differ appreciably from those of West Africa; and two of the four report associations without an identification strategy capable of supporting causal interpretation. Statements about emerging markets in this review are accordingly advanced as provisional propositions consistent with a thin evidence base, not as established regularities of the kind the developed-market findings support. Where the distinction matters for a specific conclusion it is stated explicitly in the text.

The substitution hypothesis therefore enjoys reasonable support, but it must be held alongside the Doidge, Karolyi and Stulz (2007) finding that firm-level governance is close to irrelevant in the very weakest institutional environments. The two claims are reconcilable if the relationship between institutional strength and the marginal value of firm-level governance is non-monotonic: rising as institutions improve from a very low base, because credible commitment becomes possible, and falling thereafter as public institutions supply what firms would otherwise have had to supply privately. This possibility has not been directly tested in the reviewed corpus, and it constitutes one of the more tractable research opportunities identified in the research agenda below. Table 8 summarises the comparative position.

Table 8: Comparative summary of developed and emerging market evidence

Dimension	Developed markets	Emerging markets	State of the evidence
Volume of evidence	28 of 43 empirical studies in the corpus	4 of 43 empirical studies; 1 principally sub-Saharan African	Severely imbalanced; conclusions rest on a narrow institutional base
Dominant agency conflict	Dispersed shareholders versus managers	Controlling owners versus minority shareholders	Well established (La Porta et al., 2000); insufficiently reflected in proxy design
Reporting quality and equity cost	Reliable association; risk-based interpretation contested	Limited direct evidence; cross-country studies suggest stronger effects	Under-tested at firm level outside Asia and Latin America
Assurance and debt cost	Consistent negative association across designs	Very limited evidence; bank-dominated systems differ structurally	Substantial gap given the centrality of bank finance in African markets
Firm-level governance	Effect present but modest; institutions already supply much protection	Effect larger where protection is weak, but plausibly near zero at the weakest extreme	Substitution supported; non-monotonicity untested
Transparency during stress	Association present but moderate	Association substantially stronger (Lang et al., 2012)	Supported; under-exploited as an identification opportunity
IFRS adoption	Modest liquidity and capital-cost benefits	Benefits conditional on enforcement capacity	Well established (Daske et al., 2008); directly relevant to Nigerian adoption

EMERGING FRONTIERS IN THE LITERATURE

Non-financial disclosure and ESG

Dhaliwal, Li, Tsang and Yang (2011) examined firms initiating standalone corporate social responsibility reporting and found that initiating firms with superior social performance experience a reduction in the cost of equity, attract dedicated institutional investors and analyst coverage, and are more likely to raise equity following the initiation. The design is informative because initiation provides a discrete event and because the mechanism is traced through intermediate variables rather than asserted. El Ghouli, Guedhami, Kwok and Mishra (2011) reported that firms with better CSR scores exhibit lower costs of equity, with the effect driven by employee relations, environmental policy and product strategy, while participation in controversial industries raises the cost of equity. Cheng, Ioannou and Serafeim (2014) shifted the outcome variable from price to quantity, finding that superior CSR performance is associated with lower capital constraints, and attributing this to reduced agency costs through stakeholder engagement and reduced information asymmetry through disclosure. Eliwa, Aboud and Saleh (2021) extended the analysis to debt across EU countries, reporting that lenders price ESG performance and disclosure, with the effect stronger in countries with stakeholder-oriented institutions.

The single study in the corpus principally addressing sub-Saharan Africa falls in this cluster. Maama and Marimuthu (2022) examined 147 listed firms across ten sub-Saharan African countries over 2009 to 2018 and found that integrated reporting practice is associated with a lower cost of capital. That this is the sole African contribution among 43 empirical studies is itself a finding, and it is notable that it addresses a reporting innovation rather than the more basic governance and audit-quality questions that dominate the developed-market corpus.

Technology, artificial intelligence and the assurance function

The assurance function is undergoing a structural change whose implications for information risk have not yet been priced into the academic literature. Bao, Ke, Li, Yu and Zhang (2020) provide the most rigorous evidence, applying an ensemble machine learning approach to raw financial data for the detection of accounting fraud in United States public firms and demonstrating substantially better out-of-sample performance than both logistic regression on financial ratios and models based on the Beneish framework. Two features of the study are important. It uses raw accounting items rather than researcher-specified ratios, allowing the model to discover predictive structure that theory did not anticipate; and it evaluates performance out of sample in a manner appropriate to a detection task, which much of the surrounding applied literature does not. Han, Shiwakoti, Jarvis, Mordi and Botchie (2023) survey the broader integration of blockchain and artificial intelligence into accounting and auditing and conclude that the literature remains predominantly conceptual, with limited archival evidence on outcomes.

The connection to the cost of capital is theoretically direct but empirically untested. If continuous, algorithmically-supported assurance raises the probability that misstatement is detected, it reduces the equilibrium level of misstatement and the variance of investors' posterior beliefs about reported figures. Within the integrating framework set out earlier this should compress the risk premium through the adverse selection channel. Whether it does so, and whether the benefit accrues to firms adopting the technology or to markets in which regulators and auditors adopt it, is an open question. The absence of any study in the corpus linking assurance technology to financing cost marks this as the clearest frontier in the literature.

METHODOLOGICAL SYNTHESIS

Estimating the implied cost of equity

Because expected returns are unobservable, most of the equity literature relies on implied cost of capital estimates that invert a valuation model using price and analyst forecasts to solve for the internal rate of return. Four models dominate and rest on materially different assumptions, summarised in Table 9. Their disagreement is not merely technical. Estimates from different models correlate imperfectly with one another and with realised returns, and all share a dependence on analyst forecasts that are known to be optimistically biased, which imparts an upward bias to the resulting estimates that is unlikely to be constant across firms. Since forecast optimism is itself plausibly correlated with reporting opacity, this is not a benign measurement error but a potential source of correlated omitted-variable bias operating in the direction of the hypothesised result. Prudent practice, adopted in much of the better recent work, is to report results using several models and to treat consistency across them as a necessary condition for inference.

Table 9: Comparison of implied cost of equity capital models

Model	Source	Valuation basis	Key assumption	Principal limitation
CT	Claus and Thomas (2001)	Residual income	Abnormal earnings grow at the expected inflation rate beyond the forecast horizon	Estimates highly sensitive to the assumed terminal growth rate
GLS	Gebhardt, Lee and Swaminathan (2001)	Residual income	Firm return on equity fades to the industry median over an explicit horizon	Fade-period and industry-median assumptions are imposed rather than estimated

OJN	Ohlson and Juettner-Nauroth (2005)	Abnormal earnings growth	Value expressed through expected EPS and near-term EPS growth without a clean surplus requirement	Requires positive forecast earnings; sensitive to the perpetual growth parameter
PEG (MPEG)	Easton (2004)	Abnormal earnings growth	Simultaneous estimation of the expected return and the change in abnormal earnings growth	Restrictive assumption of zero abnormal growth beyond the horizon in the basic form

Note: All four models require analyst earnings forecasts and are therefore jointly exposed to forecast optimism bias.

Endogeneity and identification

Governance research faces an unusually severe identification problem. Governance structures are chosen by firms rather than assigned, so any observed association with financing cost may reflect reverse causation, whereby firms anticipating cheap capital invest in governance, or omitted variables such as managerial ability that drive both. Larcker and Rusticus (2010) evaluated the instrumental variables strategies adopted in response and reached a discouraging conclusion: many published accounting studies employ instruments that are weak, that fail plausible exclusion restrictions, or whose validity is never seriously argued, with the consequence that the instrumental variables estimates are frequently less reliable than the ordinary least squares estimates they were intended to improve upon. The practical implication is that the burden of argument lies with the researcher proposing an instrument, and that a weak instrument is worse than no instrument.

The most credible designs in the corpus exploit external shocks rather than instruments. Costello and Wittenberg-Moerman (2011) and Ashbaugh-Skaife et al. (2009) use the Sarbanes-Oxley internal control regime; Daske et al. (2008) use mandatory IFRS adoption; and the remediation analysis in Ashbaugh-Skaife et al. (2009) uses within-firm variation to net out time-invariant heterogeneity. Table 10 sets out the principal threats and the remedies available.

Table 10: Endogeneity threats in governance and reporting research and available remedies

Threat	Manifestation in this literature	Remedy	Assessment
Reverse causality	Firms expecting to raise capital cheaply invest in governance and disclosure	Event studies around exogenous regulatory change; lead-lag designs	Effective where a genuine shock exists; regulatory change is rarely fully exogenous
Omitted variables	Managerial ability, growth opportunities or risk drive both governance and financing cost	Firm fixed effects; within-firm change designs such as remediation analysis	Strong for time-invariant confounders; cannot address time-varying omitted factors
Simultaneity	Governance, disclosure and capital structure are chosen jointly	Simultaneous equations; instrumental variables	Requires credible exclusion restrictions that are seldom available

Weak instruments	Instruments correlated only weakly with the endogenous regressor	Report first-stage F statistics; use weak-instrument-robust inference	Larcker and Rusticus (2010) find much published practice inadequate
Measurement error in the dependent variable	Implied cost of capital estimates contain model and forecast error	Multiple ICC models; forecast-bias corrections; realised-return validation	Attenuates estimates; potentially non-random and correlated with the regressor of interest
Self-selection	Firms choosing to disclose or to appoint a Big N auditor differ systematically	Propensity score matching; Heckman selection models; entropy balancing	Addresses observable differences only; unobserved selection remains

Research Gaps And Future Agenda

The geographic deficit

The composition analysis presented in the review methodology makes the field's principal structural weakness explicit. Fewer than one in ten empirical studies in the corpus takes an emerging market as its primary setting, and a single study is principally African. This matters for reasons beyond equity of representation. The theoretical predictions of the field are explicitly conditional on institutional strength, and institutional strength is precisely the dimension on which the dominant United States setting exhibits least variation. The literature has therefore tested its propositions in the setting least able to discriminate between them. Sub-Saharan African markets, with concentrated ownership, bank-dominated financing, formal IFRS adoption alongside constrained enforcement capacity, and substantial cross-country variation in code adoption dates, offer variation on exactly the margins the theory identifies as decisive.

Substantive gaps

Beyond geography, four substantive gaps emerge from the synthesis. First, the non-monotonicity question raised by the emerging market evidence is unresolved: the substitution hypothesis and the institutional-prerequisite finding of Doidge et al. (2007) generate opposing predictions at the weak-institution extreme, and adjudicating between them requires samples spanning a wider range of institutional quality than any single study in the corpus employs. Second, the asymmetric transmission of governance to equity and debt documented by Zhu (2014) has not been tested in bank-dominated financial systems, where the relevant creditor is a relationship lender with private information rather than an arm's-length bondholder. Third, internal audit function maturity, as distinct from external audit quality, is essentially absent from the capital-cost literature despite being the mechanism over which firms in weak-enforcement environments exercise most direct control. Fourth, no study in the corpus links assurance technology to financing cost. Table 11 states these as researchable questions.

Table 11: Research gaps and proposed research questions, in priority order

Code	Gap	Why it matters	Proposed research question	Feasible design
G1	Sub-Saharan African evidence on governance	Theoretical predictions are conditional on institutional strength, which is where the	Does firm-level governance quality reduce the cost of equity and debt for listed firms in sub-Saharan Africa, and	Panel study of listed firms across multiple African exchanges; governance index validated against

	and capital cost	dominant US setting offers least variation	does the effect vary with national enforcement capacity?	local codes; ICC and loan-spread outcomes
G4	Non-monotonic substitution	Substitution and institutional-prerequisite hypotheses conflict at the weak-institution extreme	Is the marginal value of firm-level governance an inverted-U function of country-level institutional strength?	Cross-country panel spanning frontier to developed markets; quadratic and threshold specifications
G3	Governance and relationship lending	Bank-dominated systems differ structurally from the arm's-length bond markets in which the asymmetry result was established	Does firm-level governance reduce bank loan pricing where the lender holds private information, and does it substitute for collateral?	Loan-level data from African or Asian banking systems; price and non-price contract terms as joint outcomes
G5	Internal audit maturity	It is the monitoring mechanism most directly under firm control in weak-enforcement environments, yet is largely unstudied	Does internal audit function maturity reduce financing costs incrementally to external audit quality?	Survey-based maturity measurement combined with archival financing-cost data; instrument using regulatory mandates
G6	Assurance technology and information risk	Continuous and algorithmic assurance should reduce posterior variance about reported figures, but no study prices this	Do firms or markets adopting AI-enabled continuous assurance experience measurable reductions in information risk premia?	Staggered adoption design exploiting audit firm technology rollout or regulatory mandate; difference-in-differences
G2	IFRS adoption under constrained enforcement	Daske et al. (2008) show benefits are enforcement-conditional; Nigerian and comparable adoptions have not been evaluated on this criterion	Did IFRS adoption reduce the cost of capital for Nigerian listed firms, and did the effect differ by pre-adoption reporting incentives?	Difference-in-differences around the adoption date with a matched control group of non-adopting or later-adopting jurisdictions

Prioritising the agenda

These six gaps are not equally urgent, and they are not equally tractable for a researcher based in the region whose evidential deficit they describe. Ranking them requires two criteria to be applied jointly. The first is expected contribution, meaning the extent to which resolving the gap would discriminate between propositions the existing literature cannot separate. The second is data feasibility, meaning whether the required data can realistically be assembled from African exchanges, regulatory filings and commercial databases accessible to a researcher without a large budget. Figure 6 plots the six gaps against both criteria, and the tiers below follow from that placement.

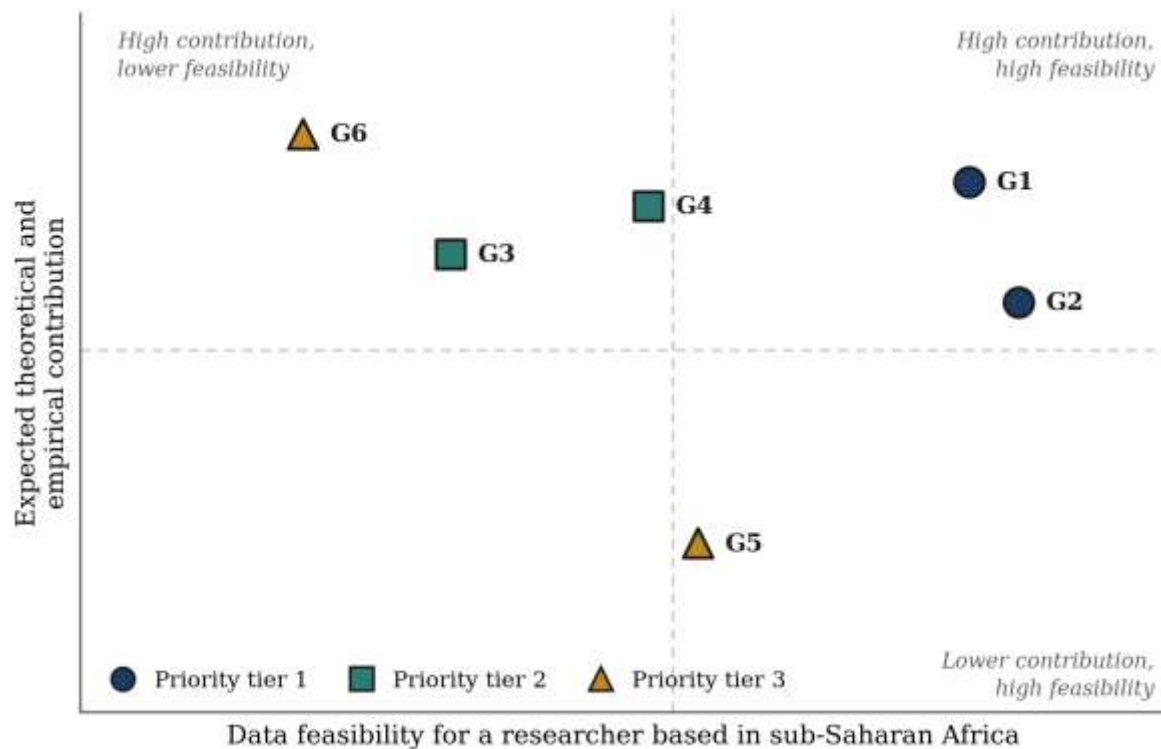


Figure 6: Prioritisation of the research agenda by contribution and data feasibility

Tier 1 comprises G1 and G2, and these offer the most immediate return. Both can be executed with data that already exist. G1, the direct estimation of governance effects on the cost of equity and debt for African listed firms, addresses the single largest evidential gap identified in this review and requires only exchange-level financial data, published governance disclosures and either analyst forecasts or observable loan terms. G2, the evaluation of IFRS adoption under constrained enforcement, is more tractable still, because the adoption dates are known and fixed, they differ across African jurisdictions in a way that supports a difference-in-differences design, and the enforcement-conditionality prediction it tests is stated precisely enough in the existing literature to be falsified. Of the two, G2 is the better first project for a doctoral researcher, since its identification strategy is the more defensible; G1 is the more important, since it establishes the baseline against which all subsequent African work would be read.

Tier 2 comprises G3 and G4, both of which would contribute substantially but demand data that are harder to obtain. G4, the test for non-monotonicity in the substitution relationship, is theoretically the most consequential question in the review, since it would reconcile the two conflicting positions identified earlier, but it requires a cross-country panel spanning frontier to developed markets and is therefore better suited to a collaborative or multi-institution project than to a single researcher. G3, governance and relationship lending, is well matched to the bank-dominated structure of African finance and would extend the literature into a setting it has not examined, but it depends on loan-level data that typically require negotiated access to bank records or a supervisory dataset.

Tier 3 comprises G5 and G6. G6, the pricing of AI-enabled assurance, is the most novel question in the agenda and would be the most significant contribution if executed, but adoption is neither widely disclosed nor systematically recorded, so the identifying variation does not yet exist in usable form; it is best regarded as a question to prepare for rather than to begin now. G5, internal audit function maturity, is feasible through survey instrumentation but would make a more incremental contribution, and its reliance on self-reported maturity measures introduces measurement concerns that the archival questions above avoid.

Methodological recommendations

The synthesis supports four recommendations for researchers entering this field:

- Prefer debt-market outcomes where the research question permits. Contracted yields and loan spreads are observed rather than estimated, which materially improves statistical power relative to implied cost of equity designs.
- Report results using multiple implied cost of capital models where equity outcomes are unavoidable, and treat consistency across models as a condition for inference rather than a robustness footnote.
- Validate governance indices against the local regulatory code rather than importing instruments developed for dispersed-ownership settings, and report component-level results in the spirit of Bebchuk, Cohen and Ferrell (2009).
- Argue explicitly for the exclusion restriction when using instrumental variables, and report first-stage diagnostics; on the evidence assembled by Larcker and Rusticus (2010), a weak instrument is more damaging than none.

CONCLUSION

This review has synthesised 66 studies spanning nearly five decades to establish what is reliably known about the relationship between corporate governance, financial reporting quality and the cost of capital. Four conclusions are supported by the weight of evidence. The association between reporting quality and the cost of equity is robust in sign and widely replicated, but the risk-based interpretation once attached to it does not survive appropriate asset-pricing tests, and the underlying analytical question of whether information asymmetry is priced in equilibrium remains genuinely open.

The evidence in debt markets is substantially more consistent, for reasons that are simultaneously methodological, relating to the observability of the dependent variable, and economic, relating to the concavity of the creditor's claim and the direct contractual use of accounting numbers.

Governance is not a scalar quantity, and mechanisms that benefit shareholders may disadvantage creditors, which means that composite indices deployed against a single class of capital provider risk mis-specifying the economics they are intended to capture.

And the entire set of firm-level relationships is conditioned by the institutional environment, with firm-level governance apparently operating as a partial substitute for weak legal protection, though plausibly ceasing to do so at the very weakest institutional extreme. This fourth conclusion should be held more tentatively than the preceding three: it rests on four emerging-market studies, only one of which addresses sub-Saharan Africa, and it is better understood as the most defensible reading of a thin evidence base than as a settled finding.

The most consequential finding of this review, however, concerns the evidence base rather than the evidence. A literature whose central theoretical propositions are explicitly conditional on institutional quality has been constructed overwhelmingly from data drawn from a single, institutionally strong jurisdiction. The resulting body of knowledge is therefore least informative precisely where its policy stakes are highest. For scholars in Nigeria and across sub-Saharan Africa this represents an opportunity rather than merely a deficiency.

The institutional variation available across African exchanges, the dominance of relationship-based bank lending, the staggered adoption of national governance codes and the gap between formal IFRS adoption and enforcement capacity together constitute a research setting capable of discriminating between propositions that the developed-market literature has been structurally unable to separate. Whether firm-level transparency can substitute for weak sovereign enforcement is not only a question of academic interest; it determines whether corporate governance reform pursued at the level of the firm is a high-return activity or a costly irrelevance. The literature reviewed here supplies the theoretical apparatus to answer that question. It does not yet supply the answer.

Declarations

Ethical approval

This study is a review of previously published literature and did not involve human participants, human data or animal subjects. Ethical approval was therefore not required.

Conflict of interest

The author declares no conflict of interest.

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Data availability statement

No new primary data were generated in the course of this study. All studies analysed are published, peer-reviewed works listed in full in the reference section and are available through their respective publishers and through the digital object identifiers provided. The coding framework applied to the corpus, comprising thematic cluster, publication period and empirical setting for each included study, is available from the author on reasonable request.

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