CORPORATE GOVERNANCE AND THE VALUE OF THE FIRM: AN EMPIRICAL ANALYSIS OF COMPANIES LISTED IN THE JSE SECURITIES EXCHANGE OF SOUTH AFRICA

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Abstract

This study examines the corporate governance characteristics influencing the value of the value of the firm in South Africa (SA). Corporate governance variables including Block shareholding, Dispensed shareholding, Board size, Proportion of non-executive directors and Audit quality were identified from the corporate governance literature. Using panel data of 247-firm years obtained from the annual reports of the 50 largest companies listed on the JSE Securities Exchange of SA, this study found that block shareholding and the proportion of NEDS as the main corporate governance characteristics influencing the value of the firm in SA. The results of this study are important to the King Committee and other corporate governance regulators in SA, in their effort to improve corporate governance practices and probably minimize corporate failure and protect the wellbeing of the minority shareholders. Furthermore, the study contributes to our understanding of the corporate governance variables affecting firm value in developing economies, especially SA.

Keywords: Corporate Governance, Firm Value, Performance, King Report, South Africa

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1. Introduction and Motivation

Cadbury committee (1992) defined corporate governance as the systems used to direct and control companies. It is concerned with the process and structures through which members interested in the overall wellbeing of the firm take measures to protect the interests of the stakeholders (Ehikioya, 2007). The wave of corporate corruption scandals has highlighted the importance of good corporate governance especially in recent years (Standard and Poor's, 2004) Agency theory which has greatly influenced corporate governance, holds that managers will not act to maximize the returns to shareholders unless appropriate governance structures are implemented in the large corporation to safeguard the interests of shareholders (Jensen and Meckling 1976; Fama and Jensen, 1983). It continues to argue that the owners are principals and the managers are agents and there is an agency loss, which is the extent to which returns to the residual claimants, the owners, fall below what they would be if the principals, the owners, exercised direct control of the corporation (Jensen and Meckling 1976). Corporate governance is becoming an increasingly important component of investor relations.

The failure of high profile companies in the USA, UK and other parts of the world has largely been attributed to failures in the corporate reporting process (IFAC, 2003). In the USA the failure of the Enron Corporation in late 2001, apart from signalling the largest corporate bankruptcy in the USA, also raised a myriad of questions about the effectiveness of contemporary accounting, auditing and corporate governance practices (Vintern, 2002). Various commissions were formed (e.g., Blue Ribbon Commission, 1999; Tread away Commission 1987) in response to corporate failure and reduced investor confidence in financial reporting which culminated with the enactment of the Sarbanes-Oxley act (SOX, 2002). The act was enacted to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes (SOX 2002).

In the UK various reports addressing the issue of corporate governance have been published (e.g., Greenbury Report, 1995; Hampel Report, 1998; Higgs, 2003; Smith Report, 2003; Turnbull Report 1999). The Cadbury committee (1992) was constituted in response to the continuing concern about standards of financial reporting and accountability, heightened by BCCI, Maxwell and the controversy over directors' pay, which had kept corporate governance in the public eye. The committee was formed to review those aspects of corporate governance specifically related to

financial reporting and accountability. The committee's recommendation on financial reporting was that although listed companies publish full financial statements annually and half-year reports in the interim, in between these major announcements, boards may need to keep shareholders and the market in touch with their company's progress. The guiding principle once again is openness and boards should aim for any intervening statements to be widely circulated, in fairness to individual shareholders and to minimise the possibility of insider trading (Cadbury 1992).

The purpose of this study is to investigate the relationship between corporate governance characteristics and firm value in companies listed in the JSE Securities Exchange of South Africa. Whereas many of corporate governance studies have been carried out in developed countries of Europe, United States of America (USA) and Japan (Joshi and Wakil, 2004), only a few studies have been completed in developing countries of Africa (for example Fawzy, 2004; Uddin and Choudhury, 2008). McGee (2009) argues that special issues in developing countries, such as dominance of government ownership make the implementation of corporate governance questionable. Tsamenyi, et al (2007) observes that corporate governance studies in developing countries are limited and available only on an individual country basis. Fawzy (2004) and Euromoney (2007) have argued that developing countries differ widely among themselves hence the need to study corporate governance of each country separately (Dahawy, 2009). Furthermore, although a number of firm attributes (including firm value) have been tested for their association with corporate governance quality, there has been no conclusive results (Khanchel, 2007), hence the need for further research.

In South Africa, the King Report (1994, 2002, 2009), sets out the code of corporate governance practices (Max, 2009). According to the World Bank (2003), there has been a number of corporate failures and financial irregularities in SA, notably, Fidentia, JCI-Randgold, Masterbond, Macmend and Regal Treasury. Most of these failures have been blamed on weakness in Corporate Governance Structures (Sarra, 2004, Mangena and Chamisa, 2007). Therefore there is need to understand whether good corporate governance practices influence the market value of companies.

The choice of South Africa is motivated by a number of factors. First, among developing countries and emerging economies, SA pioneered the publication of corporate governance guidelines and codes of best practices in 1994 (Mangena and Chamisa, 2007; Mallin, 2004). Second, although SA is classified as a developing country by the United Nations (2001) and the World Bank (2000), it lies on the upper income bracket of such countries making it a good subject for examining the way in which Corporate Governance practices are applied in a developing country. South Africa is a developing country to the extent that it is an exporter of raw materials rather than finished goods. The economy is very heavily tied to one raw material, namely gold. Furthermore SA has considerable influence on the continent as it is the largest Africa's economy (Mangena and Chamisa, 2007)

Marked economic, political and cultural differences between developed and developing countries exist (Waweru and Uliana, 2005, Bokpin and Isshaq, 2009 and McGee, 2009). For example, most developing countries suffer from a lack of skilled human resources, suggesting that companies in developing economies may experience difficulties attracting people with accounting or finance knowledge to their audit and other governance committees. Cultural differences between developed countries of North America (highly individualistic) and developing countries of Africa (highly collectivistic) may also require different corporate governance arrangements. Rabelo and Vasconcelos (2002) argue that factors such as economic trends towards globalization, structural characteristics of developing countries (under developed capital markets and government interventionism) will make the model of corporate governance different from that found in European or North American contexts.

Mensah (2002) and Dahawy (2009) suggest that African countries are ill equipped to implement the type of corporate governance found in developed countries, due to the characteristics of the economic and political systems of these economies, such as state ownership of companies, weak legal and judicial systems and limited skilled human resource capacity. Mensah (2002) notes a dominance of state enterprises (even with privatization) or closely held family-owned businesses, while companies managed by other than owners and listed companies comprise a very small proportion of GDP. Developing countries are often faced with a myriad of problems, such as underdeveloped and illiquid stock markets, economic uncertainties, weak legal controls and investor protection, and frequent government intervention Tsamenyi, et al (2007). Furthermore, there is a predominance of concentrated shareholding and controlling ownership in most developing countries (Rahman and Ali, 2006; La Porrta et al, 1999). Corporate structures in developing countries are characterized by the desire to maintain control over firms by the majority shareholder, the reliance on debt finance, weak financial markets and an ineffective legal system (Rabelo and Vasconcelos, 2002 and Uddin and Choudhury, 2008).

Using panel data of 247-firm years obtained from the annual reports of the 50 largest companies

listed on the JSE Securities Exchange of SA, this study found that block shareholding and the proportion of NEDS as the main corporate governance characteristics influencing the value of the firm in SA. The results of this study are important to the King Committee and other corporate governance regulators in SA, in their effort to improve corporate governance practices and probably minimize corporate failure and protect the wellbeing of the minority shareholders. We contribute to the debate of whether good corporate governance is a prerequisite to good business and market performance (Che Haat et al, 2008). Furthermore, the study contributes to our understanding of the corporate governance variables affecting firm value in developing economies, especially SA.

The remainder of this paper is organized as follows: The second section reviews the related literature and develops the hypotheses. The third section presents the research design. The findings are presented in section 4 while, the conclusions are presented in section 5.

2. Theory and Hypothesis development

Corporate failure and scandals have led to demand for reforms and for better regulations particularly in the field of corporate governance. In the UK a number of issues in the early 1990's, most notably the collapse of the Maxwell business empire, stimulated discussions and debate about structures for controlling executive power (Power, 2002). A code of best practice was published in December 1992 (The Cadbury Code) which included recommendations for companies to establish audit committees comprising independent non-executive directors (Power 2002). In Africa, SA was the first to develop a corporate governance code of best practices in 1994 (Mangena and Chamisa, 2007, Mallin, 2004). The report, which draws extensively from the UK Cadbury committee report of 1992 was published by the King Committee (known as the Kind Report) was revised in 2002 and again in 2009 (Max 2009). According to Mangena and Chamisa (2007), a conspicuous feature of the king report is its adoption of the "inclusive approach" to corporate governance. Unlike codes of other countries which focus on wealth maximization, the king report encourages firms to consider a wider community of stakeholders.

The king report (2009) recommends; a) a unitary board structure with a balance between executive and non-executive directors (NEDs) preferably with a majority of NEDs, of whom a majority number should be independent. However, unlike the JSE code which specifies that listed companies should have a minimum of four directors, the King report is silent on the minimum number of directors; b) a separation of the roles of the chair person (who should be an independent NED) and the role of the CEO; c) that a substantial portion of the total remuneration of the executive directors should be performance based; and d) formation of at least the audit and remuneration committees, dominated and shared by independent NEDs. Overall, the King report highlights the board as the focal point of the corporate governance system (Mangena and Chamisa, 2007). It is important to note that compliance with the King report recommendations is voluntary in SA. However the JSE Listing code (2005) require firms to disclose in their annual reports the extent of their compliance with the king Report and reasons for non-compliance (Mangena and Chamisa, 2007)

Drawing from previous literature (Gupta et al 2009; Che Haat et al 2008; Mangena and Chamisa, 2007; Ehikioya, 2007; Brown and Caylor, 2006) this study investigates the relationship between corporate governance characteristics and the value of the firm in companies listed in the JSE Securities exchange of SA. Specifically we consider Corporate governance characteristics (Board size, Board composition, Ownership structure and Audit Quality), Firm value (measured by Tobin Q) and firm characteristics (Size, age, leverage, performance and Investment Opportunities).

2.1 Board Composition

The objective of corporate governance is to realize shareholders' long-term value while taking into account the interests of other stakeholders. Effective corporate governance and related accountability mechanisms are presumed to mitigate conflicts of interest and provide reasonable assurance that each party observes certain behavioural norms. One might expect that accounting would be well equipped to examine and prescribe improvements in accountability among agents in capitalist settings. The board of directors plays a key role in accountability, with the non-Executive directors having the most crucial role. Non-executive directors' role is to ensure that managers are accountable to the shareholders and that shareholders' interests are protected. According to Shapiro (2006), a higher proportion of non-executive in the board may increase controls on self-interested managers.

Empirical evidence on the association between outside independent directors and firm performance is mixed. Previous studies have found that having more outside independent directors on the board improves performance (Daily and Dalton, 1994), while other studies have not found a link between independent NEDs and improved firm performance (Hermalin and Weisbach, 1991). The point that can be made from these studies is that there is no clear benefit to firm performance provided by independent NEDs. Petra (2005) argues that the

mixed results may be reflective of a corporate culture wherein corporate boards are controlled by management and the presence of independent NEDs has no recognizable impact on management decisions. However, other empirical evidence does suggest that independent NEDs do play the important role of being a shareholder advocate. For example, Beasley (1996) reports that an investigation commissioned by the Treadway Commission into the governance structures of failed firms indicates that the boards of directors were dominated by management and "grey" directors (i.e. outsiders with special ties to the company or management). Beasley (1996) found that independent NEDs reduce the likelihood of financial statement fraud. Managena and Chamisa also found a negative relationship between proportion of NEDs and listing suspensions in SA. These studies indicate that independent NEDs do monitor and control management and this could lead to better company performance (Mangena and Chamisa, 2007; Ajinkya et al., 2005). Given that the main role of the board is to protect shareholders' interests, their monitoring activities should curtail managers' self-value maximizing actions. Therefore, we hypothesize the following:

H1: There is a significant positive relationship between the proportion of non-executive directors on the board (NEDs) and the value of the firm.

2.2 Board Size

According to Fama and Jensen (1983) the board is the central control mechanism responsible for minimizing agency costs that arise from the separation of ownership and decision control incorporations. Mangena and Chamisa (2007) argue that a well-constituted board of directors is more likely to act in the best interests of shareholders. However, although there is a general agreement that the board plays an important role in managing the firm and its activities there is no agreement over whether a large or small board does this better (Ehikioya, 2007). Prior literature argues that board size is an important aspect of effective corporate governance (Jensen, 1993; Yermack, 1996) and is related to firm performance (Baek et al., 2004; Haniffa & Hudaib, 2006). A larger board is more likely to have a greater range of expertise to monitor the actions of management effectively (Beasley, 1996; Karamanou &Vafeas, 2005) and also in securing critical resources (Goodstein et al., 1994). In contrast, Jensen (1993) and Yermack (1996) argue that large boards may be less cohesive and slow in making decisions, less candid in discussions of managerial performance, more difficult to coordinate, and easier to control by the CEO, thus constraining the board's effectiveness (Mangena and Chamisa, 2007).

Generally, the literature (e.g., Jensen, 1993; Karamanou & Vafeas, 2005) suggests that boards must be small enough for true discussion and debate between members to take place and large enough to have members with a mix of business judgment and experience. Both Linck et al. (2008) and Boone, et al. (2007) provide evidence suggesting that firms structure their boards in a manner that reflects the costs and benefits of monitoring the firm. In South Africa, the JSE Listing Requirements (2005) specifies that the minimum number of directors for listed firms should be four, while the King Report (2009) only recommends that the board should be of a size that allows for a diversity of expertise and experience to be effective monitors. In South Africa Deutsch Bank (2002) revealed that board size ranges from five to 30 directors, with a mean directorship of 12.

Empirically, the evidence on the association of board size with different organizational outcomes is mixed. Yermack (1996) finds an inverse relationship between board size and firm performance, whilst Haniffa and Hudaib (2006) report a positive relationship with operating performance. Karamanou and Vafeas (2005) also find a positive relationship between board size and management earnings forecasts. In a study that included SA, Ho and Williams (2003) fail to detect a significant relationship between performance and board size. We hypothesize the following:

H2. *There is a significant negative relationship between the size of the board and the value of the firm*

2.4 Ownership Structure

It has been argued that ownership concentration has both an entrenchment effect as well as an alignment effect. One argument has been that, concentrated control may be detrimental to minority shareholders as it induces insider expropriation and distorts management decision making (Bebchuk, et al, 2003). The other argument has been that the presence of controlling shareholders may help alleviate the traditional agency problems between owners and managers. However, the existing literature suggests that the alignment effect is subordinated to entrenchment effect under concentrated ownership structures (Lins, 2003)

Consistent with the Cadbury Committee (1992), the King Report 2009 emphasizes the role of shareholders in enhancing corporate governance in SA. Karamanou and Vafeas (2005) and Ehikioya, (2007) suggest that block shareholders are best suited for monitoring management due to their access to better information about the firm. Weir et al. (2002) also argue that there is greater potential for agency costs related to poor performance for block holders, thus providing greater incentives to monitor. Similarly, Shivdasani

(1993) argues that block holders have stronger incentives to invest in voting on corporate issues than non-block holders. Ehikioya, (2007) argue that a highly concentrated ownership structure tends to create more pressure on management to engage in activities that maximize investors and other stakeholders interests. On the other hand, Ajinkya et al. (2005) argue that there are circumstances under which block holders behave as insiders. They suggest that block holders may have undue influence over management and, therefore, secure self-serving benefits that are detrimental to other shareholders. This view is pertinent in the context of SA, because share ownership on the JSE is relatively concentrated (Malherbe & Segal, 2001; Sarra, 2004; World Bank, 2003). The controlling shareholders exert influence on management decisions through, in certain cases, electing their own representatives to the board of directors (Malherbe & Segal, 2001; World Bank, 2003). This problem, commonly referred to in SA as shadow directorship (King Report, 2002; World Bank, 2003, Mangena and Chamisa 2007), causes inefficiencies in the monitoring process as the controlling shareholders, though not directors per se, are able to exert influence on board activities. Thus, rather than being involved in monitoring and assessing the governance of the firms, shadow directors become involved indirectly in the running of the firms (World Bank, 2003). This may lead them to have incentives to extract private benefits that are not available to minority shareholders (Shivdasani, 1993).

Empirical evidence on the relationship between shareholder concentration and the value of the firm is mixed. Ehikioya (2007) and Haniffa and Hudaib (2006) find a positive relationship with firm performance, while Baek et al. (2004) report a negative relationship. Shivdasani (1993) show that block holders who are affiliated with management increase, while unaffiliated block holders decrease hostile takeovers. In India, Sarkar and Sarkar (2000) reported ownership concentration to have a positive relationship with firm value. Ehikioya (2007) also find a positive association between dispensed shareholding and performance in Nigeria. Yet Demsetz and Lehn (1985) and Weir et al. (2002) detect no significant relationship. Following Tsamenyi et al (2007) our study uses two proxies (Block shareholding defined as the proportion of shares held by substantial shareholders in excess of 5 percent of the total shareholding and dispensed shareholding defined as the percentage of the shares held by the 10 largest shareholders to total shares) to measure ownership structure. Therefore, we hypothesize the following:

H3. *There is a significant negative relationship between block-share ownership and the value of the firm*

H4. *There is a significant negative relationship between dispensed shareholding and the value of the firm*

2.4 Audit quality

Previous research indicates that audit quality is an important element of efficient equity markets, because audits can enhance the credibility of financial information and directly support better corporate governance practices through transparent financial reporting (Che Haat et al, 2008; Francis et al., 2003). According to DeAngelo, 1981 and Beatty, (1989), large public accounting firms with greater investment in reputational capital have more reason to minimise audit errors via "auditor-reputation effects". Furthermore, Dye (1993) argues that large audit firms are inclined to supply a higher quality audit compared to small firms, as more wealth is at stake in large audit firms. They will also experience a greater loss through reputation damage if the quality of their audit does not meet the accepted quality standards (Che Haat et al, 2008). Mitton (2002), argue that since quality audit is also one aspect of corporate governance, it is expected that firms which are audited by one of Big Four audit firms (a proxy for audit quality) will have a better market performance as well as greater transparency.

Wooten (2003) found that even after controlling for audit risk, client size and audit complexity, there is an additional premium based on auditor identity. DeFond and Jiambalvo's (1993) found that large audit firms are more independent of management. Therefore, empirical evidence seems to support the differential audit quality based on the type of audit firm. There are a number of empirical studies supporting the positive relationship between audit quality and audit firm size (Palmrose, 1988, 1986; Francis and Simon, 1987; Jang-Yong Jonathan and Lin, 1993; Hogan and Jeter, 1997). Shapiro (1983), Ferguson et al (2005) and Che Haat et al (2008) have also found a positive relationship between audit firm size and audit fee. As argued by Che Haat et al (2008) the use of ratio of audit fee to sales (as a proxy for audit quality) would be expected to provide more robust results compared to the dummy variable used for audit firm size. However their study found no significant relationship between higher audit quality and firm performance. We therefore hypothesize that:

H5: *There is a significant positive relationship between higher quality of audit and the value of the firm*

2.5 Firm Characteristics

Prior studies have found evidence suggesting a relationship between the quality of corporate

governance and firm characteristics such as performance, size, leverage and investment opportunities (Ariff et al 2007; Ehikoya, 2007 and Che Haat et al 2008). However there is no consensus of the direction of this relationship since prior literature show mixed results. Klapper and Love, (2003) and Ehikioya, (2007) using return on assets as a measure of performance found evidence to support that firms with better governance have higher operating performance. However Cho and Kim (2003) argue that a company would enhance their corporate governance, when the company's performance is poor because changes in corporate governance structures are expected to bring out positive results on their performance. This argument is supported by the findings of Gompers et al (2003) and Bauer et al (2004) who found a negative relationship between the quality of corporate governance and performance.

Jensen (1986) argues that the effect of firm size on governance is ambiguous as large firms may have greater agency problems and therefore need to compensate with stricter governance mechanism. On the other hand smaller firms have better growth opportunities and greater needs for external financing and better control mechanisms. The results of prior research have been mixed. Some previous studies (e.g. Cho and Kim, 2003; Ariff et al 2007) support a positive relationship between the size of the firm and its level of corporate governance. On the contrary studies by Gompers et al (2003), Brown and Caylor (2004) and Fama and French (1992) found a negative relationship between firm size and corporate governance.

Previous research on the relationship between leverage and the quality of corporate governance has yielded mixed results. Whereas Black et al (2003) and Brown and Caylor (2004) studies found a positive relationship between leverage and corporate governance, other studies e.g. Faccio et al (2001) and Friendman et al (2003) have found that higher levels of debt are associated with lower governance. Khanchel (2007) argue that good governance would increase capital expenditure and this increase would have a positive effect on the value of the firm. It has also been argued that firms with profitable investment opportunities will have better corporate governance (La Porrta et al, 1999; Dunery and Kim, 2002).

Based on the above literature review this study hypothesis that:

H6: There is a significant positive relationship between firm performance and the value of the firm

H7: There is a significant negative relationship between size and the value of the firm

H8: There is a significant negative relationship between leverage and the value of the firm

H9: There is a significant positive relationship between investment opportunities and the value of the firm

3.0 Research Method

3.1 Sample and data source

Quantitative methods are employed to examine the relationships between the independent variables (block shareholders, shareholder concentration, board size, proportion of non-executive directors, audit quality, investment opportunities, performance, company size and leverage) and dependent variable (value of the firm, measured Tobin Q). The data is drawn from annual reports of 50 largest companies listed on the JSE Securities Exchange of South Africa. These companies represent over 85% of the JSE market capitalization (Max 2009). The companies selected represent the largest companies in the market value on the JSE and as such would represent a wide spectrum of stakeholders' interest and shareholders' wealth, in South Africa. The data collected is for a 5-year period from year 2006 to the year ended 2010, which result in about 247-firm years. The design is chosen because the population is small and the use of panel data increases the number of observations, thus allowing meaningful statistical analysis. Where information was not available in annual reports, data was obtained from the companies' websites, or JSE Securities Exchange. In order to calculate values of variables to test the hypotheses, directors' report, profit and loss account, balance sheet and notes to the accounts were all read.

3.2 Firm value measurement

To measure the value of the firm (our dependent variable), we consider a company's market capitalization, the book value of debt and the book value of assets. Tobin's Q compares the market value of the firm with the replacement cost of the firm's assets. It also implies that the greater the real return on investment, the greater the value of Q (Che Haat et al, 2007). Following Che Haat et al (2007) we measure our Tobin Q as the market value of equity and the books value of the firm's debt divided by the book value of total assets.

3.3 Model specification

Following our hypotheses development in Section 2, we specify the following ordinary least squares OLS) regression model:

$$\text{TOBIN'S Q} = \alpha_0 + \alpha_1 \text{BLOCKSH} + \alpha_2 \text{DISPENSH} + \alpha_3 \text{BSIZE} + \alpha_4 \text{OPRONED} + \alpha_5 \text{AQUAL} + \alpha_6 \text{IOP} + \alpha_7 \text{PERF} + \alpha_8 \text{SIZE} + \alpha_9 \text{LEV} + \varepsilon$$

Where:

TOBIN'S Q = Measured as (MV of Equity + BV of Debt)/BV of total assets.

BLOCKSH = Measured as the number of block holders with shareholdings of 5% or more.

DISPENSH = Measured as the percentage of the shares held by the 10 largest shareholders to total shares
BSIZE = Measured as the total number of Directors
PROPNED = Proportion of non-executive directors, measured as the percentage of non-executive directors on the board.
AQUAL = Measured as the statutory audit fees divided by amount of sales
IOP = Measured as the Capital expenditures divided by total assets
PERF = Measured as Return on Assets (ROA) as measure by EBIT divided by Total Assets
SIZE = Company size measured as the Ln of total assets collected from the annual reports at the end of the financial year end
LEVER = Leverage measured as total liabilities divided by total assets both collected at the financial year end.

4.0 Results

In this section we present the results of the regression analysis. We first report the descriptive statistics and correlation results in Section 4.1. This is followed in Section 4.2 by a presentation of the regression results.

4.1 Descriptive Statistics and Correlation Matrix

Table 1 below presents a summary of the descriptive statistics of the dependent and independent variables.

Table 1. Descriptive Statistics

Variable	Obs	Mean	Std. Dev	Min	Max
TOBIN's Q	247	0.6883	0.7607	0.0270	9.780
BLOCKSH	247	85.9648	17.2682	22.200	99.940
DISPENSH	247	63.2202	20.1018	16.110	98.110
BSIZE	247	13.8664	3.78195	4	27
PROPNED	247	0.73839	0.11752	0.4545	0.9444
AQUAL	247	0.01668	0.11260	0	1.0741
IOP	247	0.09944	0.15992	0.0003	1.0047
PERF	247	0.22102	0.38455	-0.3241	2.8512
SIZE	247	18.64226	1.67889	9.24	25.12860
LEVER	247	0.63446	1.24691	0.003	0.96850

The table shows that the average firm value is 0.6688, suggesting low market valuation during our sample period. This may have been influenced by the 2008/2010 economic crises that may have slowed down the SA capital market. Block shareholding average 85.9% suggesting a high presence of institutional investors among the sample firms. Rahman and Ali, (2006), argued that there is a predominance of concentrated shareholding and controlling ownership in most developing countries. The mean size of the board is 13.8, with a minimum of 4 directors an indication that all the subject firms had complied with the JSE listing code (Mangena and Chamisa (2007).

The mean proportion of NEDs is 73.8%, suggesting that most SA boards are dominated by NED's as recommended by the King Report (2009). The mean leverage ratio of 63.4% means that SA companies maintain a well-balanced capital structure. Furthermore, the mean performance as measured by ROA was 22%, which is considered high. Therefore the dominance of independent directors within SA boards may have translated to higher financial performance in the subject companies.

The Pearson correlations are presented on Table 2.

Table 2. Correlation Matrix for the independent variables

	BLOCKSH	*DISPENSH*	*BSIZE*	*PROPNED*	*AQUAL*	*IOP*	*PERF*	*SIZE*	*LEVER*
BLOCKSH	1.000								
DISPENSH	0.065	1.000							
BSIZE	0.277	0.012	1.000						
PROPNED	0.356	0.069	0.003	1.000					
AQUAL	-0.087	0.090	0.001	-0.051	1.000				
IOP	-0.273	-0.262	0.170	0.076	0.067	1.000			
PERF	0.009	0.016	0.009	-0.021	-0.004	0.039	1.000		
SIZE	-0.238	-0.020	0.003	-0.167	-0.074	0.449	0.056	1.00	
LEVER	-0.138	-0.035	0.035	-0.227	-0.139	0.172	0.058	-.031	1.000

We use the correlation matrix to determine whether the independent variables are highly correlated. *Table 2* shows that there is little correlation among most of the independent variables as the highest correlation is 0.449 is less the benchmark of 0.7, suggesting that the problem of multicollinearity is not serious (Tibachnick and Fidel, 1996).

4.2 regression Results

The Multiple regress results are shown on Table 3 below:

As the table shows, the regression model has significant explanatory power. The adjusted R^2 of the model is 0.1957 and the F-value of 7.62 is significant at the 1% level or better. The adjusted R^2 of the model indicates that the model explains 19.57% of the variation in the firm value (Tobin's Q).

In terms of the explanatory factors, our findings indicate that there is a significant positive relationship between the proportion of NEDs and the value of the firm. The hypothesis that there is a significant relationship between the proportion of NEDs and firm value is therefore supported. These findings are consistent with those of Daily and Dalton (1994) who found that having more outside directors improves firm performance and Mangena and Chamisa (2007) who found a significant negative relationship between proportion of NEDs and listing suspensions in SA. Our study support the view that independent NEDs do monitor and control management and this leads to better company performance (Ajinkya et al, 2007).

Table 3. OLS regression results

Variable	Coeff.	SE	t-statistics	VIF
Constant	3.2351	0.5393	5.9980	
Block Shareholding	-0.01287	0.00280	-4.589***	1.23
Dispensed Shareholding	-0.00121	0.00225	-0.539	1.09
Board Size	-0.01216	0.01392	-0.874	1.44
Prop of NEDs	1.14917	0.42211	2.722**	1.29
Audit Quality	0.45806	0.40276	1.137	1.08
Investment Opportunity	0.58701	0.31801	2.046**	1.36
Performance	0.48207	0.13154	3.665***	1.35
Size	-0.05877	0.03406	-1.926**	1.72
Leverage	-0.02181	0.35133	-0.621	1.01
Adjusted R^2		19.57		
F-value		7.62***		

***,**,*Significant at the 1%, 5% and 10% respectively

We find that board size is not significantly related to firm value, although the direction of the coefficient is negative. Therefore, H2 is rejected. The negative coefficient suggests that large boards may lead to a decrease in the value of a firm. Yermack (1996) argues that large boards may be slow in making decisions and more difficult to coordinate and this may affect firm performance.

Our study finds a significant negative relationship between block shareholding and firm value, thus H3 is supported. Consistent with the findings of Mangena and Chamisa (2007) the results suggest that block shareholders are not effective in monitoring management. The findings are important as they support the view of the King report (2009) that no individual block shareholder should dominate management. Further our results suggest a negative relationship between dispensed shareholding and firm value. Although this relationship is not significant, it offers additional support to the view that large shareholders may participate in management as owner-manager and their participation becomes an obstacle to the CEO's effort to improve governance mechanism (Cho and Kim, 2003) and this would reduce firm value.

Our results find that audit quality is not significantly related to firm value. Although the direction of the relationship is positive as predicted our H5 is rejected. Chee Haat et al (2008) also found no significant relationship between higher audit quality and firm performance. However, our findings show a positive and significant relationship between firm performance and investment opportunity and the value of the firm, thus consistent with H6 and H9. The results support the view that better governed firms can offset myopia and allow managers to make long-term decisions to increase capital expenditures and this could have a positive effect on firm value (Khanchel (2007).

We also found a significant negative relationship between firm size and the value of the firm, which is consisted with H7. However we found no significant relationship between leverage and firm value, thus H8 is not supported. Although the findings are inconsistent with those of Ehikioya (2007) who found that larger firms with higher levels of debt ratio perform better than smaller firms, they support the view that smaller firms may have more growth opportunities, hence a higher valuation by the market.

5.0 Conclusions

The purpose of this study is to investigate the relationship between corporate governance characteristics and firm value in companies listed in the JSE Securities Exchange of South Africa. Specifically we draw from Agency theory to examine whether corporate governance characteristics (Board size, Board composition, Block shareholding and dispensed shareholding and Audit quality) influence the value of the firm. Consistent with agency theory, the results show a positive significant relationship between the proportion of NEDs and firm value, suggesting that independent NEDs help to monitor and control management. Furthermore the results support the recommendations of the King Report (2009) which calls for a board consisting of a balance between executive and non-executive directors preferably with a majority of NEDs, of who a majority number should be independent.

Block shareholding is found to be negatively related to the value of the firm, suggesting that high shareholder's concentration decreases the market value of the firm. The results indicate that block shareholding plays an insignificant role in monitoring and controlling corporate management in SA. This finding is important given the "shadow directors" problem in the SA corporate sector. Indeed the king Report (2009) recommends that shadow directors should be discouraged in SA firms.

Finally, we find no significant relationship between board size, dispensed shareholding and firm value. However we note that the direction of the coefficient is positive suggesting that larger boards may impede firm value maximization. Likewise, higher shareholding concentration inversely affects firm value, suggesting the need for leaner boards and a more dispensed shareholding in SA firms.

Our study contributes to the literature on corporate governance debate both in SA as well as the other developing countries of Africa. In particular the findings are important to those countries, including SA where recent corporate failures have been blamed on poor corporate governance structures. Moreover our study makes the first attempt to evaluate whether compliance with the recommendations of the King Report (2009) increases the value of the firm. In this respect, we have found that good corporate governance practices are associated to higher firm values. Therefore, in the context of Africa, strengthening of corporate governance practices may improve the market value of African firms, which would in turn attract more foreign investors, thus impinge upon economic growth. Empirical evidence suggests that foreign investors avoid investing in developing countries because of weak corporate governance practices (Gibson 2003; Bokpin and Isshaq, 2009)

Despite the importance of our study, the findings should be interpreted in the light of the following limitations. First our study sample consists of the fifty largest firms listed in the JSE of SA. Therefore the results may not be generalized to other smaller firms operating in SA. Second, this

study is constrained to SA. Firms in other developing countries may differ from their SA counterparts. This may be so because of legal and regulatory constraints and economic policies that may differ between countries. Future research may be designed to compare the findings of this study with findings that relate to firms operating in other developing countries of Africa.

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