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**The relationship between corporate governance and
company performance**

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Abstract

Corporate Governance and in particular, the role of the board of directors, have been placed at the centre of attention due to the recent well-publicized corporate scandals (Adams, Hermalin, & Weisbach, 2009). In South Africa, both the King II and recently published King III reports emphasise the importance of the board of directors, as being the crucial aspect of the South African corporate governance system (Institute of Directors, Southern Africa, 2002, 2009).

The aim of this study was to determine the relationship between corporate governance and company performance. This was achieved by defining six specific characteristics of the board of directors in relation to corporate governance (independent variables of board independence, CEO-Chairman duality, staggered boards, board size and the presence and composition of the board remuneration committee), as well as identifying five company performance measures (dependent variables of net profit margin, return on equity, return on assets, share price and dividend payout).

In reviewing the available literature, it was found that there is a lack of an appropriate and publicly available corporate governance measurement tool in South Africa. The Delphi technique was used to garner the views of four experts in the corporate governance field, in order to obtain their views as to what constitutes the research selected independent variables. The emergent themes from these interviews guided the measurement of these board variables and empirical testing against the selected company performance measures using the 21 Consumer Goods Companies listed on the Johannesburg Stock

Exchange with published financial statements over the time period commencing on 01 January 2006 and ending on 31 December 2010.

The overall results of this study indicate that the vast majority of board selected variables relating to corporate governance had a positive relationship with company performance. Of the six independent variables selected for testing, board independence, board size and composition of the board remuneration committee were found to have statistically significant relationships with the dependent variables of company performance, while the presence of a board remuneration committee indicated a moderate relationship (with only return on assets and net profit margin indicating a significant relationship) and staggered boards revealed no statistical significant difference.

The relationship between CEO-Chairman duality and company performance could not be assessed, due to the sector data set revealing only one instance in which this duality existed.

Key Words

Corporate governance

Company performance

Board of directors

Declaration

I declare that this research project is my own work. It is submitted in partial fulfilment of the requirements for the degree of Master of Business Administration at the Gordon Institute of Business Science, University of Pretoria. It has not been submitted before for any degree or examination in any other university. I further declare that I have obtained the necessary authorisation and consent to carry out this research.

Anusha Rambajan

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I initiated the MBA program with specific expectations and goals in mind and I never would have imagined that these would have been so greatly surpassed. I have matured immensely both personally and professionally and this is a journey I would recommend to all seeking a revolutionary change in their lives. The completion of this gargantuan qualification would not have been possible without the support and understanding of my dear husband, family and colleagues.

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1. Introduction to the Research Problem

1.1 Research Title

The relationship between corporate governance and company performance.

1.2 Research Problem

The onslaught of corporate scandals has compelled the world to recognise and acknowledge the importance of corporate governance practices on the global economy (Vaughn & Verstegen Ryan, 2006).

“The downfall of Enron, conviction of Arthur Anderson, and bankruptcy of WorldCom define what has been called an historic period of corporate greed, unprecedented fraud, widespread “gatekeeper” failure, and organisational misgovernance” (Coffee, 2004a; Gordon, 2002; Langevoort, 2003, 2004; Ribstein, 2002 cited in (Laufer, 2006, p. 239)).

On a more recent front, the 2008 global financial crisis can also be attributed to weaknesses and failures within corporate governance structures. According to Kirkpatrick (2009), there were a number of corporate governance mechanisms which failed to safeguard against the excessive risk-taking at many financial services companies, which included issues surrounding risk management, board accountability and monitoring,

company disclosure on foreseeable risks and review of remuneration systems.

Investors, in having lost a great deal of money as a result of these corporate frauds and mismanagement, are now looking for ways to prevent and detect this from happening again (Bradley, 2010).

Developing economies (such as South Africa) have as a result come to recognise the need for good corporate governance, as international investors are hesitant to lend money or buy shares in companies which do not subscribe to good corporate governance principles (McGee, 2010).

Following the implementation of the South African King II Committee Report, it was evident that “South Africa benefited enormously from its listed companies following good governance principles and practices, as was evidenced by the significant capital inflows into South Africa before the global financial crisis of 2008” (Institute of Directors, Southern Africa, 2009, p. 6).

The application of good governance is therefore increasingly being viewed as a valued feature of a well-run company. However, is good governance an additional burden on companies or is there a return on the investment? “Although there is a growing literature linking corporate governance to company performance there is, equally, a growing diversity of results” (Korac-Kakabadse, Kakabadse, & Kouzmin, 2001, p. 24).

Ammann, Oesch, & Schmid (2011) highlighted within their research results that better corporate governance practices are reflected in both statistically and economically significantly higher market values. For the average firm within the sample, the costs of implementing corporate governance mechanisms were found to be smaller than the benefits, resulting in higher cash flows accruing to investors and lower costs of capital for the companies (Ammann *et al.* 2011). This is further supported by studies carried out by Brown & Caylor (2006) and Balasubramanian, Black, & Khanna (2010), who found positive and statistically significant correlations between corporate governance and firm value.

In contrast, some studies identify either negative or no correlations between corporate governance and company performance. Erkens, Hung, & Matos (2010) in their study of corporate governance during the 2007-2008 financial crisis found that companies with more independent boards and higher institutional ownership experienced worse stock returns during the crisis period. The study suggests that this was attributable to (1) companies with higher institutional ownership taking more risk prior to the crisis, which resulted in larger shareholder losses and (2) companies with more independent boards raising greater equity capital during the crisis, leading to wealth transfer from existing shareholders to debt holders (Erkens *et al.* 2010).

Even though a study by Bauer, Frijns, Otten, & Tourani-Rad (2008) highlighted that well-governed companies significantly outperform poorly governed companies by up to 15 percent per year, even after correcting

statistics for market risk and size and book-to-market effect, only 50 percent of the tested governance variables were positively correlated with stock performance.

It is apparent that the relationship between corporate governance and company performance is not clearly established and therefore companies develop and rely on their board of directors to serve as a source of counsel, advice and discipline, in executing their fiduciary duty of protecting shareholder interests (Adams, Hermalin, & Weisbach, 2009).

However, the recently well-publicized corporate scandals have placed corporate governance and in particular the role of the board of directors at the centre of attention (Adams *et al.* 2009). This was evidenced, in particular, with the directors of Enron and WorldCom, who paid \$168 million (\$13 million of which was out of pocket and not covered by insurance) and \$36 million (of which \$18 million was out of pocket) to investor plaintiffs, respectively (Adams *et al.* 2009).

Albeit the recent topical focus, corporate governance has been a subject of longstanding interest in economics, dating as far back at least to Adam Smith in 1776, who wrote the following in respect to directors (Adams *et al.* 2009):

The directors of such companies, however, being the managers rather of other people's money than of their own, it cannot well be expected that they should watch over it with . . . anxious vigilance . . . Negligence

and profusion, therefore, must always prevail, more or less, in the management of the affairs of such compan[ies] (Book v, Part iii, Article i, “Of the Publick Works and Institutions which are necessary for facilitating particular Branches of Commerce,” paragraph 18 cited in Adams *et al* (2009, p. 44).

The King II Committee Report, in echoing the importance of the board of directors, emphasized this as being the crucial aspect of the South African corporate governance system (Institute of Directors, Southern Africa, 2002).

1.3 Research Aim

Thus, the aim of this study to determine through empirical evidence, the relationship between specific board characteristics of corporate governance and company performance of listed South African companies in the Consumer Goods sector.

The need for this study is supported by the following compelling reasons:

- The inconclusive results of studies carried out in various countries; and
- Limited availability of research on the subject matter within South Africa.

2. Literature Review

2.1 Background

Corporate governance is broadly defined as the system by which a company's processes are directed and controlled, in the pursuit of creating and maximising shareholder value (Institute of Directors, Southern Africa, 1994).

The corporate failures experienced over the recent years signalled a need for systems and frameworks to be established that not only governed the internal operating controls and systems of an organisation but also provided shareholders with the required level of comfort that value and wealth were being created and maintained as a result. This view culminated in countries all over the world developing codes of practices best suited to their individual needs (Brennan & Solomon, 2008).

For example, in the UK, The Cadbury Report (1992), The Combined Code (1998), The Combined Code on Corporate Governance (2003, 2006), the Greenbury Report (1995) and the Higgs Report (2003) all approached corporate governance reform from the perspective of protecting and enhancing shareholder wealth; similarly in the USA with the arguably costly Sarbanes-Oxley (SOX) legislation. Other countries have adopted similar approaches and perspectives (Brennan & Solomon, 2008, p. 886).

Advocates and reformers of corporate governance claim that good governance policies are essential for high performance (Valenti, Luce, & Mayfield, 2011). Scholars and practitioners reason that if a company is paying attention to safeguarding the interests of its owners, the assets of the firm will be employed in a manner to minimize waste and maximize profitability, resulting in above average gains to shareholders (Valenti *et al.* 2011).

This view of corporate governance forms the basis of Agency Theory, which proposes that boards of directors are put in place to protect shareholders' interest against the agency problem (Jermias, 2008). The agency problem arises when there is a role divide between ownership (shareholders) and control (generally management) of a company and due to the resultant information asymmetry; managers tend to behave opportunistically to maximize their own interest at the expense of the shareholder (Jermias, 2008). One of the main functions of the boards of directors is to monitor management on behalf of shareholders, effective monitoring of which will reduce agency costs leading to better performance (Jermias, 2008).

Another theory that focuses on board of directors as a governing body is Resource-dependence theory (Valenti *et al.* 2011). This view centres on the relationship between board capital (resources) and company performance, with board capital defined as board expertise, experience, counsel, advice, reputation and linkages to other institutions and

companies (Udayasankar, 2008). Hillman and Dalziel (2003) cited in Jermias (2008) contend that board capital will improve the effectiveness of firms' governance mechanisms.

Stakeholder theory on the other hand takes a more inclusive approach to corporate governance and considers the interests of all stakeholders affected either directly or indirectly by a company's actions. The South African corporate governance King II and King III Committee Reports are said to adopt a more inclusive stakeholder approach. However, while acknowledging that the company is responsible to its stakeholders, the King Committee Reports maintain that accountability is limited to shareholders, and no attempt is made to alter or supplement the shareholder-oriented financial reporting system (West, 2009). Further, the board is referenced as the focal point of corporate governance within the King Committee Reports (Institute of Directors, Southern Africa, 2009; Mangena & Chamisa, 2008). Therefore, companies are encouraged to adopt the stakeholder approach while maintaining formal structures with a shareholder orientation (West, 2009).

Looked at through the various corporate governance theories, it is evident that the board of directors is an important component of internal governance that enables management and performance of companies (Che Haat, Rahman, & Mahenthiran, 2008). Therefore, the focus of this study will be on the relationship between the board characteristics of corporate governance and company performance.

2.2 Corporate Governance in South Africa

Given South Africa's significance as an emerging market, its potential leadership role on the African continent and the country's notable corporate governance reform since the collapse of apartheid in 1994; corporate governance is of particular importance considering that the infusion of international investor capital and foreign aid is essential to economic stability and growth (Vaughn *et al.* 2006).

In 1992, the King Committee was established, under the chairmanship of Mervyn King, with the task of providing a set of corporate governance guidelines for South Africa. This followed the release of the Cadbury Report in the UK in 1992. The first King Committee Report was released in 1994 and was seen both as an effort to reinforce the fundamentals of a capitalist corporate system in light of significant political uncertainty and as a means of aligning the economy with international trends and imperatives (West, 2009). The report covered many of the same issues as the Cadbury Report, with considerable attention paid to the board of directors and the protection of shareholders (West, 2009). The exception though was the inclusion of some non-financial concerns and engagement with stakeholders (West, 2009).

The King II Committee Report soon followed in 2002, addressing many of the highlighted corporate governance failures of Enron, WorldCom and

Parmalat, amongst others (West, 2009). A differentiating factor of the King II Committee Report was the adopted “inclusive” approach, whereby a more holistic stakeholder view was taken as opposed to the shareholder view adopted by many governance systems with developed countries.

In terms of the board of directors, the King II Committee Report highlighted the board as the focal point of the corporate governance system (Mangena & Chamisa, 2008) and recommended the following board specific variables relevant to this study:

- Every board consider whether or not its size, diversity and demographics makes it effective;
- The board comprise a balance of executive and non-executive directors (NEDs), preferably with a majority of NEDs, of whom a sufficient number should be independent of management;
- A programme ensuring a staggered rotation of directors be put in place by the board;
- Separation of the roles of the chairperson (who should be an independent NED) and the chief executive officer (CEO); and
- Formation of a remuneration committee dominated and chaired by independent NEDs.

The King II Committee Report has since evolved into the King III Code of Governance Principles published in 2009. The aim of the framework is to ensure integrated business reporting on an annual basis with particular focus on three elements, namely people, planet and profit.

The King III Report became effective on 01 March 2010 and also references the board as the focal point for corporate governance (Institute of Directors, Southern Africa, 2009), recommending the following board specific variables relevant to this study:

- The board comprise a balance of executive and NEDs, with the majority being independent NEDs;
- The board be led by an independent non-executive Chairman, who is not the CEO;
- The board consider whether its size, diversity and demographics makes it effective;
- At least one-third of non-executive directors retire by rotation annually; and
- Formation of a remuneration committee chaired by and comprising independent NEDs.

The defining difference between the King II and King III Committee Reports, is that where previously the King II Committee Report applied to only JSE listed companies, King III applies to all entities with the adopted view of an “apply or explain” approach to the outlined principles. Changes and additional requirements within the King III Committee Report provide emphasis to integrated sustainability performance, directorship appointments, shareholder approved remuneration policies, board approval of executive director remuneration, issue of share options to non-executive directors, positioning of and approach followed by internal audit and companies’ risk management processes.

In addition to the principles outlined in the King III Committee Report, the duties, responsibilities and obligations of directors within South Africa are legally bound by the 2008 Companies Act, which was recently reformed and made effective on 01 May 2011. In terms of section 66(1) of the Act, “the business and affairs of the company must be managed by or under direction of its board, which has the authority to exercise all of the powers and perform any of the functions of the company, except to the extent of this Act or the company’s Memorandum of Association” (Burger, 2011, p. 7). This requires directors and prescribed officers in executing their fiduciary duties, to (i) act in the best interests of the company, (ii) act in good faith and for a proper purpose and (iii) not to disclose/misuse confidential information (Burger, 2011).

However, with this power and authority comes greater accountability on the part of company directors and prescribed officers, in that non-compliance to the Act could equate to the company or individual being fined or imprisoned.

2.3 Corporate Governance and Company Performance

One of the most debated governance topics centres on the relationship between corporate governance and company performance, which is the underlying aspect being addressed in this study. If the level of corporate governance does not affect the performance of companies, then the

importance of governance is diminished in the eyes of managers and shareholders (Stanwick & Stanwick, 2010).

Due to the recent corporate scandals, investor behaviour has become more conservative. The investment in corporate governance can act as a mechanism to attract and provide a level of comfort to potential and current investors. However, studies have highlighted mixed views in this respect.

In their study examining the relationship between corporate governance and share price performance, Bauer *et al.* (2008) found that well-governed companies significantly outperform poorly governed companies by up to 15 percent per year, after correcting statistics for market risk and size and book-to-market effect. Bhagat & Bolton (2008) on the other hand, found that none of the governance measures were correlated with future stock market performance.

Brown & Caylor (2006) through empirical testing and by using a summary of defined internal and external governance measures (in their model termed Gov-Score) found a significant and positive correlation between firm valuation and the provisions underlying the Gov-Score. The study, however, identified no significant link between firm valuation and five corporate governance measures relating to accounting and public policy (Brown & Caylor, 2006).

Jiraporn, Kim, & Kim (2010) noted that the quality of corporate governance has a definite impact on dividend policy in mitigating agency problems and ultimately ensuring a more robust process in terms of policy development. Empirical evidence demonstrates that companies with stronger governance quality exhibit a stronger propensity to pay dividends and those that do pay; pay larger dividends (Jiraporn *et al.* 2010). This is further supported by a study carried out by Reddy, Locke, & Scrimgeour (2010), who found that the governance mechanism of dividend payouts can be used to minimise agency problems in an efficient manner and was found to contribute positively to company performance. Contrary to this was the evidence presented by Renneboog & Szilagyi (2007) who found that the dividend payouts for a sample of Dutch companies were smaller for those imposing stronger restrictions on governance controls.

Recent research covering the South African environment related to the use of the relevant governance framework available to companies in 2002, being the King II Committee Report. The study analysed the stock returns and company valuations of 97 South African listed companies in nine JSE sectors over the time horizon defined by the period at which the King II Committee Report had been implemented (Abdo & Fisher, 2007). A governance scorecard (termed G-score) developed exclusively for the study, was underpinned by seven distinct governance categories based largely on the King II principles and the Standard & Poors (S&P) International Corporate Governance Score (CGS) Index. The study found that overall, corporate governance was positively correlated with share

price returns (correlation of 0.27) over the period from 30 June 2003 to 30 June 2006, with the governance measures of internal audit and risk management having the lowest correlations, being 0.08 (Abdo & Fisher, 2007).

A further study carried out on the corporate governance environment in South Africa by Muniandy, Hillier, & Naidu (2010), examined the impact of internal corporate governance via the association of firm performance (measured by return on assets and return on equity) and the investment opportunity set (IOS) of 105 companies listed on the Johannesburg Stock Exchange. The corporate governance variables used were the proportion of non-executive directors on the board, proportion of non-executive directors on the audit committee and having a non-executive chairman on the board. The results of the study suggest that a greater proportion of non-executive directors on the audit committee and a non-executive chairman moderate the relationship between IOS (measured by market-to-book value of equity) and firm performance (Muniandy *et al.* 2010). However, a greater proportion of non-executive directors on the board strengthen the relationship (Muniandy *et al.* 2010). These results are, however, based on a limited time period, being only 2002, as this was the year the King II Committee Report was released and enforced. Hence the primary purpose of the study by Muniandy *et al.* (2010) was to evaluate whether there was any association between the corporate governance variables and firm performance following the introduction of the King II Committee Report.

In noting the mixed results, Che Haat *et al.* (2008) argue that in the absence of corporate governance mechanisms, the overall economic performance of companies is likely to suffer, as outside investors would be unwilling to lend to companies or buy their securities.

Thus, the investment in corporate governance facilitates the ability to secure confidence for both shareholders and stakeholders, in ensuring that companies are accountable for their actions (Stanwick & Stanwick, 2010). The dominant form of corporate governance for these companies is the board of directors (Stanwick & Stanwick, 2010).

2.4 Board of Directors and Company Performance

“The board of directors is one of a number of internal governance mechanisms that are intended to ensure that the interests of shareholders and managers are closely aligned, and to discipline or remove ineffective management teams” (Kang, Cheng, & Gray, 2007, p. 194).

The underlying assumption is that if the board executes its responsibilities correctly, the resultant effect is higher company performance (Stanwick & Stanwick, 2010). Therefore, the focus of this study is on the relationship between selected board characteristics of corporate governance and company performance.

2.5 Board of Director Characteristics and Company Performance

2.5.1 Board Independence

Directors are typically divided into two groups, being executive directors and non-executive directors (NEDs). A director who is a full-time employee of the company is deemed an executive director, whereas a director, whose primary employment is not with the company, is deemed to be a NED or independent NED (Adams *et al.* 2009).

Within a South African context, both the King II and King III Committee Reports require a balance between executive and NEDs to sit on any board, preferably with a majority of NEDs, of whom a sufficient number should be independent (Institute of Directors, Southern Africa, 2002, 2009). Mixed results have, however, been produced from studies that examined the relationship between board independence and company performance.

A study conducted by Mashayekhi & Bazaz (2008) of 240 companies (excluding banks) listed on the Tehran Stock Exchange over the years 2005 and 2006, considered four characteristics of board of directors (being board size, board independence, board leadership and directors as institutional investors) in investigating the relationship between corporate governance and company performance. Using the dependent variables of earning per share (EPS), return on equity (ROE) and return

on assets (ROA) as measures of performance, Mashayekhi & Bazaz (2008) found a negative correlation between the corporate governance variables of board size and institutional investors, and a statistically insignificant correlation to board leadership. The only positive and significant correlation to all three dependant variables of company performance was that of board independence (Mashayekhi & Bazaz, 2008). Board independence was operationally tested as a higher proportion of independent directors on the board.

In their research relating to the effects of corporate governance on stock price volatility and overreaction to a time of political crisis in Taiwan (being the 2004 presidential elections), Huang, Chan, & Huang (2011) indicated that volatility and overreaction was lower in companies with independent NEDs (one of three selected board structure variables) than in companies without. The reasons provided indicated that NEDs are more capable of independently and objectively monitoring managers than inside directors, and thus increase investors' confidence in companies (Huang *et al.* 2011).

An opposing view was the study carried out by Bhagat & Bolton (2008) over the sample period of 1990 to 2004 using the independent governance variables of board independence, board ownership and CEO-Chairman duality. In using the dependent performance variables of ROA, stock return, Tobin's Q (being the book-to-market value of assets) and the four-digit SIC code average (industry performance measure), Bhagat & Bolton (2008) found a negative correlation between board

independence and future operating performance. The board independence variable was operationally tested as the number of unaffiliated independent directors divided by the total number of board members (Bhagat & Bolton, 2008).

This was further supported by Che Haat *et al.* (2008), who found that the internal governance factors consisting of four independent variables namely, composition of independent NEDs on the board, no role duality, quality of directors and insider ownership, all had no significant influence on company performance (represented by Tobin's Q).

Therefore, from the negative correlations, it is apparent that if the purpose of board independence is to improve performance, then such efforts may be misguided (Bhagat & Bolton, 2008). However, if the purpose of board independence is to discipline management of poorly performing firms, then board independence has merit (Bhagat & Bolton, 2008).

Positive correlations, on the other hand, indicate stronger monitoring and benefits from the presence of NEDs (Mashayekhi & Bazaz, 2008).

2.5.2 CEO-Chairman Duality

The role duality of CEO and Chairman can have significant impact on the relationship between corporate governance and financial performance. Should this role duality exist within a company, this appointed individual has the power to determine the structure, content and presentation of

information at board meetings which could impact board performance, board accountability and the level of board disclosures (Kang *et al.* 2007). This is supported by both the South African King II Committee Report and the more recent King III Report which requires a role split between the function of CEO and Chairman, given the strategic operational role of the CEO (Institute of Directors, Southern Africa, 2002, 2009). Based on this, the role split is seen as one of the important determinants and measurements of corporate governance.

This view is substantiated by the study carried out by Bhagat & Bolton (2008), who found that CEO-Chair separation is significantly positively correlated with operating performance. Further, a study conducted within the developing economy of Nigeria by Ehikioya (2009) found significant evidence to support the fact that CEO duality adversely impacts on company performance, substantiating further the need of the role split in order to achieve optimal performance. Contrary to this, was the study by Mashayekhi & Bazaz (2008) who found that the issue of duality does not have a significant negative impact on company performance.

In all these studies, the CEO-Chair duality was operationally tested as equating to one when the duality did exist and zero if not.

Even though the literature seems to argue that the separation of the CEO and the Chairman roles leads to improved corporate governance, the real question is whether this leads to improved monitoring by the board

and a resultant increase in company performance (Mashayekhi & Bazaz, 2008).

2.5.3 Staggered Boards

A staggered board (also known as a classified board) exists when instead of holding annual director elections, directors are elected for multiple years at a time and only a fraction of the directors are elected in a given year (Adams *et al.* 2009). A recent wave of shareholder activism focuses on de-staggering corporate boards and instituting annual elections of all directors, underpinned by the basic notion that staggered boards entrench management and reduce the effectiveness of directors, thereby hurting firm value (Faleye, 2006). “In response, management often defends staggered boards as promoting board stability, director independence, and a culture of effective long-term strategic planning” (Faleye, 2006, p. 33). Further, staggered boards are seen as a mechanism that serves to protect management by making takeovers difficult (Adams *et al.* 2009).

Empirical evidence indicates that having staggered boards benefits management at the expense of shareholders, resulting in a reduction in company value (Bebchuk, Cohen, & Wang, 2010; Faleye, 2006). An implication of this view is that when companies do “de-stagger” and return to annual elections for all directors, value should increase (Adams *et al.* 2009).

In a South African context, both the King II and King III Committee Reports call for the staggered rotation of the board of directors (Institute of Directors, Southern Africa, 2002, 2009). This perhaps indicates that a movement towards greater accountability demands the de-staggering of corporate boards (Faleye, 2006).

2.5.4 Board Size

“There is no one optimal “size” for a board” (Reddy *et al.* 2010, p. 194). The King II Committee Report, did not provide a specific number regarding the size of a board, but required that every board consider whether or not its size, amongst the factors that include diversity and demographics, makes it effective (Institute of Directors, Southern Africa, 2002).

Reddy *et al.* (2010) in their study of publicly listed New Zealand companies argued that to balance skills required in the boardroom, companies may require a larger board size. This was, however, not supported by their empirical testing which indicated that board size did not have any significant effect on company performance across all selected financial performance measures (Reddy *et al.* 2010).

This was further supported by a study of Iranian companies carried out by Mashayekhi & Bazaz (2008) concluding that a larger board size generally reflects weaker controls and therefore weaker performance.

These researchers argued that if the board size is large, board members would find efficient communication and consensus difficult to achieve, whereas a smaller board may be less encumbered with routine problems and may provide better company performance (Mashayekhi & Bazaz, 2008).

In an opposing view, Tanko & Kolawole (2008) found a high correlation between the board's size (operationally measured as the number of directors on the board) of the Nigerian companies used in the study and their financial performances. This supports the view that larger boards are better for corporate performance because members have a range of expertise to help make better decisions and these boards are typically more difficult for a powerful CEO of a company to dominate (Tanko & Kolawole, 2008).

2.5.5 Board Remuneration Systems

One of the key contributing factors to the 2008 financial crisis was the remuneration and incentive systems which encouraged excessive risk taking. It was found that the remuneration systems in a number of cases were not closely aligned to the strategy, risk appetite and longer term interests of the companies concerned (Kirkpatrick, 2009). Morck *et al.* (2000) cited in Bauer *et al.* (2008) noted that remuneration affects corporate governance: First, remuneration is directly related to the amount of funds distributable to shareholders and second, the concept of

aligning managers' interests with shareholder interests through financial incentives. Furthermore, the establishment of a board remuneration committee has been viewed as a mechanism for improving board effectiveness (Main and Johnston, 1993; Newman and Mozes, 1999; Newman, 2000) cited in (Brennan & Solomon, 2008)).

From a South African perspective, the King III report has identified remuneration systems as a governance point requiring greater transparency and alignment to the long-term strategies of companies (Institute of Directors, Southern Africa, 2009).

In their study, Bauer *et al.* (2008) found that remuneration systems, that were measured through the existence of an independent remuneration committee, transparent remuneration policies and remuneration being equity based, was deemed significant for stock price performance. In a further study carried out by Reddy *et al.* (2010) of publicly listed New Zealand companies, it was found that using the variables of Tobin's Q and ROA, the presence of a remuneration committee had a positive effect on company performance.

The results of these studies indicate the need by shareholders and stakeholders for greater transparency in the way in which senior executives are remunerated and alignment to overall company performance.

In conclusion, it is apparent that although there is extensive research carried out in the field of corporate governance and its impact on company performance, the results show inconsistencies and therefore remain inconclusive (Abdo & Fisher, 2007); (Bauer *et al.* 2008); (Bebchuk *et al.* 2010); (Bhagat & Bolton, 2008); (Brown & Caylor, 2006); (Che Haat *et al.* 2008); (Ehikioya, 2009); (Faleye, 2006); (Huang *et al.* 2011); (Jiraporn *et al.* 2010); (Mashayekhi & Bazaz, 2008); (Muniandy *et al.* 2010); (Reddy *et al.* 2010); (Renneboog & Szilagyi, 2007); (Tanko & Kolawole, 2008)), therein providing a compelling case for this study within the South African business environment.

The study by Abdo & Fisher (2007) on the South African corporate governance environment explored seven governance categories based largely on the King II principles of board effectiveness, remuneration, accounting and auditing, internal audit, risk management, sustainability and ethics. The seven governance categories were assessed against the financial performance measures of share price and firm valuation, in determining the relationship between corporate governance and company performance over the period between 30 June 2003 to 30 June 2006. All companies within nine sectors covering major industries on the JSE were chosen for this analysis.

Abdo & Fisher's (2007) study was replicated by Kolobe (2010) over an extended period being between 2003 and 2009. While the study carried out by Abdo & Fisher (2007) revealed a positive correlation between governance disclosure and company performance, the replication study

by Kolobe (2010) confirmed only a positive correlation to firm valuation and not share price.

Consistent with the positive results of Abdo & Fisher (2007), was the study conducted by Ntim, Opong, & Danbolt (2009) on the relationship between a broad corporate governance index (based largely on the principles of the King II Committee Report) and firm value (measured by Tobin's Q), over an entire usable sample of 169 South African listed firms between 2002 and 2006. Therefore, the studies by Abdo & Fisher (2007) and Ntim, Opong, & Danbolt (2009) were found to have similarities in terms of the governance and company performance variables used, company period assessed and empirical results.

This study, on the other hand, will focus on specific board characteristics of corporate governance being board independence, CEO-Chairman duality, staggered boards, board size and the board remuneration committee. Additionally, dependent variables of company performance to be used in this study include net profit margin, return on equity, return on assets, dividend payout percentage and company share price.

The purpose of this study is therefore to determine through empirical evidence, the relationship between the discrete variables of corporate governance and performance of listed South African companies in the Consumer Goods sector. This study thus adopts a more focused

approach in terms of the corporate governance variables and JSE sector used, when compared to the broad range of governance variables and company data set used by Abdo & Fisher (2007), Kolobe (2010) and Ntim, Opong, & Danbolt (2009).

3. Research Questions

“A research question is the hypothesis of choice that best states the objective of the research study” (Blumberg, Cooper, & Schindler, 2008, p. 64). It should be considered a fact-orientated, information-gathering question (Blumberg, Cooper, & Schindler, 2008).

The purpose of this study was to determine through empirical evidence, the relationship between selected board characteristics of corporate governance and company performance. The following research questions were therefore defined:

Research Question 1: Is there a relationship between the proportion of independent non-executive directors on the board and company performance?

Research Question 2: Is there a relationship between CEO-Chairman duality and company performance?

Research Question 3: Is there a relationship between staggered boards and company performance?

Research Question 4: Is there a relationship between board size and company performance?

Research Question 5: Is there a relationship between the presence of a board remuneration committee and company performance?

Research Question 6: Is there a relationship between the proportion of independent non-executive directors on the board remuneration committee and company performance?

4. Research Methodology

4.1 Variables Defined

The aim of this study was to determine the relationship between the board characteristics of corporate governance and company performance of listed South African companies within the Consumer Goods sector. In doing so, selected independent board variables of corporate governance and dependant variables relating to company performance were used.

These variables were defined as follows:

4.1.1 Dependent Variables - Company Performance

Operating Performance

The following profitability ratios were defined as the operating performance measures for this study:

- Net profit margin = Net profit for the year ÷ Total revenue for the year;
- Return on Equity = Net profit for the year ÷ Average shareholder equity for the year; and
- Return on Assets = Net profit for the year ÷ Average assets for the year.

Shareholder Returns

The following market ratios were defined as the shareholder return measures for this study:

- Dividend payout = Annual dividends per share ÷ Earnings per share;
and
- Company share price.

4.1.2 Independent Variables - Corporate Governance

Board Characteristics

The rationale for the selection of the independent variables for this study was motivated by the existing literature and was therefore based on the following six parsimonious board characteristics used in this study:

- Board independence;
- CEO-Chairman duality;
- Staggered boards;
- Board size;
- Presence of a board remuneration committee (REMCO); and
- Composition of the board REMCO.

Collection and measurement of these variables are discussed next in section 4.2.

4.2 Data Collection

Internationally, there have been attempts to develop governance ratings or indices to measure the level of governance within companies. Gompers, Ishii, & Metrick (2003) published their G-Index, which was based on the 24 distinct provisions of corporate governance provided by the Investor

Responsibility Research Centre (IRRC). A year following this, Bebchuk, Cohen, & Ferrell (2004) produced their E-Index, based on six of the 24 provisions of the IRRC. Another index compiled by Brown & Caylor (2006) termed G-Score included both external and internal governance measures based on 51 Institutional Shareholder Services (ISS) governance factors. The IRRC usually entails a measure of corporate governance measures over the S&P 500 companies, whereas the ISS governance factors are primarily measured by North American and European countries.

According to Bradley (2010), South Africa currently does not have a developed corporate governance measurement system. Ratings Africa attempted to implement such a system in 2009 by asking companies via a survey to assess their individual levels of corporate governance, for which a disappointing response rate was received and thus the initiative was considered unsuccessful (Bradley, 2010). The Institute of Directors in South Africa (IoDSA) launched a similar tool in February 2010, called the Governance Assessment Instrument (GAI). It entails 300 questions relating to tangible aspects of company corporate governance and thus has its limitations in measuring intangible aspects of governance such as corporate culture (Bradley, 2010).

A Unit established through the University of Stellenbosch and appointed by the South African Public Investment Cooperation (PIC) in 2008 undertook to develop a corporate governance measurement tool to be applied to South African listed companies (Unit for Corporate Governance in Africa,

2011). The result was the PIC Corporate Governance Rating Matrix, which is based purely on publicly disclosed information. The matrix focuses on the fundamental corporate governance values of transparency, honesty and accountability; and incorporates existing PIC, South African and international corporate governance standards and best practice (Unit for Corporate Governance in Africa, 2011). Some of the key governance metrics used are independence of directors and auditors, transformation, attendance at board meetings, remuneration and legal contraventions (Unit for Corporate Governance in Africa, 2011). The content make-up of the tool is, however, not publicly available.

Therefore, in having searched the literature and in the absence of an appropriate or developed measurement tool in South Africa, the Delphi technique was used.

“The Delphi method is a flexible research technique well suited when there is incomplete knowledge about phenomena” (Skulmoski, Hartman, & Krahn, 2007, p. 12). This technique has been used in studies to develop, identify, forecast and validate a wide variety of research areas (Skulmoski *et al.* 2007). According to Skulmoski *et al.* (2007), the sample sizes typically used in research studies range from four to 171 “experts”, as there are no hard and fast rules surrounding this.

This technique was considered appropriate for use within this study, for the following reasons:

- This study is an investigation into the discrete board variables relating to corporate governance, which in itself is a complex issue requiring the

solicitation of knowledge from experts in the field (Okoli & Pawlowski, 2004);

- The research questions within this study are those of high uncertainty and speculation, consistent with what a Delphi study typically aims to investigate; and
- “The Delphi study is flexible in its design, and amenable to follow-up interviews. This permits the collection of richer data leading to a deeper understanding of the fundamental research questions” (Okoli & Pawlowski, 2004, p. 18).

Therefore, four experts in the field of corporate governance were invited and interviewed about the research selected independent variables to obtain their opinions about what constitutes these variables and how each one is linked to company performance. The information obtained from these interviews guided the measurement of each board characteristic and eventual testing against the six research questions. The interview questions have been outlined in Appendix 1.

Data relating to the dependent variables of operating performance and shareholder returns were sourced from the McGregor BFA Research Domain. The corporate governance disclosures relating to the selected board characteristics were sourced from published company annual reports. These relate specifically to:

- Board independence;
- CEO-Chairman duality;
- Staggered boards;

- Board size; and
- Existence or presence of a board REMCO; and
- Independence or composition of the board REMCO.

4.3 Population and Sampling

The universe for this study was limited to listed South African Consumer Goods companies with published financial statements over the time period commencing on 01 January 2006 and ending on 31 December 2010; thereby also accommodating the time horizon of when the King III Report became effective to all entities, being 01 March 2010. Thus, the research was longitudinal in nature, as it studied and tracked changes and relationships between variables over time (Blumberg, Cooper, & Schindler, 2008). The unit of analysis was the application of corporate governance practices specifically relating to the board selected independent variables.

In order to compare like with like, companies within one listed Johannesburg Stock Exchange (JSE) sector were selected, as the corporate governance impact on company performance may vary from one sector of industry to another (Ehikioya, 2009). This is further supported by Reddy *et al.* (2010) who noted that in practice, each company has different corporate governance structures which are assumed to be similar for those companies in the same industry.

The Consumer Goods sector was selected as retail sales accounted for 14 percent of South Africa's gross domestic product (GDP) in 2009, making

this the third biggest sector in the country's economy (SA Market Summaries - Retail, 2009). Further, according to published Stats SA results in January 2011, retail sales were up a relatively impressive 6.4 percent year on year (Lings, 2011).

Thus, the population and sampling for this study included the 26 Consumer Goods companies (as defined by the McGregor BFA Research Domain) listed on the JSE with published financial statements over the time period commencing on 01 January 2006 and ending on 31 December 2010.

Specific exclusions were those companies with secondary listings in South Africa (as their financials would be published as part of the holding company and may be subject to variables which may influence or distort the results of this study) and those not having been listed over the full five year period of this study. Subsequent to these adjustments, the sample size for the listed South African consumer goods sector equated to 21.

Table 1 - Summary of Research Data Set (Consumer Goods Sector)

Total companies in sector	26
Less: Companies with secondary listings on the JSE	(2)
Less: Companies not listed over the full research period	(3)
Companies with full data set	21

4.4 Data Analysis

The Delphi technique was used in interviewing four experts in the field of corporate governance and obtaining their views on what each of the research selected independent variables comprised. The emergent themes from these interviews were used to measure and test the specific board characteristics (independent variables) against the performance measures (dependent variables) of the 21 JSE listed companies within the Consumer Goods sector over the time period commencing on 01 January 2006 and ending on 31 December 2010.

The Spearman correlation coefficient was used to determine the association among the independent and dependent variables.

Unlike prior studies that use the Ordinary Least Squares (OLS) regression method (Abdo & Fisher (2007); Mashayekhi & Bazaz (2008); Ehikioya (2009) and Reddy *et al.* (2010)) to establish the relationship between variables, this study used the Spearman correlation coefficient to measure the strength of association between numerical variables, in line with research carried out by Brown & Caylor (2006) and Bhagat & Bolton (2008). The Spearman correlation coefficient was selected for the following reasons:

- It is a non-parametric measure of correlation, in that it does not assume that the data is normally distributed; and
- It assesses the relationship between ranked data without making any assumptions about the nature of their relationship.

Additionally, due to the data not being normally distributed, the Kruskal-Wallis non-parametric test was used to assess whether the relationship between the categorical data relating to the board characteristics of corporate governance and dependent variables of company performance were significant or not.

5. Research Results

The Delphi technique was used in interviewing four experts within the field of corporate governance on the research selected independent variables to obtain their opinions on what constitutes these and how each is linked to company performance. The respective profiles of the four interviewed experts are outlined within Appendix 2.

The information obtained from the expert interviews led to the measurement of each board characteristic and eventual testing against the six research questions. The emergent themes under each board characteristic are discussed next.

5.1 Expert Interview Results

5.1.1 Board Independence

All interviewed experts agreed that having a majority (being greater than 50 percent) of independent non-executive directors (NEDs) on the board is a defining factor and basis for board independence. This is seen as critical to maintaining the balance of power, as independent NEDs will ensure that the interests of both the shareholders and stakeholders are addressed. Even though there was consensus around what constituted

board independence, all experts noted that independent NEDs should further have independence of mind and appearance.

Additionally, one of the interviewed experts noted that board independence revolved around the numbers of years that directors served on the board, as the King III Report noted that a tenure of greater than nine years impacts on independence. This expert further noted that independence of NEDs should be assessed in terms of shareholding, as the King III Report outlined that independent NEDs should not hold more than five percent of the total company shares in issue (including any parent or subsidiary within a consolidated group).

There was, however, consensus between the interviewed experts that having a majority of independent NEDs serving on the board impacts positively on company performance. The main reason cited for this, is that independent NEDs influence the board through their collective guidance and varying perspectives. The independent NEDs are further seen to be in the best position to ask the difficult questions that others may be afraid to do and to probe on the areas which may have been overlooked internally by the executive directors.

5.1.2 CEO-Chairman Duality

All interviewed experts agree that when CEO-Chairman duality exists, control and ownership of a company rests with one person, which can negatively impact on company performance, specifically in terms of the

triple bottom line (people, planet and profit). It may come to pass that the individual holding both roles will make short-term decisions for personal gain, thereby impacting on the long-term sustainability of the company. The interviewed experts all alluded to an underlying element of greed which needs to be controlled.

Some of the interviewed experts noted that should the role duality exist, the board should have a lead independent NED, which enables the Chairman to hand over control of the meeting when a conflict of interest arises (Institute of Directors, Southern Africa, 2009).

5.1.3 Staggered Boards

All interviewed experts agree that staggered boards exist when members have been serving on the board for multiple years without rotation. An emergent theme from one of the interviewed experts was that the board Chairman should rotate every five years, in order to ensure adequate rotation of all board members. There was, however, consensus that in order to ensure adequate rotation among board members, one-third of the NEDs should retire by rotation on an annual basis.

Staggered boards are seen to impact negatively on company performance, with the main reason cited by the interviewed experts being that it impacts on overall board quality; that is, in not having the correct mix of skills and expertise, diversity, new ideas, varying industry

knowledge, etcetera. Additionally, one of the interviewed experts noted that the more stagnant a board is, the more prevalent the risk of self-interests being pursued.

5.1.4 Board Size

Three of the four interviewed experts provided a number range of between six and twelve as an adequate board size, inclusive of executive directors. The remaining expert, however, felt that this was something left up to each company to decide, as there is no right or wrong answer in terms of how large a board should be but deemed that it was rather more pertinent to ensure that the board was made up of the correct skills and expertise.

Regarding the impact that the board size may have on company performance, three of the four interviewed experts felt that a big board may negatively impact on performance, as not every voice may be heard and it may take longer for decisions to be reached. Hence, bigger boards were seen as difficult to effectively and efficiently manage with a possibility of resulting in being counter-productive or dysfunctional. There was a differing opinion from one of the experts who believed that board size has no impact on company performance but rather that it is the performance of each director which should be seen as more relevant.

5.1.5 Board Remuneration Committee

The overall theme noted by all interviewed experts in terms of what constitutes an effective board remuneration committee (REMCO), is that it should comprise of NEDs, with the vast majority being independent. One of the interviewed experts further added that in order to maintain objectivity and transparency in the process, the board REMCO should not be chaired by the company/group Chairman.

The interviewed experts were further in agreement that the presence of a board REMCO positively impacts on company performance, in terms of the following:

- It ratifies the CEO's targets and agrees bonus parameters, which are normally directly linked to company performance;
- It objectively evaluates and rewards the CEO's performance against set targets; and
- It prevents the board from undertaking unfair compensation practices which could culminate into a de-motivated and unethical company.

5.1.6 Summary of Emergent Themes based on Expert Interviews

Table 2 provides an overall summary of the emergent themes from the expert interviews which formed the basis of corporate governance variable measurements used within this study.

Table 2 - Summary of Emergent Themes from Expert Interviews

Governance Variable	Key Themes
Board independence	<ul style="list-style-type: none"> • Having majority (being greater than 50 percent) of independent non-executive directors on the board was seen as critical in maintaining the balance of power. • Independent non-executive directors should have independence of mind and appearance. • Directors should not serve on the board for a period longer than nine years. • Independence of non-executive directors in terms of shareholding - independent non-executive directors should not hold more than five percent of the total company shares in issue (including any parent or subsidiary within a consolidated group).
CEO-Chairman duality	<ul style="list-style-type: none"> • The role of CEO and Chairman should be separated. • When duality does exist, the board should have a lead independent non-executive director, which enables the Chairman to hand over control of the meeting when a conflict of interest arises.
Staggered boards	<ul style="list-style-type: none"> • One-third of non-executive directors should retire by rotation on an annual basis to allow for adequate rotation of board members. • The board Chairman should rotate every five years, in order to ensure adequate rotation of all board members
Board size	<ul style="list-style-type: none"> • A range of between six and 12 directors, inclusive of executive directors, was deemed an adequate board size.
Board remuneration committee	<ul style="list-style-type: none"> • The presence of a board remuneration committee allows for objectivity and transparency.
Board remuneration composition	<ul style="list-style-type: none"> • The board remuneration committee should comprise of non-executive directors, with the vast majority being independent. • The board remuneration committee should not be chaired by the company/group Chairman.

Table 3 provides an overall summary of the corporate governance variable measurements (outlined by each research question) used within this study for empirical testing of the data. These measurements were selected from the emergent themes obtained through the expert interviews.

Table 3 - Summary of Governance Variable Measurements used in this Study

Research Question	Governance Variable	Overall Measurement
1	Board independence	The majority (being greater than 50 percent) of the board comprising independent non-executive

Research Question	Governance Variable	Overall Measurement
		directors.
2	CEO-Chairman duality	The separation of the CEO and Chairman roles.
3	Staggered boards	One-third of non-executive directors retiring by rotation on an annual basis.
4	Board size	The number of executive and non-executive directors serving on the board.
5	Board remuneration committee	The presence of a board remuneration committee.
6	Board remuneration composition	The board remuneration committee comprising non-executive directors, with the vast majority being independent.

5.2 Empirical Results

Empirical testing was carried out on the 21 Consumer Goods companies listed on the JSE with published financial statements over the time period commencing on 01 January 2006 and ending on 31 December 2010.

The total number of observations within this data set over the selected period equated to 104, instead of 105. The reason for this was that one of the companies within the dataset altered their company financial year-end (from December to March) and thereafter published consolidated annual financials for the 15 months year-ending.

5.2.1 Descriptive Statistics

Table 4 presents the descriptive statistics of the dependent variables of company performance over the overall data set. Due to the data not being normally distributed, non-parametric tests were used.

Table 4 - Descriptive statistics: Dependent Variables

Dependent Variable	Mean	Median	Standard Deviation	Skewness	Kurtosis
Net Profit Margin %	3.6404	5.9400	14.9918	-3.5760	22.0095
ROE %	11.5202	15.8600	28.7168	-1.6355	10.5845
ROA %	11.7366	12.9700	15.6157	0.1582	5.6618
Share Price (cents)	3567.2718	1602.000	4781.6812	2.5129	7.8252
Dividend Payout %	41.1509	49.1703	178.9109	-5.9789	57.9693

5.2.2 Results by Governance Variable

The Kruskal-Wallis one way Analysis of Variance test was used to assess all categorical data. This applied to five of the six independent variables of corporate governance, being board independence, CEO-Chairman duality, staggered boards, presence of a board REMCO and composition of the board REMCO. The Spearman correlation coefficient was used on the governance variable of board size, as this was not considered categorical data. The empirical results of each governance variable are discussed below.

Board Independence

Table 5 provides an overview of the Kruskal-Wallis test performed in assessing the relationship between company performance and the independence of the board, which was measured through whether majority (being greater than 50 percent) of the board of directors comprised independent NEDs.

Table 5 - Kruskal-Wallis Test: Board Independence

Observation	Observation Frequency	Statistics	Net Profit Margin %	ROE %	ROA %	Share Price (c)	Dividend Payout %
P-value			0.0324	0.0219	0.0033	0.0035	0.7357
Yes	42	Mean	4.5595	17.4661	15.1878	5157.10	41.7493
		Median	7.3650	19.1200	18.0800	3212.00	49.7463
		Standard Deviation	17.7517	19.7755	13.6520	5302.53	44.7656
No	62	Mean	3.01790	7.4924	9.39870	2472.64	40.7455
		Median	4.5550	14.8600	11.2050	1417.00	44.0941
		Standard Deviation	12.9121	32.9965	16.5142	4082.77	229.5666

The data set revealed 42 observations in which company board of directors comprised of a majority of independent NEDs. The mean for the dependent variables of company performance relating to net profit margin, return on equity (ROE), return on assets (ROA), share price and dividend payout were found to be significantly higher, on the five percent level ($p\text{-value} < 0.05$) for companies with board independence than for those without. Thus, a statistically significant relationship between board independence and company performance was noted. The only exception

was that of dividend payout for which no statistical significant relationship was evident.

CEO-Chairman Duality

Table 6 below indicates the frequency of observations around the existence of CEO-Chairman duality (one individual holding both roles) within companies.

Table 6 - Frequency Distribution: CEO-Chairman Duality

Observation	Observation Frequency	Percent
Yes	1	0.96
No	103	99.04

Due to there being only one “Yes” observation and therefore a possible distortion in results, no further statistics were run, as the eventual results cannot be relied upon to be representative of the population.

Staggered Boards

Table 7 provides the results of the Kruskal-Wallis test in ascertaining whether there was a relationship between company performance and staggered boards. The existence of staggered boards was measured through assessing whether one-third of the board’s NEDs retired by rotation on an annual basis.

Table 7 - Kruskal-Wallis Test: Staggered Boards

Observation	Observation Frequency	Statistics	Net Profit Margin %	ROE %	ROA %	Share Price (c)	Dividend Payout %
P-value			0.8163	0.6801	0.1683	0.3856	0.5112
Yes (lack of rotation)	58	Mean	2.9731	11.7834	12.1810	3397.66	47.8281
		Median	6.3300	15.5950	15.4100	1512.50	47.5038
		Standard Deviation	15.8965	24.5967	13.5922	4672.88	76.7674
No (adequate rotation)	46	Mean	4.4819	11.1884	11.1763	3785.89	32.7318
		Median	4.7850	16.1900	11.0900	2291.00	49.8331
		Standard Deviation	13.8943	33.4815	17.9876	4962.86	256.2627

There were 58 observations within the data set noted as having staggered boards. The companies within this data set were found to have higher means relating to ROE, ROA and dividend payout than for companies without staggered boards.

No statistical significant difference (all p-values > 0.05) between the yes and no observations were noted, thereby indicating no relationship between staggered boards and company performance, even though the means seem to differ. This is potentially caused by the relatively small sample size or outliers. Review of the medians between the two observations indicates less disparity, as these are not influenced by outliers.

Board Size

Table 8 provides the results of the Spearman Correlation test in ascertaining the relationship between company performance and board size.

Table 8 - Spearman Correlation Test: Board Size

Observation Frequency	Statistics	Board Size	Net Profit Margin %	ROE %	ROA %	Share Price (c)	Dividend Payout %
104	Mean	10.1826	3.6404	11.5202	11.7366	3567	41.1509
	Median	10.0000	5.9400	15.8600	12.9700	1602	49.1703
	Standard Deviation	3.8886	14.9918	28.7168	15.6157	4782	178.9109
	R		0.4657	0.2159	0.3956	0.3893	0.2969
	P-value		<.0001	0.0277	<.0001	<.0001	0.0022

The average board size within the data set was 10. All dependent variables were found to have a significant positive correlation with board size, indicative through all p-values being found to be significant at the five percent level.

Board Remuneration Committee

Table 9 provides the results of the Kruskal-Wallis test in determining the relationship between company performance and the presence of a board remuneration committee.

Table 9 - Kruskal-Wallis Test: Presence of Board Remuneration Committee

Observation	Observation Frequency	Statistics	Net Profit Margin %	ROE %	ROA %	Share Price (c)	Dividend Payout %
P-value			0.0044	0.5153	0.0004	0.3911	0.2383
Yes	94	Mean	5.3811	11.3714	13.1368	3601.61	42.7141
		Median	6.4200	15.5600	14.9200	1602.00	49.1703
		Standard Deviation	10.3058	29.0047	15.3400	4912.62	188.0149
No	10	Mean	-12.7220	12.9190	-1.4250	3247.90	26.4564
		Median	2.4400	18.9600	-0.0800	2285.00	24.9159
		Standard Deviation	33.8459	27.2421	12.0903	3507.65	27.9592

The data set revealed the presence of board remuneration committees for 94 observations. The companies within this observation set were found to have higher means relating to net profit margin, ROA, share price and dividend payout than for companies without board remuneration committees. However, only the dependent variables of net profit margin and ROA were found to have a statistically significant relationship (on the five percent level) with the presence of a board remuneration committee.

Table 10 further provides the results of the Kruskal-Wallis test in determining the relationship between company performance and the composition of a board remuneration committee. The composition was measured through assessing whether the majority (being greater than 50 percent) of the board remuneration committee comprised of independent NEDs.

Table 10 - Kruskal-Wallis Test: Composition of Board Remuneration Committee

Observation	Observation Frequency	Statistics	Net Profit Margin %	ROE %	ROA %	Share Price (c)	Dividend Payout %
P-value			0.0042	0.0022	0.0004	0.0006	0.5598
Yes	58	Mean	6.7950	16.3248	16.9303	4507.24	23.3337
		Median	7.7900	18.1550	17.6350	2280.50	49.7463
		Standard Deviation	9.9140	27.6070	14.6184	4840.70	219.6546
No	36	Mean	3.1033	3.3911	7.0250	2100.86	73.9382
		Median	2.9100	12.8600	10.0800	1345.00	43.1004
		Standard Deviation	10.6535	29.7995	14.6620	4722.50	117.1672

Board remuneration committees that comprised of a majority of independent NEDs were prevalent for 58 observations within the data set. The companies within this observation set were found to have higher means relating to all dependent variables of company performance, with the exception of dividend payout. Additionally, board remuneration committees that comprised of a majority of independent NEDs were found to have a statistically significant relationship with all dependent variables of company performance (on the five percent level), with the exception of dividend payout.

5.3 Summary of Results by Research Question

Table 11 provides an overview of the p-value results by research question and each dependent variable relating to company performance.

Table 11 - Summary of Results by Research Question

Research Question	P-values					
	1	2	3	4	5	6
Governance Variable tested	Board independence	CEO-Chairman duality	Staggered boards	Board size	Presence of board REMCO	Composition of board REMCO
Net Profit Margin	0.0324	-	0.8163	<.0001	0.0044	0.0042
ROE	0.0219	-	0.6801	0.0277	0.5153	0.0022
ROA	0.0033	-	0.1683	<.0001	0.0004	0.0004
Share Price	0.0035	-	0.3856	<.0001	0.3911	0.0006
Dividend Payout	0.7357	-	0.5112	0.0022	0.2383	0.5598
Result	Statistical significant relationship	Insufficient data to make an inference	No statistical significant difference	Significant positive correlation	Moderately significant relationship	Statistical significant relationship

Research questions one and six were found to have statistically significant relationships to all dependent variables of company performance, with the exception of dividend payout. Additionally, research question four was found to have a significant positive correlation to all dependent variables of company performance.

Research question five, however, revealed a statistically significant relationship to only two of the dependent variables of company performance, being net profit margin and ROA.

Research question three, on the other hand, was found to not have any statistical significant difference (all p-values > 0.05), indicating no relationship to all dependent variables of company performance.

6. Discussion of Results

The results are discussed in this section, in context of the research questions initially set out.

6.1 Results by Research Question

6.1.1 Research Question 1 – Board Independence

Is there a relationship between the proportion of independent non-executive directors on the board and company performance?

The independence of the board was measured by determining whether majority (being greater than 50 percent) of the board comprised of independent non-executive directors (NEDs). Companies with noted board independence were found to have a statistically significant relationship to all performance variables, with the exception of dividend payout. This is consistent with the research results of studies carried out by Mashayekhi & Bazaz (2008) and Huang *et al.* (2011), who found positive correlations between board independence and company performance.

This is further supported by all four interviewed experts, who agreed that the independence of the board positively impacts on company performance, through their collective knowledge, guidance and persistent

questioning, provided the board is comprised of strong, resilient and highly skilled individuals. One expert's opinion in particular seemed to associate considerably with the results of this study; in that the board's independent view or opinion can at times also impact negatively on company performance, with the provided example being the withholding of dividends for reinvestment back into the company.

Dividend payout was the only company performance variable within this study found to not have a statistically significant relationship with board independence. This is consistent with the results of the study by Renneboog & Szilagyi (2007), who found that the dividend payouts were smaller for companies imposing stronger restrictions on governance controls.

In being held accountable for the strong financial performance of companies, independent NEDs tend to closely monitor and interrogate management's decisions, to ensure that they are always acting in the best interests of the company. This is an indication of the benefits and stronger monitoring provided by independent NEDs in maximising shareholder value, a view consistent with that of agency theory (Stanwick & Stanwick, 2010). It can be argued that the need for this is due to the highly publicised corporate scandals which have placed the role of the board of directors at the forefront of corporate governance (Adams *et al.* 2009). This is further supported by the principles outlined in the King III Report which note that having a majority of independent NEDs on the

board reduces the possibility of conflicts of interest and promotes objectivity (Institute of Directors, Southern Africa, 2009).

6.1.2 Research Question 2 – CEO-Chairman Duality

Is there a relationship between CEO-Chairman duality and company performance?

Due to the population revealing only one instance in which CEO-Chairman duality existed; no further statistics were carried out. Therefore, no inferences could be made regarding the relationship between CEO-Chairman duality and company performance. The literature reviewed appears to have split views in this regard.

Through empirical testing, Mashayekhi & Bazaz (2008) found that CEO-Chairman duality does not have a significant negative impact on company performance, whereas Bhagat & Bolton (2008) and Ehikioya (2009) provided substantial evidence supporting the adverse impact of one person holding both positions of power.

Although the King III Report denotes that the board should not be chaired by the CEO but rather an independent NED, one begs the question as to the absolute necessity of this role split. Where boards comprise strong-willed, passionate, skilled and able directors who are free from personal

conflicts, would this not be enough to counter the risk of a dominant CEO?

6.1.3 Research Question 3 – Staggered Boards

Is there a relationship between staggered boards and company performance?

The existence of staggered boards was measured through assessing whether one-third of the board's NEDs retired by rotation on an annual basis. The research results indicated no evident relationship between staggered boards and company performance. This appears to support the defence being made by literature for staggered boards, as it is seen as promoting board stability, director independence and a culture of effective long-term strategic planning (Bebchuk *et al.* 2010; Faleye, 2006).

The proposition of staggered boards is in direct contravention of the views raised by all four interviewed experts, who noted in their opinion that staggered boards do tend to eventually impact negatively on company performance. They all alluded to the impact that the lack of director rotation can have on overall board quality and harnessing the fresh perspectives needed. These views are further supported by the principles outlined in the King III Report, which suggests that at least

one-third of NEDs retire by rotation on an annual basis (Institute of Directors, Southern Africa, 2009).

With the noted difference between the test results and the expert views supported by the King III Report, it can be concluded that the required rotation of board directors does not necessarily have a direct impact on company financial performance but rather contributes to the diversity of skills and knowledge required by a company to allow it to act in the best interests of all its stakeholders. This can be seen as an indirect contribution to company performance and the long-term sustainability thereof.

6.1.4 Research Question 4 – Board Size

Is there a relationship between board size and company performance?

A significant positive correlation was evident between board size and all company performance variables. This high correlation was found to be consistent with the study carried out by Tanko & Kolawole (2008) and contradicted the research results of Mashayekhi & Bazaz (2008) and Reddy *et al.* (2010).

The average board size within the data set was 10, consistent with the views held by three of the four interviewed experts who noted this number of directors to be within their range as an adequate board size.

However, all experts tend to agree that the performance of the board is not merely dependent on its size but on its characteristics and ability to efficiently and effectively execute its responsibilities.

Therefore, while the empirical testing of this study supports the view that larger boards are better for company performance, it should be noted that each company should assess their need in terms of a board size, deemed fit for the specific purpose at any given time. Additionally, board members should have a range of expertise to help make better decisions, therefore making it difficult for a powerful CEO to dominate the process (Tanko & Kolawole, 2008).

6.1.5 Research Question 5 – Board REMCO Presence

Is there a relationship between the presence of a board remuneration committee and company performance?

Companies with the presence of board remuneration committees (REMCOs) were found to have a statistically significant relationship with the dependent variables of net profit margin and ROA. This was consistent with the study carried out by Reddy *et al.* (2010) using ROA as one of the performance measures and contrary to the study conducted by Bauer *et al.* (2008), in terms of a correlation to share price performance.

The existence of a board REMCO impacts both directly and indirectly on company performance. The REMCO ratifies the CEO's targets and agrees on bonus parameters, which are normally directly linked to company performance. The REMCO impacts indirectly on performance through allowing for greater transparency and objectivity in evaluating and awarding remuneration. It assists in preventing the board from undertaking unfair compensation practices which could culminate in a de-motivated and unethical company, ultimately impacting on performance.

6.1.6 Research Question 6 – Board REMCO Composition

Is there a relationship between the proportion on independent non-executive directors on the board remuneration committee and company performance?

The board REMCOs that comprised a majority of independent NEDs were found to have a statistically significant relationship with all dependent variables of company performance, with the exception of dividend payout. This supports the principles outlined in the King III Report that suggests that the board REMCO should comprise a majority of independent NEDs. However, the literature that covers the scope of board REMCOs does not allude to empirical testing surrounding the composition in terms of majority members being independent non-executive directors.

It is, however, evident that having majority independent NED's can have a direct influence on company performance, as they are more prepared to objectively evaluate performance and take tough decisions which company executives may not be willing to do.

6.2 Corporate Governance and Company Performance

Corporate governance is considered a current topical issue, due to the fact that managers and shareholders have started questioning the importance thereof, especially where there is no deemed link to company performance (Stanwick & Stanwick, 2010).

The results of this study have empirically shown that there is a positive relationship between specific board characteristics of corporate governance and company performance. Of the six independent variables selected for testing, board independence, board size and composition of a board REMCO were found to have statistically significant relationships to the dependent variables of company performance, while the presence of a REMCO indicated a moderate relationship (with ROA and net profit margin indicating a significant relationship) and staggered boards revealed no statistical significant difference at all.

Therefore, in noting the positive relationship between the specific board variables and company performance to that of prior studies carried out by Mashayekhi & Bazaz (2008), Tanko & Kolawole (2008), Bauer *et al.*

(2008), Reddy *et al.* (2010) and Huang *et al.* (2011), it is evident and in line with the argument presented by Stanwick & Stanwick (2010), that the board of directors is considered to be the dominant form of governance within companies.

Furthermore, this study's results are consistent with that of prior research carried out by Abdo & Fisher (2007), Ntim, Opong, & Danbolt (2009) and Muniandy *et al.* (2010) on the South African environment that indicated an overall positive relationship between corporate governance and company performance.

6.3 Research Limitations

It is important to note the following research limitations of this study:

- The relationship between corporate governance and company performance was assessed using only South African listed companies within the Consumer Goods sector and thus no inferences can be made across other sectors;
- The small sample size of companies within this sector (being 21) after providing for specific exclusions;
- This study extended over the time period commencing on 01 January 2006 and ending on 31 December 2010; and
- The level of disclosure by the respective companies in terms of the board characteristics relating to corporate governance within the respective companies' annual reports may not necessarily be a true

reflection of actual governance practices employed by the company
(Abdo & Fisher, 2007).

7. Conclusion

7.1 Overall Summary

The application of good governance is being increasingly viewed as a valued feature of a well-run company. Therefore, world economies, especially developing ones (such as South Africa), have awakened to recognise the need for good governance, as investors are hesitant to invest in companies that do not subscribe to good corporate governance principles (McGee, 2010).

Through review of the various corporate governance theories, it has become evident that the board of directors is an important component of internal governance that enables management to successfully achieve objectives and enhance the performance of these companies (Che Haat *et al.* 2008). Therefore, the board of directors was selected as the dominant form of corporate governance within companies on which this study was based.

The aim of this study was to determine the relationship between corporate governance and company performance. This was achieved through defining six specific board characteristics of corporate governance (independent variables of board independence, CEO-Chairman duality, staggered boards, board size and board REMCO presence and composition) and five company performance measures (dependent

variables of net profit margin, ROE, ROA, share price and dividend payout).

The literature review revealed that there is currently a lack of an appropriate and publicly available corporate governance measurement tool in South Africa. As such, the Delphi technique was used. This entailed interviewing four experts in the field of corporate governance in order to obtain their views regarding what constitutes the research selected independent variables. The emergent themes from these interviews guided the measurement of these board variables and empirical testing was conducted against the selected company performance variables using the 21 Consumer Goods companies listed on the JSE with published financial statements over the time period commencing on 01 January 2006 and ending on 31 December 2010.

The overall results of this study indicate that the vast majority of board selected variables relating to corporate governance had a positive relationship with company performance. Of the six independent variables selected for testing, board independence, board size and composition of the board REMCO were found to have statistically significant relationships to the dependent variables of company performance, while the presence of a REMCO indicated a moderate relationship (with ROA and net profit margin indicating a significant relationship) and staggered boards revealed no statistical significant difference.

Therefore, the following overall conclusions can be drawn from the test results of this study:

- Board independence allows for greater benefits and stronger monitoring provided by independent NEDs in acting in the best interests of the company and therein maximising stakeholder value.
- Although the de-staggering of boards is seen as important in ensuring overall board quality, it is not deemed pertinent in terms of contributing directly to company performance. It could, however, be seen that the diversity of skills and knowledge that each director possesses, allows the board to act in the best interests of all its stakeholders. This can be seen as an indirect contribution to company performance and the long-term sustainability thereof.
- The empirical testing indicates that larger boards are better for company performance. It should, however, be noted that the performance of the board is not merely dependent on its size but on its overall characteristics (skill, expertise, diversity) and capabilities.
- The presence and composition of the board REMCO positively contributes to company performance through providing the required objectivity, transparency and ethical practices in terms of rewarding executive remuneration in line with company performance.

The relationship between CEO-Chairman duality and company performance could not be assessed, due to the sector data set revealing only one instance where this duality existed.

This, however, could be an indication of the maturity of the governance environment in terms of the shareholders' need for the power of these two roles not to be vested in one person, in order to drive optimal performance and greater monitoring.

7.2 Recommendations for Future Research

This study focused on six defined variables relating to company boards, which were obtained through review of company annual reports. Future research could be carried out on the intangible aspects surrounding board governance as outlined within the King III Report, such as the role and function of the board, board appointment processes, director development, performance assessment and director remuneration. This could be performed through the use of anonymous surveys.

Future research is further recommended on the emergent themes from the expert interviews which were not specifically tested for within this study. These would include empirical testing around the following characteristics in assessing the relationship with company performance:

- Independence of non-executive directors in terms of both mind and appearance. This would entail assessing conflicts of interests which may potentially exist;
- Independence of non-executive directors in terms of the numbers of years served on the board. The King III Report denotes that a tenure of greater than nine years impacts negatively on independence;

- Independence of non-executive directors in terms of shareholding. The King III Report notes that independent non-executives directors should not hold more than five percent of the total company shares in issue (including any parent or subsidiary within a consolidated group);
- The board Chairman being rotated every five years, in order to ensure adequate rotation of all board members; and
- In terms of REMCO composition and independence, the board REMCO not being chaired by the company/group Chairman.

Additionally, this study focused on the time period commencing on 01 January 2006 and ending on 31 December 2010, which included 10 months within which companies had been applying the principles of the newly published King III Report (the King III Report came into effect on 01 March 2010). Therefore, future research should focus on a period allowing for sufficient application and entrenchment, in order to gauge the resultant effects of the newly implemented governance framework.

7.3 Concluding Remarks

There has been extensive international research carried out on the subject of corporate governance and company performance (Bauer *et al.* 2008); (Bebchuk *et al.* 2010); (Bhagat & Bolton, 2008); (Brown & Caylor, 2006); (Che Haat *et al.* 2008); (Ehikioya, 2009); (Faleye, 2006); (Huang *et al.* 2011); (Jiraporn *et al.* 2010); (Mashayekhi & Bazaz, 2008); (Muniandy *et al.* 2010); (Reddy *et al.* 2010); (Renneboog & Szilagyi, 2007) and (Tanko &

Kolawole, 2008)), with minimal research having been carried out in South Africa (Abdo & Fisher, 2007); (Kolobe, 2010); (Muniandy *et al.* 2010) and (Ntim *et al.* 2009)).

This study therefore aimed at increasing the body of relevant, current literature surrounding the South African environment and provided sufficient evidence supporting the positive relationship between corporate governance and company performance.

The South African governance environment has been steadily evolving since the introduction of the first King Report in 1994 and as such, can one argue, has the maturity towards voluntary application of these governance frameworks. The pivotal role of corporate governance within the South African economy is now more evident than in past eras, not only due to the much needed foreign direct investment but also because of the need to be perceived as a country that undertakes sound practices which allows for the ongoing viability of doing business with the rest of the world.

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Appendix 1 – Interview Questions

Consent Section:

I am conducting research on the relationship between corporate governance and company performance of listed South African companies within the Consumer Goods sector. To this end, I am trying to find out more about what constitutes the following specific board characteristics of corporate governance and how each is linked to company performance:

- Board independence;
- CEO-Chairman duality;
- Staggered boards;
- Board size; and
- Board remuneration committee.

The information obtained from the interview will help guide the measurement of each board characteristic and eventual testing.

Our interview is expected to last about an hour. Your participation is voluntary and you can withdraw at any time without penalty. All data will, of course, be kept confidential. If you have any concerns, please contact me or my supervisor. Our details are provided below.

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Signature of participant: _____

Date: _____

Signature of researcher: _____

Date: _____

Interview Questions:

1. Board independence

- a. What in your opinion constitutes board independence?
- b. How, in your opinion, should board independence be measured?
- c. How is board independence linked to company performance?

2. CEO-Chairman duality

- a. What in your opinion constitutes CEO-Chairman duality?
- b. How, in your opinion, should CEO-Chairman duality be measured?
- c. Do you believe that CEO-Chairman duality is linked to company performance?
- d. If no, please provide reasons.

3. Staggered boards

- a. What in your opinion constitutes staggered boards?
- b. Do you believe that staggered boards are linked to company performance?
- c. If no, please provide reasons.

4. Board size

- a. What in your opinion constitutes an adequate board size?
- b. Do you believe that the size of a board is linked to company performance?
- c. If no, please provide reasons.

5. Board remuneration committee

- a. What in your opinion constitutes an effective remuneration committee?
- b. Do you believe that the presence of a board remuneration committee is linked to company performance?
- c. If no, please provide reasons.

Appendix 2 – Profiles on Interviewed Corporate Governance

Experts

Expert	Qualification	Career History	Accomplishments	Board Roles
1	Law degree	Has held governance roles in varying industries, comprising parastatals, consultancy, hospitality, pharmaceutical and finance; equating to 16 years of governance experience.	Has written and published books in the field of corporate governance, specifically pertaining to the South African corporate environment.	Holds independent non-executive director roles on two boards - one with a listed company and the other with an academic institution.
2	Chartered Accountant CA(SA)	CA(SA) article period served at one of the <i>Big Four</i> audit firms in South Africa, through which has received much exposure through being a technical expert in the field of Corporate Governance (specifically the King Code). Currently holds a specialist role in South Africa's largest Governance institution.	Has published many articles, completed television interviews and drafted practice notes in the field of corporate governance.	None, as it would be a direct conflict of interest in terms of the professional role currently held.
3	Five law degrees	Has held governance roles in varying industries, comprising mining, information technology and finance; equating to 16 years of governance experience. Additionally, lectures on the subject of Corporate Governance at one of the acclaimed business schools in South Africa.	Bestowed an honorary FCIS (Fellow of the Chartered Institute of Secretaries) degree. A pioneer in South African Environmental Law.	Currently a member of the King III Committee
4	Chartered Accountant CA(SA)	CA (SA) article period served at one of the <i>Big Four</i> audit firms in South Africa, after which has held various finance and operational roles within a large listed FMCG company. This includes a governance role currently held for the last six years.	None.	Holds an executive director role on current company board.