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# Corporate governance and value relevance of accounting information

## Evidence from Kuwait

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## Abstract

**Purpose** – This paper aims to explore how the characteristics of the board of directors (BoD) shape earnings and book value information available to market participants.

**Design/methodology/approach** – The authors investigated the impact of board size, presence of non-executives and role duality as proxies of effective corporate governance on the value relevance of financial reporting for 178 firms on the Kuwait stock exchange in 2013. Regression analysis based on Ohlson's (1995) valuation model was used to test hypotheses.

**Findings** – The authors found that board size was significantly associated with company value and that Kuwaiti firms with large boards increased the value-relevance of earnings and book value. The influence of role duality was positive although not significant. The presence of non-executives on the board had a negative correlation with market value (not significant).

**Research limitations/implications** – These findings deliver empirical support for the prediction that the characteristics of the BoD improve the value relevance of financial reporting. Limitations such as small sample size and one-year duration of the study did not negate the basic findings, however. Future studies will use larger samples, longer duration and additional board characteristics.

**Practical implications** – This study provides empirical support for the hypothesis that board size influences market valuation. This study may benefit managers, investors and other decision-makers.

**Originality/value** – This study delivers empirical evidence on the impact of board characteristics on the value relevance of accounting information. It will be useful for regulators and market participants monitoring the influence of board characteristics on the value relevance of accounting information.

**Keywords** Kuwait, Value relevance, Board of directors, Corporate governance, Market valuation

**Paper type** Research paper

## 1. Introduction

A company's board of directors (BoD) plays a central role in corporate governance as the ones who do the hiring and firing, set the compensation for senior management teams and resolve conflicts of interest among decision-makers and residual risk bearers (Fama and Jensen, 1983; Baysinger and Butler, 1985). It has been argued that the multiple activities of the BoD have allowed companies to economize on the agency costs associated with the separation of ownership and control and to facilitate their survival in a public organizational form (Baysinger and Butler, 1985). The empirical literature on the role of the BoD demonstrates that there is a significant relationship between the quality of financial reporting and the quality of corporate governance as measured by the composition of the board (Di Pietra *et al.*, 2008). In surveying the literature on corporate governance, John and Senbet (1998) claimed that the effectiveness of the BoD in monitoring corporate actions was

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determined mainly by its independence, size and composition. There is a significant association between the effectiveness of internal and external corporate governance mechanisms and a firm's valuation (Di Pietra *et al.*, 2008). For example, studies on Australian firms showed that those with a strong governance structure exhibited a higher value-relevance of accounting information (Habib and Azim, 2008). Focusing on Italy, a country, that is, characterized by pyramidal firm structures, family and concentrated ownership with few legal protections for investors, a study by Di Pietra *et al.*, 2008 provided evidence that the market value of a firm correlated with the quality of corporate governance as measured by the board's size and the fraction of directors that served on several corporate boards.

Corporate governance has been an extensively researched area (Habib and Azim, 2008), but the various levels of influence of the BoD on the value relevance of accounting information have not been clearly defined. Although agency theory supports the hypothesis that a better structured BoD should result in better quality financial reporting in the marketplace (Habib and Azim, 2008), there are limited empirical data to support this hypothesis. Given this scarcity, this study explored how the characteristics of the BoD (size, presence of non-executives and Chief Executive Officer (CEO) duality) shaped the information on earnings and book value of companies listed on the Kuwait stock exchange (KSE) available to market participants.

Three hypotheses were developed to investigate the relationship between BoD characteristics and the value relevance of accounting information. A regression method based on Ohlson's (1995) valuation model was used to test the hypotheses. The influence of board size, presence of executives and their role duality on the board as enforcers of effective corporate governance and promoters of the value relevance of financial reporting for 178 firms listed on the KSE in 2013 was examined. After controlling for firm-specific characteristics, the study findings revealed that board size was significantly associated with company value and suggested that Kuwaiti firms with the largest boards had increased value-relevance of earnings and book value. The influence of role duality was positive, although its relationship with a firm's value was not statistically significant. The presence on the board of a higher percentage of non-executives showed a negative, although non-significant parallel with market value.

This paper contributes to the ongoing literature in three main aspects. First, it delivers empirical support for the theoretical prediction that the characteristics of the BoD influence market valuation and highlights the usefulness of these characteristics in improving the value relevance of financial reporting. Second, it presents evidence as to the effectiveness of a firm's board characteristics on enhancing the value relevance of accounting information. Third, the study explored the relationship between BoD characteristics and the value relevance of accounting information in the unique setting of Kuwait, where listed companies show substantial variations in corporate governance practices.

The remainder of this paper is organized as follows. Section 2 presents a brief background about corporate governance practices in Kuwait. Section 3 reviews the related theoretical and empirical literature and develops the hypotheses. Section 4 describes the methodology, data and sample characteristics. Section 5 outlines the results of the analysis and Section 6 concludes with a summary and discussion of the results and an outline of the study's major contributions and implications.

## 2. Corporate governance practices in Kuwait

In accordance with the Commercial Companies Law No.15 of 1960 and its amendments, a KSE-listed company must be managed by a BoD, whose structure is described in the

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company's Articles of Association (Article, 138). It must comprise at least three directors, elected by secret ballot. Their tenure may not exceed three years, but appointments are renewable and there is no limit to the number of times they can be reelected. As a result, directors of KSE-listed companies are seldom replaced (Alfraih, 2016b; Alfraih, 2017). To qualify for appointment as a director of a KSE-listed company, an individual must be qualified to act, must not have been convicted of a crime involving negligence, fraud or bankruptcy affecting their honor or involving a breach of trust, unless they were later reinstated. Directors must own shares constituting no less than 1 per cent of the company's capital or shares with a nominal value of KD 7,500 (US$26,000) unless the company's articles require a different percentage or nominal value. Within one month of appointment, a director must deposit the minimum shareholding as a security with a bank, where it must remain until the appointment expires and the balance sheet for the past fiscal year of service has been certified (Article, 139). The 1960 law, however, lacks provisions to protect minority shareholders' interests, as a nomination to the board and election depends on the majority shareholders. Election to the board is by statutory voting, which implies one share, one vote. Thus, a majority shareholder is able to control its composition and structure. KSE directors may sit on more than one board, but the law prohibits an individual from being a director of more than three KSE-listed firms. Furthermore, an individual cannot be a delegated director or board chairman of more than one KSE company – a chairman can be a member of three boards, but the chairman of only one (Alfraih, 2016b; Alfraih, 2017).

The law is silent about board composition. It does neither distinguish between executive and nonexecutive directors nor does it specify their relative numbers. Consequently, the composition of the board is determined by a company's Articles of Association. Banks and some larger KSE-listed companies have audit committees as are commonly found in developed markets along with remuneration and nominating committees, but again the law does not require or even mention such committees. As directors of KSE-listed companies are generally nominated by its majority shareholders, the most important factor influencing the composition of the board is the aspiring member's relationship with them. This contrasts, at least in appearance, with the Anglo-American pattern of drawing from those nominated by a nomination committee. In contrast to best practice in other jurisdictions, directors of KSE-listed companies tend to be non-independent (executive managers) and can hold the role of both chairmen of the BoD and CEO, as there is no legal requirement to separate the two roles (Alfraih, 2016b; Alfraih, 2017).

## 3. Literature review and hypotheses

Corporate governance has become a popular subject in the international academic and business debate and gained particular prominence after corporate scandals and frauds occurred (Aluchna, 2009). It can be defined as the stewardship responsibility of board directors to provide oversight for the strategies of a company and to foster it is goals achievement, thus, in that sense, corporate governance may be perceived as the set of interlocking guidelines by which companies, shareholders and managers govern their behavior (Cornelius, 2005). Shleifer and Vishny (1997, p. 737) state that "corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment." Substantial regulatory reforms concerning corporate governance around the world give the impression that regulators believe that corporate governance plays a crucial role in ensuring, reliable financial reporting (Habib and Azim, 2008).

Oliveira *et al.* (2016) argue that the effectiveness of rules and norms on corporate governance practices are the focus of several theoretical and empirical studies because of the

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derived benefits of these rules of on company value, minority shareholders protection and efficiency of corporate governance codes. Mertzanis (2011) claim that the effectiveness of corporate governance enforcement is a complex matter necessitating the *thorough* understanding of the role of institutional factors, however, Mertzanis (2011) emphasis that the effectiveness of corporate governance enforcement mechanisms differ notably among market economies, and thus, cannot be attributed to one single factor nor does any such factor have the same importance in all markets. Driven by the necessity to offer a platform for debating both theoretical and empirical issues on corporate governance, Tsamenyi and Uddin (2008) encourage more research on corporate governance in less developed and emerging economies that explore the effectiveness of various corporate governance mechanisms suitable for less developed and emerging economies.

Empirical research has examined the effectiveness of various corporate governance mechanisms. For example, in the Australian context and using board, audit committee and external audit-related variables to proxy for corporate governance, Habib and Azim (2008) investigate the relationship between corporate governance and the value-relevance of accounting information. Their results reveal that companies with a strong governance structure display higher value-relevance of accounting information. In Poland, Aluchna (2009) explore whether companies complying with corporate governance best practice deliver higher returns and higher value for investors as compared with companies that do not follow best practices. The empirical results of Aluchna (2009) fail to support the assumption that higher return on investment and higher Tobin' Q are associated with companies complying with best practices. Aluchna (2009) attribute this observation to the weak institutional system and relative underdevelopment of the corporate governance system in Poland.

In exploring the influence of internal corporate governance mechanisms on insurance companies' risk-taking in the UK context, Elamer *et al.* (2018) observe that the board size and board meetings are significantly and negatively related to risk-taking. In contrast, their results document that board independence and audit committee size is statistically insignificant but negatively related to risk-taking. Elamer *et al.* (2018)' study highlight the significant role of corporate governance mechanisms in constraining risk-taking behavior in an industry with significantly complex context such as insurance companies. In the Indonesian context, Rudyanto and Veronica (2018) examine the effects of corporate governance on the quality of sustainability report and reveal that the board of commissioner effectiveness positively affects the quality of sustainability report, while family ownership has no effect on the quality of such report.

In the Islamic context, Elghuweel *et al.* (2017) explore the influence of Islamic and corporate governance mechanisms on corporate earnings management behavior in Oman. Their results suggest that companies that represent greater commitment toward incorporating Islamic religious beliefs and values into their operations through the establishment of Islamic governance mechanisms tend to engage significantly less in earning management than their counterparts without such mechanisms. Similarly, in their exploration of the effect of Islamic values on the extent of voluntary corporate governance disclosure, Albassam and Ntim (2017) observed that government ownership, institutional ownership, audit firm size, board size and the presence of a corporate governance committee are positively associated with the extent of voluntary corporate governance disclosure, whereas block ownership is negatively associated with the level of voluntary corporate governance disclosure. Albassam and Ntim's (2017) study clearly highlights the influence of Islamic values on corporate governance practices.

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On the same context and based on Malaysian Shari'ah-compliant companies, Alkdai and Hanefah (2012) explore the effectiveness of the board of director's characteristics, namely, the board size, number of independent nonexecutive directors in the board, the CEO duality and the number of Muslim directors in the board in enhancing the value relevance of accounting information. Alkdai and Hanefah (2012) observe that board size and CEO duality are not significant mechanisms that affect the value relevance of accounting information. Furthermore, the study document that there is a positive but insignificant relationship between the board independence and value relevance of accounting information. The number of Muslim directors in the board was deemed to be an insignificant influencer on the value relevance of accounting information. Mardnly *et al.* (2018) investigate the influence of corporate governance mechanisms on company performance on all firms listed at Damascus Securities Exchange and document that ownership structure is the only significant corporate governance mechanisms influencing Syrian companies' performance, as it loads positively and significantly on company performance proxies.

The body of current research is focused on the theoretical background of the effect of board characteristics on the value relevance of earnings and equity book value. Based on a review of these previous studies, research hypotheses were developed to investigate the effect of three characteristics – size, presence of non-executives and role duality – on earnings and book value.

### *3.1 Board size*

Size is one of the most widely discussed board characteristics in the literature (Alfraih, 2016b). It is argued that large boards are more likely to have greater knowledge, skills and experiences at their disposal than their smaller counterparts, resulting in superior resources available for sharing that make the appearance of mutual peer influence more feasible (Vandewaerde *et al.*, 2011). Similarly, Van den Berghe and Levrau (2004) suggested that increasing the number of directors may allow boards to draw on a diversity of perspectives on corporate policy and may shrink control by the CEO. However, while the board's capacity for monitoring company functions increases as more directors are added, the benefit may be outweighed by the incremental cost of inefficient communication and decision-making associated with larger boards (John and Senbet, 1998).

In Kuwait, the size of the BoD of KSE-listed companies tends to vary substantially (Alfraih, 2016b). For example, in 2013 the number of board members ranged from 3 to 10. Given the benefits associated with large boards such as knowledge, skills and experiences, the larger boards are more likely to produce higher-value relevance of accounting information. This leads to *H1 as follows*:

*H1*. Board size is positively associated with the value relevance of accounting information.

### *3.2 Non-executive directors on the board*

Boards of directors generally incorporate some non-executive directors who are not internal corporate managers. Non-executive directors often act as arbiters in disagreements among internal managers and handle agency problems (Alfraih, 2016a). The corporate governance literature has clearly supported the idea that non-executive directors tend to be more motivated to carry out their monitoring tasks and less likely to collude with corporate managers to expropriate stockholder wealth (Beasley, 1996). Given the argument that non-executive directors on the board have an important role to protect the interests of all

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shareholders, increasingly in more recent years, companies around the world are adopting the practice of maintaining a minimum number of non-executive directors on company boards (McCabe and Nowak, 2008). Given the importance of the non-executive directors and their influence on the quality of financial reporting, it can be argued that they are likely to influence the value relevance of accounting information. This conclusion leads to *H2*:

*H2*. The presence of non-executives on the board is positively associated with the value relevance of accounting information.

*3.3 Role duality*

Role duality is the practice of combining the CEO and BoD chair positions into a single role, which, in turn, reduces the board's monitoring capacity and gives the CEO greater powers (Wang *et al.*, 2019). Fama and Jensen (1983, p. 314) argued that the shared role of chair and CEO "signals the absence of separation of decision management and decision control." The literature of corporate governance has frequently suggested that CEO/chair duality was a sign of higher agency costs produced by greater information asymmetries between management stakeholders (Beisland *et al.*, 2015). Given the expected negative impact of shared CEO/chair responsibilities on a board's ability to effectively monitor corporate management, it can be argued that the presence of role duality is likely to lead to lower financial reporting quality. This leads to *H3*:

*H3*: Role duality is negatively associated with the value relevance of accounting information.

## 4. Research methods

*4.1 Sampling and data*

This study investigated the impact of board size, presence of executives and degree of role duality as proxies for effective corporate governance mechanisms, on the value relevance of financial reporting for firms listed on the KSE in 2013. The 2013 investor guide for the KSE listed 215 Kuwaiti firms as of the end of 2013. Some data were missing for some companies listed on the KSE and they were excluded from the sample. The final sample contained the remaining 178 companies. Financial data included stock prices, the book value of equity, net income, total assets, total liabilities and common shares outstanding. All data regarding board characteristics and value relevance variables were obtained from the official website of the KSE (www.kse.com.kw). The data from 2013 were the most recent available at the time of the study.

*4.2 Ohlson valuation model*

The leading valuation model in the literature of market-based research is the Ohlson valuation model (Ohlson, 1995). The model has also been widely adopted by researchers to empirically test the value relevance of earnings and book value (Collins *et al.*, 1999; Hellstrom, 2006; Habib and Azim, 2008; Lee *et al.*, 2011; Brugni *et al.*, 2012; Larsson and Bogstrand, 2012; Kargin, 2013; Alfraih *et al.*, 2015; and Almujamed and Alfraih, 2019). It is described below as follows:

$$P_{\mathrm{it}} = \beta_0 + \beta_1 \mathrm{EPS}_{\mathrm{it}} + \beta_2 BVS_{it} + \varepsilon_{it} \quad (1)$$

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where:

$P_{it}$ = stock price per share for firm $i$ at time $t$, three months after the end of the fiscal year;
$EPS_{it}$ = earnings per share of firm $i$ at time $t$;
$BVS_{it}$ = book value per share of firm $i$ at time $t$;
$T$ = 2013, corresponding to the fiscal year 2013; and
$\varepsilon_{it}$ = other value relevant information.

Stock prices, earnings and book value were evaluated here using statistical association as the main metric to measure the value relevance of financial reporting. If accounting variables – earnings and book value – are values relevant to investors, then there will be an association between stock price, earnings and book value and earnings and book value coefficients will be statistically significant. This reminder is measured by the explanatory power ($R^2$) of the regression model.

*4.2.1 Control variables.* Numerous researchers have found that the value relevance of earnings and the book value can be influenced by several company-specific factors including size (Alfraih and Alanezi, 2011) and industry category (Hellstrom, 2006). Consequently, these company-specific factors are implemented as control variables in the regression model.

*4.2.2 Board characteristics and the value relevance of accounting information.* This research examined the effect of the board characteristics, size, non-executive and role duality, on the value relevance of earnings and book value. Assuming that a strong board is valued by decision-makers in the stock market, its characteristics represent additional information that leaders incorporate into their valuation models. The following equation incorporates size, non-executive and role duality variables along with earnings and book value as follows:

$$\mathrm{P_{it}} = \beta_0 + \beta_1 EPS_{\mathrm{it}} + \beta_2 BVS_{\mathrm{it}} + \beta_3 BSIZE_{\mathrm{it}} + \backslash\beta_4 EXCTV_{\mathrm{it}} + \beta_5 DUAL_{\mathrm{it}} + \varepsilon_{it} \quad (2)$$

However, equation (2) does not test the interactions between these variables. Therefore, to test the three study hypotheses, price model accounting constructs (earnings and book value) were compared with board characteristics (size, numbers of non-executives and role duality). In addition, company size and industry category were included as control variables. The extended price model is as follows:

$$\begin{aligned} P_{it} = {} & \beta_0 + \beta_1 EPS_{it} + \beta_2 BVS_{it} + \beta_3 BSIZE_{it} + \backslash\beta_4 EXCTV_{it} + \beta_5 DUAL_{it} \\ & + \beta_6 EPS{*}BSIZE_{it} + \beta_7 EPS{*}EXCTV_{it} + \beta_8 EPS{*}DUAL_{it} \\ & + \beta_9 BVS{*}\ BSIZE_{it} + \beta_{10} BVS{*}EXCTV_{it} + \beta_{11} BVS{*}DUAL_{it} \\ & + \beta_{12} LSIZE_{it} + \beta_{13}\ IND_FINST_{it} + \beta_{14} IND_INVEST_{it} \\ & + \beta_{15} IND_INDUS_{it} + \beta_{16} IND_SERV_{it} + \varepsilon_{it} \end{aligned} \quad (3)$$

where:

$P_{it}$ = stock price per share for firm $i$ at time $t$, three months after the end of the fiscal year;
$EPS_{it}$ = earnings per share of firm $i$ at time $t$;
$BVS_{it}$ = book value per share of firm $i$ at time $t$;
$BSIZE_{it}$ = number of directors on the board of firm $i$ at time $t$;

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$EXCTV_{it}$ = number of non-executives on the board of firm $i$ at time $t$;
$DUAL_{it}$ = dummy variable that equals 1 if the CEO of firm $i$ at time $t$ is also the chairman of the board and 0 otherwise;
$LSIZE_{it}$ = natural logarithm of total assets of firm $i$ at time $t$;
$IND_FINST$ = dummy variable that equals 1 for firms in the financial category and 0 otherwise;
$IND_INVEST$ = dummy variable that equals 1 for firms in the investment category and 0 otherwise;
$IND_INDUS$ = dummy variable that equals 1 for firms in the industrial category and 0 otherwise;
$IND_SERV$ = dummy variable that equals 1 for firms in the services category and 0 otherwise, (if both of these categories are zero then the firm is in the real estate category);
$t$ = 2013 fiscal year; and
$\varepsilon_{it}$ = other value relevant information.

The main coefficients of interest are the interaction between earnings and board size ($\beta_6$), executives ($\beta_7$), role duality ($\beta_8$), book value and board size ($\beta_9$), non-executives ($\beta_{10}$) and role duality ($\beta_{11}$). Given the benefits associated with larger boards in improving the quality of financial reporting, a positive relationship between size and the value relevance of earnings and book value was anticipated. A significantly positive ($\beta_6$) and ($\beta_9$) coefficient would confirm this prediction. Because previous studies reported the benefits associated with an increasing proportion of non-executives in improving the quality of financial reporting, a positive relationship between a number of executives and the value relevance of earnings and book value was expected. Significantly positive ($\beta_7$) and ($\beta_{10}$) coefficients would confirm this hypothesis. The literature on corporate governance reiterates the importance of splitting the roles of CEO and chairman. Consequently, a negative relationship between role duality and value relevance of earnings and book value was expected. This would be supported by significantly negative ($\beta_8$) and ($\beta_{11}$) coefficients.

## 5. Results

### *5.1 Descriptive statistics*

Panel A of Table I shows descriptive statistics for the dependent variable stock price (*P*), together with the independent variables tested in the price models. The stock price per share for the year 2013 ranged from KD 0.020 to KD 2.520 with a mean of KD 0.250. Mean earnings per share during the study period were KD 0.020 and the mean book value per share was KD 0.210. Board sizes ranged from 3 to 10 members, with a mean of 6.12. The number of non-executives ranged from zero to two with a mean of 0.65, suggesting that few members were involved in the board. Panel A also shows that 36 per cent of the firms had CEO duality. This variation could be attributed to the fact that KSE-listed firms are not legally required to separate the roles of chairman and managing director (Alanezi and Albuloushi, 2011). Finally, the firms' size ranged from KD 14.34 to 23.65m, with a mean of KD 18.28m. Panel B of Table I shows the sample of firms according to their categories on the KSE.

Pearson correlations between independent variables are presented in Table II. No pair-wise coefficients appeared to exceed 0.8 and, therefore, there were no multicollinearity concerns (Gujarati, 2003).

Variance inflation factors (VIFs) were calculated to detect multicollinearity between independent variables. VIFs ranged from 1.63 to 2.12 with a mean of 1.78, which verified the absence of multicollinearity (Table III).

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| Variable | Mean | SD | Minimum | Maximum |
|---|---|---|---|---|
| *Panel A: continuous variables* | | | | |
| Stock price (P) | 0.250 | 0.32 | 0.020 | 2.520 |
| Earnings per share (*EPS*) | 0.020 | 0.03 | −0.080 | 0.150 |
| Book value per share (*BVS*) | 0.210 | 0.19 | −0.01 | 1.61 |
| Board size (*BSIZE*) | 6.12 | 1.56 | 3.00 | 10.00 |
| No of non-executive (*EXCTV*) | 0.65 | 0.56 | 0.00 | 2.00 |
| Role of duality (*DUAL*) | 0.36 | 0.48 | 0.00 | 1.00 |
| Firm size (LSIZE) | 18.28 | 1.59 | 14.34 | 23.65 |
| *Panel B: dummy variables* | | | | |
| Variable | Frequency | Percent | Valid percent | Cumulative percent |
| Bank and insurance | 17 | 9.6 | 9.6 | 9.6 |
| Investment | 40 | 22.5 | 22.5 | 32.0 |
| Real estate | 35 | 19.7 | 19.7 | 51.7 |
| Industrial | 32 | 18.0 | 18.0 | 69.7 |
| Service | 54 | 30.3 | 30.3 | 100.0 |
| Total | 178 | 100.0 | 100.0 | – |

**Table I.** Descriptive statistics of variables

| Independent variable | *EPS* | *BVS* | *BSIZE* | *EXCTV* | *DUAL* | *LSIZE* |
|---|---|---|---|---|---|---|
| Earnings per share (*EPS*) | *1* | | | | | |
| Book value per share (*BVS*) | 0.65* | *1* | | | | |
| Board size (*BSIZE*) | −0.04 | 0.18* | *1* | | | |
| Non-executive (*EXCTV*) | −0.07 | −0.01 | −0.01 | *1* | | |
| Role duality (*DUAL*) | −0.03 | 0.01 | −0.06 | 0.61** | *1* | |
| Firm size (*LSIZE*) | 0.14* | 0.26** | 0.34** | −0.18* | −0.12 | *1* |

**Notes:** *, **Correlation is significant at $p \leq 0.05$ and $p \leq 0.01$ levels, respectively (two-tailed). Note that the American Medical Association, American Psychological Association and other style guides all say that the leading zero in the $p$-value should be omitted because the value can never exceed 1.00. That is why I have deleted all the leading zeros

**Table II.** Bivariate correlations between independent variables

| Independent variable | VIF |
|---|---|
| Earnings per share (*EPS*) | 1.90 |
| Book value per share (*BVS*) | 2.12 |
| Board size (*BSIZE*) | 1.60 |
| Non-executive (*EXCTV*) | 1.65 |
| Role duality (*DUAL*) | 1.63 |
| Firm size (*LSIZE*) | 1.72 |
| Financial | 1.81 |
| Investment | 1.68 |
| Industrial | 1.76 |
| Service | 1.90 |
| Overall mean VIF | 1.78 |

**Table III.** Variance inflation factors (VIFs) for independent variables

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*5.2 Regression results*

Column 2 of Table IV displays the findings of regressing stock price on earnings and book value (Model 1). The results show that the model is statistically significant ($F = 55.341$, $p < 0.01$). The adjusted $R^2$ for the pooled cross-sectional regression of Model (1) demonstrates that earnings and book value jointly explained 68.2 per cent of the variation in the stock prices of KSE-listed firms in 2013. Consistent with earlier research (Alfraih and Alanezi, 2011; Alkdai and Hanefah, 2012), Model 1 shows convincing evidence that earnings and book value reported by KSE-listed firms in 2013 played a significant role in equity valuation.

Column 3 of Table IV (Model 2) displays the findings of regressing stock price on earnings, book value and board characteristics. Model 2 is also statistically significant ($F = 39.777$, $p < 0.01$) and explains about 68.7 per cent of the variation in the stock price of KSE-listed firms in 2013. Consistent with our predication, board size is positive and statistically significant ($p < 0.010$), indicating that the larger the board the better the market valuation. This finding supports the conclusion of Van den Berghe and Levrau (2004) that increasing the number of directors promoted board functionality and enhanced financial reporting

| | Dependent variable: *stock price* | | |
|---|---|---|---|
| Variable | Model (1) Coefficient | Model (2) Coefficient | Model (3) Coefficient |
| *Intercept* | −0.017 | −0.072 | −0.097 |
| *EPS* | 2.494*** | 2.784*** | −2.978 |
| *BVS* | 0.990*** | 0.952*** | 0.888** |
| *BSIZE* | | 0.024* | 0.001 |
| *EXCTV* | | −0.011 | 0.53 |
| *DUAL* | | 0.016 | 0.017 |
| *EPS*BSIZE* | | | 0.850** |
| *EPS*EXCTV* | | | −1.534 |
| *EPS*DUAL* | | | 4.053* |
| *BVS*BSIZE* | | | 0.056 |
| *BVS*EXCTV* | | | −0.260 |
| *BVS*DUAL* | | | −0.301 |
| *LSIZE* | 0.001 | 0.001 | 0.002 |
| *IND_FINST* | 0.103 | 0.046 | 0.026 |
| *IND_INVEST* | −0.006 | −0.013 | −0.021 |
| *IND_INDUS* | 0.092** | 0.083* | 0.095* |
| *IND_SERV* | 0.052* | 0.052 | 0.054 |
| *Adj.* $R^2$ | 0.682 | 0.687 | 0.717 |
| *F-stat* | 55.341*** | 39.777*** | 29.040*** |
| *n* | 178 | 178 | 178 |

**Notes:** *, **, ***Significant at the 0.10, 0.05 and 0.01 levels, respectively (two-tailed). $P_{it}$ is the stock price per share for firm $i$ at time $t$, three months after the end of the fiscal year; $EPS_{it}$ is the earnings per share of firm $i$ at time $t$; $BVS_{it}$ is the book value per share of firm $i$ at time $t$; $BSIZE_{it}$ is the number of directors on the board of firm $i$ at time $t$; *EXCTV* is a number of non-executives on the board of firm $i$ at the time $i$; $DUAL_{it}$ is a dummy variable that equals 1 if the CEO of firm $i$ at time $t$ is also the chairman of the board and 0 otherwise; $LSIZE_{it}$ is the natural logarithm of total assets of firm $i$ at time $t$; *IND_FINST* is a dummy variable that equals 1 for firms in the financial category and 0 otherwise; *IND_INVEST* is a dummy variable that equals 1 for firms in the investment category and 0 otherwise; *IND_INDUS* is a dummy variable that equals 1 for firms in the industrial category and 0 otherwise; *IND_SERV* is a dummy variable that equals 1 for firms in the services category and 0 otherwise (if these categories are zero, then the firm is in the real estate category); and $t = 2013$ fiscal year

**Table IV.** Results of regression of price on earnings, book value and board characteristics

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quality. Similarly, the role duality variable was positively associated with market value but statistically non-significant as ($p > 0.10$). The non-executive variables were negatively associated with market value and their coefficients were not significant. This could be attributed to the competence of these members, as they might represent the management team and be ineffective BOD members. Others may mostly represent the owners on the board, making the non-executive variables easily defeated.

In this study, the variables of interest were the interaction between board size, executives and role duality and earnings and book value. The interaction between effective corporate governance and the accounting measures could affect the usefulness of accounting information produced. It could be argued that effective corporate mechanisms could mitigate information asymmetry and increase the value relevance of accounting information to market participants. Column 4 of Table IV provides the results of this investigation (Model 3). Again, the model was statistically significant ($F = 29.040, p < 0.01$) and explained 71.7 per cent of the variance. The predictable coefficients of book value were positively correlated with value ($p < 0.05$), but not with earning value. After controlling for firm size and industry category, the *EPS*BSIZE* and *EPS*DUAL* coefficients were positive and significant, but not for the *BVS*BSIZE*, which appeared not to be significant. This suggests that role duality was significantly associated with market value and those KSE-listed firms with larger BoDs and joint roles for the CEO and chairperson offered better value-relevant earnings information. The significant interaction terms between board characteristics and accounting measures clearly highlight the inter-relationship and influence of board size and role duality on the usefulness of earnings. This suggests that increasing the size of the BoD of KSE-listed firms and joining the roles of CEO and chairperson improved the value-relevance of financial reporting despite the fact that the effectiveness of corporate governance mechanisms requires separating then roles of CEO and chairperson. The significant interaction observed between board characteristics and accounting measures highlights the influence of culture and social environment on the value relevance of accounting information. In contrast, *EPS*EXCTV, BVS*EXCTV* and *BVS*DUAL* coefficients were negative and not significant. Column 4 of Table IV displays the coefficients of value relevance of earnings and book values, but all the interactions were non-significant.

## 6. Conclusions

The importance of an effective BoD in monitoring managers, limiting agency conflicts and mitigating agency costs were discussed in previous studies of corporate governance mechanisms. Shareholders demand continuing updates of financial information from managers to evaluate their performance. However, in the absence of an effective board, managers may deliver financial information that does not represent the underlying performance of the company. Therefore, it has been argued that better-structured boards should result in better-quality financial reporting in the marketplace.

The relationship between the efficiency of the members of the BoD and the communications with stakeholders about earnings and company book value was the focus of this study. Regression analysis confirmed the importance of increasing the number of members and the proportion of CEOs on the BoD in guaranteeing quality governance. Having a diversity of separate members such that a CEO is not also the chair is critical for best performance.

The results of our investigation were consistent with the conclusion that increases in the size and diversity of the BoD will translate into better communications to stakeholders and improvements in governance. There are limitations due to the relatively small sample and the omission of some potentially important variables such as BoD committee participation,

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member independence and inclusion of minorities. The study covered only one year and longer periods are necessary for greater statistical relevance. This does not detract from the value of the study's findings about how the make-up of the BoD affected value relevance. Future investigations could use different models for data analysis and include other variables with regard to committees, minorities and diversity.



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## Further reading

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