A Study on Corporate Governance and Value Relevance of Accounting Information: Evidence from Listed Companies in Mauritius

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Abstract

Purpose- This study evaluates the liaison between Corporate Governance and Value relevance of accounting information in Mauritius for the listed companies on the Stock Exchange of Mauritius, basically how by abiding to the Corporate Governance code can bring out more value for investors in terms of earnings per share and net asset value per share.

Design/Methodology/Approach- Panel data regression model using fixed effect is used for 30 listed companies on the Stock Exchange of Mauritius for a period of 5 years, 2009-2013 by employing the Ohlson (1995) model.

Findings- Both earnings per share and net asset value are significant to share prices. Moreover a preference towards a smaller board size, having more independent directors on board has been noticed and where the roles of the Chief Executive officer and the board chair should be separated when NAV is being considered.

Originality/Value: This paper examines the relationship between EPS and NAVPS with share prices and looks into the effect of Corporate Governance for listed companies on the Stock Exchange of Mauritius in order to measure the quality of those accounting information and evaluate whether it brings any changes to the value relevance of accounting information in the Mauritian case scenario.

Keywords: Value Relevance, Corporate Governance, Accounting information, Mauritius
1. Introduction

Due to all kinds of recent corporate scandals, Corporate Governance has not only been a sensitive matter to regulators, but also to the public thus, urging companies to better their governance practices and provide for more disclosures. Corporate Governance portrays a system whereby companies are directed and controlled. It takes into account the management of a company and the welfare of shareholders and stakeholders. Moreover, it helps companies in achieving their objectives and makes sure that corporations fulfill their duties towards the society by considering the social and environmental aspect as well. Mauritius also has laid much emphasis on having a good Corporate Governance system in launching the Corporate Governance code in 2003.

Investors depend on accounting information for their investment purposes, therefore the quality of this information should be reliable and of good quality as those financial accounting information is of significance to share prices. Accounting information is said to be value relevant only if it is linked to share prices, if such association does not co-exist, accounting information are not value relevant, also financial statements here fail to meet its most important objective that is, providing value for investors. Moreover, since Corporate Governance is supposed to help companies perform better and because companies on the Stock exchange have to comply with the code, it would be thought-provoking to study the influence of Corporate Governance on firm valuation, especially because good governance is in the limelight these days in Mauritius.

2. Literature Review

Due to recent financial issues such as enormous CEO compensation and mishap of basic corporate governance have led to the emergence of corporate governance as never before and many legislatives took the initiative to set up with the purpose to improve accountability and financial transparency where all of them confirm that good corporate governance improves firm’s value.

Value relevance is the ability of accounting numbers to explain market price per share. Beisland (2009) describes value relevance as the capability of financial statement information to tap and summarize firm value.

2.1 Value Relevance and Corporate Governance linkage

Investors look up to Corporate Governance as they are much interested on the effect it has on value creation. Investors are ready to pay more for those firms they feel are well governed. According to Bushman et al. (2004) and Karamazov and Vafea (2005), the quality of information improves by having more external directors on board. Many authors argued that a small board size can improve the quality of financial reporting as directors can communicate better and increase the information content and this reduces the scope for earnings
management. According to Jensen (1993), when the roles of the board chair and the CEO are split, it brings more transparency thus improving financial reporting where there is less risk of violating accounting principles.

Many academics have studied the rapport between corporate governance and firm value, among which, a stand out example is the study of LaPorta et al. (2000), where he questioned the variances in governance standards among 27 countries and the results showed that countries with superior governance standards has got more valuation. There has been another study of inter-firm variation within one country where Gompers et al. (2003) for US, Drobetz et al. (2004) for Germany, Black (2001) for Russia and De Jong et al. (2001) for Netherlands and these studies generated a positive relationship between firm value and governance standards. Black, Jang and Kim (2004) did a research on market value and corporate governance structures of Korean firms and advocate that Corporate Governance is an imperative aspect in explaining the market value of public companies in Korea.

2.2 Board Size and Value Relevance

The effect of board size has been quite significant in recent years as such Forbes and Milliken (1999) found out that board size has an outcome on board effectiveness in various ways, such as larger board possesses more skills and knowledge to share, however, since each of them has got a different point of view, it is likely to reinforce cognitive conflict. It also becomes difficult to identify the individual significant contribution of the group members and to effectively use the knowledge and skills of the board members. Yermack (1996) is in favour of smaller boards. In addition Abdellatif (2009), during his research on BS and BC has found out that board size is positively correlated to firm value and negatively correlated to the companies’ performance. Chen et al. (2008) concluded a negative significant relationship between firm value and board size.

2.3 Board Composition and Value Relevance

There exists mixed opinion about whether board composition can lead to more firm valuation or not. There can be an increase in profitability of companies by having more external directors on board according to Ezzamel and Watson (1993) for a research conducted on UK firms. Beeks et al., (2004) observed that organizations with a higher percentage of external directors tend to be more conservative. However, Pi and Timme (1993), Adams and Mehran (2008), Belkhir (2006) and Weisbach and Hermalin (1991) argued that there are no benefits from having independent directors on boards.

2.4 CEO Duality and Value Relevance

It is stressed that the role of the chairman and the CEO should be separated as both of them have got different tasks, Ponnu (2008). This idea is very well supported in countries such as Saudi Arabia as well as Mauritius. Yermack (1996) stated that CEO duality reduces
firm value. Lin and Liu (2009) pointed out that when the CEO is not occupying the role of the chairman, the former will treat everyone equally and reinforce the corporate governance mechanism.

2.5 Value Relevance over Time

Earnings and book values (BV) display a strong relevance than cash flows when it comes to firm’s valuation, whereby according to Ohslon (1995), Collins et al. (1999), Barth et al. (1998), cash flows tend to have matching and time problem. Many studies have revealed that EPS and BVPS are among the most considerable accounting measures and are positively associated with firm’s market value; however, Hunt et al., (1997) claimed that the analytical power of BVPS is higher than that of EPS. Moreover, Chen et al., (2001) during their research on the Chinese stock market for the period 1991-1998 concerning the link between EPS, BVPS and stock prices, concluded that accounting information was value relevant for both times series regression and pooled cross-section analysis.

The value relevance of earnings is exhibited by the previous works of Ball and Brown (1968), Beaver and Dukes (1972) and Patell and Kaplan (1977). Relevance on earnings has definitely changed over the years and this revision has been investigated by many people, for instance, Collins, Maydew and Weiss (1997) where they adopted a cross-sectional regression in the course of 40 years and noted that the incremental value of earnings decreased from the year 1953 to 1993 and pointed out a shift from the value relevance of earnings to that of book value due to the bigger average size of the firm.

Beaver, Barth and Landsman (1998), discovered that BV becomes more relevant when firms are reporting losses whilst other studies have shown a fall in the value relevance of earnings when losses are present. Few of the reasons due to the collapse in the value relevance of earnings and BV are such that Lev and Amir (1996) and Lev and Zarowin (1999) stated that accounting information is less relevant to investors if they are dealing with service companies or technological firms. Moreover the decline could be explained by the escalation in the number of firms reporting losses.

3. Research Methodology

3.1 Sample and Data Collection

For the evaluation of the value relevance and corporate governance of accounting information in Mauritius, the listed companies on the Stock Exchange of Mauritius (SEMDEX) is taken out as sample with 30 official listed companies for a five year period 2009-2013. Information has been collected from the annual report of companies and other relevant reports by those companies.
3.2 Modelling

The Ohlson valuation model (1995) will be used by employing panel data regression model to analyze the variables in this study. Panel data analysis, also known as cross-sectional or longitudinal time series allows for the study of repeated cross-sections of the same entity. The model being used for the purpose of this study is built from the modified Ohlson (1995) earnings model of stock valuation. Earnings and net asset value (book value) are important indicators of firm valuation for this particular concept. The model is also based on the assumption of ceteris paribus where value of accounting records should finally be allied to the valuation of market shares; following this the model is given as such:

\[ P_{it} = \beta_0 + \beta_1 \text{EPS}_{it} + \beta_2 \text{NAV}_{it} + \beta_3 \text{BC}_{it} + \beta_4 \text{BS}^2_{it} + \mu_{it}, \ldots \]  \hspace{1cm} (1)

\[ P_{it} = \beta_0 + \beta_1 \text{EPS}_{it} + \beta_2 \text{NAV}_{it} + \beta_3 \text{BC}_{it} + \beta_4 \text{BS}^2_{it} + \beta_5 \text{CEO}_{it} + \beta_6 \text{BC} \times \text{EPS}_{it} + \beta_7 \text{BS}^2_{it} \times \text{EPS}_{it} + \beta_8 \text{CEO}_{it} \times \text{EPS}_{it} + \mu_{it}, \ldots \]  \hspace{1cm} (2)

\[ P_{it} = \beta_0 + \beta_1 \text{EPS}_{it} + \beta_2 \text{NAV}_{it} + \beta_3 \text{BC}_{it} + \beta_4 \text{BS}^2_{it} + \beta_5 \text{CEO}_{it} + \beta_6 \text{BC} \times \text{NAV}_{it} + \beta_7 \text{BS}^2_{it} \times \text{NAV}_{it} + \beta_8 \text{CEO}_{it} \times \text{NAV}_{it} + \mu_{it}, \ldots \]  \hspace{1cm} (3)

Where;

- \( P_{it} \) Which is the dependent variable and represents the end-of-year share price.
- The explanatory variables are given by:
  - \( \text{EPS}_{it} \) This is Earnings per share and defined as earnings after tax divided by shares outstanding.
  - \( \text{NAV}_{it} \) This is Net Asset value (book value) and defined as total assets minus total liabilities of firm I in period t divided by the number of shares outstanding.
- The Corporate Governance measures in this study focus on:
  - **Board composition** (\( \text{BC}_{it} \)), is defined as the percentage of external directors on board.
  - **Board size** (\( \text{BS}_{it} \)), refers to the number of members constituting the board.
  - **CEO duality** (\( \text{CEO}_{it} \)), is a dummy variable, taking a value of 1 if the CEO doubles as the board chair and 0 otherwise.

It is to be noted that share prices and NAV has been logged to allow for standardization and board size has been squared to capture the non-linear effect.

3.3 Hypotheses of the study

H1: Book Value is more relevant than earnings per share in the Mauritian case scenario.
H2: The higher the proportion of outside directors on the board, the more the value relevance of accounting information.
H3: The size of the board of directors is negatively related to the value relevance of accounting information.

H4: Corporate governance is positively associated with value-relevance of accounting information.

4. Analysis and Findings

This section deals with the findings and analysis of the study. It is presented through descriptive statistics, the Spearman’s correlation test and the results from the regression are presented based upon the work of Ohlson (1995) model.

4.1. Descriptive Statistics

Table 1 demonstrates the descriptive statistics of the study.

<table>
<thead>
<tr>
<th>Variables</th>
<th>Observation</th>
<th>Mean</th>
<th>Std.Dev</th>
<th>Min</th>
<th>Max</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share Price</td>
<td>150</td>
<td>84.59267</td>
<td>83.34851</td>
<td>1.04</td>
<td>398</td>
</tr>
<tr>
<td>EPS</td>
<td>150</td>
<td>7.14527</td>
<td>9.416064</td>
<td>-5.68</td>
<td>60.8</td>
</tr>
<tr>
<td>NAV</td>
<td>150</td>
<td>67.72953</td>
<td>69.67698</td>
<td>0.69</td>
<td>378.38</td>
</tr>
<tr>
<td>BS</td>
<td>150</td>
<td>9.76667</td>
<td>1.998042</td>
<td>5</td>
<td>15</td>
</tr>
<tr>
<td>BC</td>
<td>150</td>
<td>0.4621333</td>
<td>0.2582195</td>
<td>0.13</td>
<td>1</td>
</tr>
<tr>
<td>CEODUALITY</td>
<td>150</td>
<td>0.0333333</td>
<td>0.1801069</td>
<td>0</td>
<td>1</td>
</tr>
</tbody>
</table>

The average share price on the Stock Exchange of Mauritius is 84.59 rupees ranging from Rs 1.04 as its lowest price and others as high as Rs 398. As far as EPS is concerned the values range from negative Rs 5.68 to positive Rs 60.8, reporting an average amount of 7.14. In terms of net asset value, it records an approximate average amount of 67.73, with a minimum value of Rs 0.69 and a maximum amount of Rs 378.38. Moreover in terms of Corporate Governance, it can be seen that the average board size is 9.77, with a minimum of 5 directors up to a maximum of 15 directors on board. Moreover, approximately 47% directors on board are independent and only 33% of the board have the same person occupying the same place as chairperson and CEO at the same time.

4.2. Correlation Matrix

Table 2: Correlation Matrix

<table>
<thead>
<tr>
<th>Variables</th>
<th>Share Price</th>
<th>EPS</th>
<th>NAV</th>
<th>BS</th>
<th>BC</th>
<th>CEODUALITY</th>
<th>BS²</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share Price</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>EPS</td>
<td>0.7665</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NAV</td>
<td>0.7247</td>
<td>0.5990</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
As per the correlation matrix, it can be noted that share prices are positively correlated with NAV, EPS and BS² but negatively related with CEO duality and BC. Earnings per share are positively related with net asset value and BS but negatively related with CEO duality and board composition. In terms of NAV, it is positively associated with board size and board size to the square but negatively related to board composition and CEO duality. As far as board size is concerned, it is negatively related to both board composition and CEO duality. BC turns out to be positively related to CEO duality and negatively related to the square of board size. CEO duality is negatively correlated to all the variables except for board composition.

4.3. Regression Output

Since the models have got cross sectional dependence and heteroskedasticity problems, they had to be corrected in order to provide a better estimation. Therefore, taking into account of what the Hausman test has generated that is fixed effect models across the 3 models, the corresponding test was applied in order to provide a better result, which is the Driscoll-Kraay standard error estimation model.

Following this, the results from the Driscoll-Kraay standard error estimation model are presented in the table below:

<table>
<thead>
<tr>
<th>Variables</th>
<th>Regression 1</th>
<th>Regression 2</th>
<th>Regression 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>EPS</td>
<td>0.0053412</td>
<td>0.0149206</td>
<td>0.0063414</td>
</tr>
<tr>
<td></td>
<td>(0.040)**</td>
<td>(0.026)**</td>
<td>(0.016)**</td>
</tr>
<tr>
<td>LOGNAV</td>
<td>0.9353467</td>
<td>0.9413546</td>
<td>0.9847907</td>
</tr>
<tr>
<td></td>
<td>(0.000)****</td>
<td>(0.000)****</td>
<td>(0.000)****</td>
</tr>
<tr>
<td>BC</td>
<td>0.7238459</td>
<td>0.6092498</td>
<td>1.259987</td>
</tr>
<tr>
<td></td>
<td>(0.000)****</td>
<td>(0.000)****</td>
<td>(0.000)****</td>
</tr>
<tr>
<td>BS²</td>
<td>-0.003855</td>
<td>-0.003128</td>
<td>-0.0043603</td>
</tr>
<tr>
<td></td>
<td>(0.061)*</td>
<td>(0.118)</td>
<td>(0.026)**</td>
</tr>
<tr>
<td>EPS*BS</td>
<td>-</td>
<td>-0.0020773</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(0.000)****</td>
<td></td>
</tr>
</tbody>
</table>
The accounting measures variables (EPS and NAVPS); they are both highly significant at 1% and 5%. Both NAV and EPS are considered to be powerful determinants of share prices and the significant and positive coefficient proves that Mauritian investors rely much on these two variables before undertaking any investment decisions. Many studies talk about EPS losing its relevance to investors and about an increased dependence on BV, where for instance such evidence has been found on the Ghana Stock Exchange for a research conducted by Vera OgehFiador in 2013. However, this is not the case in Mauritius where clearly EPS is still very significant along with BVPS, this contradicts with the findings of Maydew, Weisis and Collins (1997) who acknowledged a shift from the value relevance of earnings to book value.

The reason as to why Earnings per share are still significant maybe due to the adoption of Corporate Governance and this has made a positive impact on investors’ mindset whereby they believed that companies were disclosing a true and fair valuation of accounts and that the figures provided were not manipulated. Correspondingly it can be deduced that companies have been disclosing proper information to the investing public. And the significance of NAV here signifies that, all the things being equal, a rise in NAV will lead to an increase in shareholder’s basket. Consequently H1 is rejected.

In terms of BC as an individual independent variable, is significant in all the three equations at 1% to share prices suggesting that BC affects share prices directly when the board consists of more independent directors, thus accepting H2. The significance of the board composition is very compelling as such that companies listed on the Stock Exchange of Mauritius are very well in line with the stock market requirements and in conjunction with the Corporate Governance code. This is in line with the OECD principles of Corporate Governance (2004) which lays much emphasis on having independent directors on board contributing significantly to an organization.
Concerning board size, as mentioned previously, the variable was squared to capture the non-linear effect. From the regression results, board size as an individual independent variable has got a negative coefficient throughout, however it happens to be significant in all the first and last regression models at 10% and 5% respectively and is insignificant in the second model. This also suggests, that board size in negatively correlated with share prices when the board size is large, entailing that smaller board is preferred in this case, which is very much in line with what Yermack (1996) pointed out about smaller boards, as it becomes easier to share different ideas and point of view due to the downsized number of people on board.in this line H3 is seemingly accepted.

Equation 2 in the model takes into account both corporate governance variables and the accounting measures, for instance they were paired with EPS. EPS is negatively associated to share prices when the board is larger, which again vouch for smaller boards over larger ones. BC on its side still possesses a positive coefficient meaning that EPS is positively related to share prices when the board consists of more independent directors.CEODUAL also has got a positive coefficient but it is rather insignificant, signifying that earnings per share when paired with CEODUAL do not bring any more value to the firm especially when the same person is occupying the same position as board chair and CEO, as indicated by the positive coefficient.

As far as regression 3 is concerned, it also follows the same principle where it incorporates corporate governance variables and accounting measures, for instance net asset value. in this case BS paired with NAV is both positive and significant at 5% along with a positive coefficient, deducing that NAV is positively related to share prices when the board size is large, which is right from an agency perspective as according to Kiel and Nicholson (2003), larger board is important for larger companies for the monitoring of management activities. NAV is negatively related to share prices when the board is composed of less independent directors this is in line to what Adams and Mehran (2008), Belkhir (2006) and Pi and Timme (1993) among others have said about having no benefits from having independent directors on board. CEO duality here has got a negative coefficient and is significant, meaning that NAV is negatively related to share prices when the same person occupies the post of chairman and CEO simultaneously.

5. Conclusion and Implications

The study assessed the relationship between Corporate Governance and Value Relevance of Accounting information in Mauritius employing the Ohlson model. The results were as such that both earnings per share and net asset value per share are very much significant to share prices and is value relevant to investors in terms of decision making. Moreover a preference towards smaller board size has been notices, in addition to having more
independent directors on board and that the role of CEO and Chairman should be separated when NAV is being considered. The implications of the study may be as such, to prevent corporate scandals which have been quite prominent in Mauritius recently and gain investors’ confidence in an organization, bringing more independent directors on board seems to be a good initiative in bringing impartial and objective opinions and decision making.

References


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