CORPORATE GOVERNANCE AND THE VALUE RELEVANCE OF ACCOUNTING INFORMATION: EMPIRICAL EVIDENCE FROM SOUTH AFRICA

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In the 21st century, the expectations placed on organisations have increased significantly. There has also been a general decline in the level of trust in organisations, due to the prevalence of corporate scandals in recent years. Because of this, the importance of corporate governance has grown dramatically over the last 20 years, owing to corporate fraud, negligence and management misconduct, resulting in substantial losses of shareholder wealth (Krechovská, 2014). Key corporate governance reforms, around the world, indicate that regulators and policymakers regard corporate governance as an important means of establishing reliable financial reporting (Tshipa, 2018). As a result, a proliferation of corporate governance reforms has ensued in many developing African economies, over the last two decades. Regulators have introduced new rules to enhance the quality of corporate governance, that should ultimately improve reporting practice (Byard, 2006).

South Africa has kept up to date with international standards, by consistently analysing and revising its corporate governance practices. The latest such effort was the King IV Report on Corporate Governance, commissioned in 2016. One of the perceived disadvantages of corporate governance is that it is often considered a mindless compliance exercise (Ramalho, 2020). For this reason, King IV changed King III's "apply or explain" approach to an "apply and explain" approach. This approach presumes that firms are already applying the principles and expects it to explain how this is being achieved. The reason behind this was to move away from a simple "tick box" approach, towards illustrating how the implemented practices accomplish the principles and validate the outcomes. When King IV was being drafted, the King Committee elected to pursue a broader understanding of "governance", shifting away from simply being a system and moving towards "the exercise of ethical and effective leadership by the governing body" (IoDSA, 2016).

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Globally, there is mixed evidence as to whether corporate governance leads to higher-quality accounting information. From a South African perspective, the change from King III's "apply or explain" approach to King IV's "apply and explain" approach may have caused a shift in the value relevance of accounting information. The authors therefore considered whether internal corporate governance attributes, namely board size, board independence, board activity, staggered board, internal board committees and board gender diversity, affect the value relevance of accounting information for JSE-listed firms. The authors also examined the individual effect of these six internal corporate governance attributes on firm value. Lastly, they investigated whether the introduction of King IV in South Africa had any impact on firm performance.

Board Size

Board size represents the sum of directors, including executive and non-executive directors, on the board of directors, at the date of the annual meeting in each financial year. It is believed that larger boards tend to have more time and experience, resulting in the more effective monitoring of firms. On the other hand, smaller boards could result in more effective communication and interaction between directors (Ozkan, 2011).

Board Independence

One of the primary objectives of the King reports have been to enhance firm valuation by improving the independence and monitoring capacity of South African boards of directors (Ntim, 2012). King IV has departed from "boxing" independence into set criteria and, instead, contains factors to be considered when evaluating independence. The overarching general assessment for independence is whether or not "there is no interest, position, association or relationship which, when judged from the perspective of a reasonable and informed third party, is likely to influence unduly or cause bias in decision-making in the best interests of the organisation" (Hofmeyr, 2023).

Board Activity

Board meetings are a vital tool of the supervisory function by board members, as it allows the discussion of pending issues and possible solutions (Vafeas, 1999). (Lipton, 1992) concluded that frequent board meetings are not associated with higher firm performance as directors spend their time on numerous ineffective routine activities simply to satisfy company regulations that results in the usefulness of board meetings being reduced.

Staggered Board

King IV suggests the periodic, staggered rotation of board members as it can safeguard board stability and enhance long-term commitment to value creation (IoDSA, 2016). A minimum of one-third of the non-executive directors of JSE-listed public companies are expected to retire at the annual general meeting. These directors may be re-elected if they qualify for re-election. To qualify for re-election, a director would require nominations from the board, that is dependent on the director's past performance and contributions (JSE, 2019). In a non-staggered board, all directors stand for election each year, as they serve for a term that does not vary in length.

Internal Board Committees

The various King Codes have issued disparate recommendations on board committees. In contrast to the later King Codes, King I advised against the formation of a nominations committee. King II recommended the establishment of, at a minimum, an audit- and a remuneration committee. King II expanded on King II, by recommending the formation of risk-, nomination- and IT steering committees, in addition to the audit- and remuneration committees. Principle 8 in King IV deals with the issue of board committees, leaving the decision up to the governing body, as to whether any internal committees should be established, or the number of such committees. It does, however, recommend that establishment of audit-, nominations-, risk remuneration- and social- and ethics committees, be contemplated (IoDSA, 2016). The formation of board committees has been touted as an effective tool for enhancing corporate governance, by assigning certain duties from the primary board to smaller bodies and limiting the inputs of non-executive directors (Kosovic, 2013).

Gender Diversity

The Global Gender Gap Report (Forum, 2015) emphasised the importance of women in leadership roles as it could lead to enhanced decision-making, more efficient strategic control, stricter monitoring and improved financial performance (Conyon, 2017). The report added that there has been resistance from firms in transforming into more gender equal organisations (Landel, 2016).

The authors found that board size is negatively and significantly associated with share price. This suggested that the market is in favour of smaller boards and supported the argument that smaller boards allow for more effective communication and interaction between directors. Essentially, the number of board members yields changes in market valuation. The remaining corporate governance attributes, namely board independence, board gender diversity, board activity, staggered board and the presence of internal board committees, were found to have no association with share price. Whilst the findings suggested that the size of a board affects the value relevance of JSE-listed firms, it also indicated that the introduction of King IV did not have any effect on the share price of JSE-listed firms.

The results highlighted the value of creating and maintaining adequate supervisory and enforcement techniques, to ensure adherence to accounting standards and corporate governance. Essentially, compliance with corporate governance generates changes in market valuation, as it is key in inter alia ensuring reliable financial reporting.

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