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Corporate boards and ownership structure: Evidence from Sub-Saharan Africa

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ABSTRACT

This study examines the relationship between board structure and ownership structure for firms listed on the stock exchanges of twelve Sub-Saharan African countries, using data for the period 2006–2009. We find that ownership concentration, foreign ownership and managerial ownership are negatively associated with board size. We also find that government ownership is positively associated with the proportion of outside directors while ownership concentration is negatively associated with the proportion of outside directors. These results emphasize that board and ownership structure are both corporate governance mechanisms that are used as substitutes to one another in reducing agency problems.

1. Introduction

Publicly traded corporations are characterized by a separation of ownership and control (Shleifer & Vishny, 1997). This separation creates agency problems between the owners and management. The classical corporate governance literature discusses the prevalence of agency problems in modern corporations, discussing the role of market and organizational mechanisms in protecting stakeholders, mitigating agency problems, and better aligning the interests of management and shareholders (e.g., Dalton, Hitt, Certo, & Dalton, 2007; Fama & Jensen, 1983). While, in developed economies, external (i.e., market) and internal (i.e., organizational) corporate governance mechanisms may complement each other in solving agency problems, this is generally not the case in most developing economies (Boubakri, Cosset, & Guedhami, 2005).

In developing economies, external corporate governance mechanisms such as the market for corporate control, external auditors, rating agencies, and institutional frameworks (such as legal systems and financial institutions) that facilitate efficient corporate governance practices, particularly those that provide shareholder protection, are absent or underdeveloped (Mishra, 2011). In the presence of ineffective external corporate governance mechanisms, the main solution to agency problems must therefore be found internally (Jensen, 1993). Given that boards and how they are structured play a central role in internal corporate governance (Gillan, 2006), they are one of the most important corporate governance mechanisms in developing economies.

Board structure, in terms of size (i.e., the number of board members) and composition (i.e., the share of inside versus outside, or independent, board members), has received a lot of attention, both in relation to policy discussions on corporate governance and in academic research because boards occupy the pinnacle of their organizations, which implies that the boards' activities and decisions can be expected to be related to organizational outcomes – such as financial performance. Therefore, understanding the determinants of board structure is an important research question for corporate owners and public policy makers. Yet, although research on boards has been quite substantial, there is no consensus about what drives their size and composition. Moreover, a large part of the literature discusses the boards of firms located in developed economies, in most cases the United States (Boone, Casares Field, Karpoff, & Raheja, 2007; Coles, Daniel, & Naveen, 2008; Linck, Netter, & Yang, 2008; Sur, Lvina, & Magnan, 2013) and the United Kingdom (Guest, 2008). Only recently have some studies been conducted using data from emerging economies such as Russia (Iwasaki, 2008), South Korea (Chizema & Kim, 2010) and China (Chen & Al-Najjar, 2012). Broadening the research to

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cover new countries is important because, as Filatotchev and Boyd (2009) argue, the country context may be an important factor in explaining the lack of consensus among researchers about the antecedents of board structure. Therefore, Filatotchev and Boyd suggest that further research should focus on emerging and developing countries, in order to get closer to a global theory of corporate governance.

In this paper we make several contributions to the corporate governance literature. First, we contribute to the understanding of the determinants of board structure by focusing on firms that are active in Sub-Saharan African countries. The institutional setting in these countries is clearly different from that in countries and regions that have been the focus of corporate governance research in the past. To begin with, many African countries have, at least until recently, been characterized by a high level of government intervention. One area in which government intervention has been fierce is with respect to the financial system (Hermes & Lensink, 2013), which has contributed to the existence of underdeveloped capital markets. Moreover, many countries are characterized by an ineffective enforcement of laws and regulations, highly bureaucratic systems, low regulatory quality and relatively high levels of corruption (Kaufmann et al., 2009).

Second, although recently there has been some corporate governance research on Sub-Saharan Africa (see, e.g., Hearn, 2013; Kyereboah-Coleman, 2007; Kyereboah-Coleman & Biepke, 2006; Mangena, Tauringana, & Chamisa, 2012), only one recent study focuses on explaining firms' board structure in this region (Fiador, Abor, & Abor, 2012). Third, while Fiador et al. (2012) use data on listed firms from four countries (Ghana, Nigeria, Kenya and South Africa), we extend this analysis by using data from twelve Sub-Saharan African countries.

Finally, and in contrast to Fiador et al. (2012), who take a broad perspective when investigating the antecedents of board structure, we focus on one specific set of determinants of board structure, i.e., ownership structure. In the literature, ownership structure has received relatively little attention. Yet, in the context of Sub-Saharan Africa the role of ownership may be particularly important because ownership concentration is extensive and foreign ownership common.

The remainder of this paper is organized as follows. The following section discusses the African institutional and financial market context to support our decision to analyze the association between the ownership structure and board structure of African companies. Section 3 provides a review of the literature with respect to the determinants of board structure. In this section, we also develop our hypotheses. In Section 4 we discuss the data and the research methodology while in Section 5 we present the regression results and discussion. In the last section of the paper we provide a summary of our findings, concluding remarks and suggestions for further research.

2. Institutions and corporate governance in Sub-Saharan Africa

Since the late 1990s the world has experienced a number of financial and economic crises, such as the Asian financial crisis in 1997, the dotcom bubble of 2001 and, more recently in 2007–2008, the global financial crisis. In many cases, problems related to corporate governance mechanisms have been seen as important triggers of these crises. This has led to debates among academics, as well as among governmental and institutional bodies, about the effectiveness of different existing corporate governance mechanisms and the need to implement corporate governance reforms. In many countries, governments and/or stock exchanges have issued corporate governance codes containing recommendations regarding corporate governance best practices. In the United States, several of these recommendations have even been specified in law via the Sarbanes-Oxley Act of 2002. The theoretical underpinning of these responses is the expectation that the implementation of effective corporate governance mechanisms will reduce agency problems (e.g., by increasing the effective monitoring of management, increasing transparency and the accountability of decision-making processes, and strengthening shareholders' rights to voice their interests in public companies), in turn improving corporate performance. Yet, the effectiveness of corporate governance mechanisms depends on the institutional framework and the existence of well-developed financial markets.

Sub-Saharan African countries typically have underdeveloped institutions and financial markets. To begin with, although many of these countries are currently undertaking economic, political and institutional reforms (Jones, Morrissey, & Nelson, 2011; Rossouw, 2005), they are still perceived as having weak legal systems and highly bureaucratic and corrupt governments, low levels of "voice and accountability"[1], and poor-quality regulations and public services (Kaufmann, Kraay, & Mastruzzi, 2010). Moreover, neither well-developed financial institutions nor active equity markets are in place. Government intervention has long been an important determinant of how the financial markets and institutions have been created and developed in these countries. Policies such as interest rate controls, credit allocation programs, bank entry restrictions and capital account controls have been vigorously used. Whereas many emerging countries started to liberalize their financial markets in the 1980s, most African countries only commenced liberalization programs from the mid-1990s (Hermes & Lensink, 2013). The dominant role of government has been an important constraining factor in the development of strong financial markets in this region.

Table 1 shows evidence of the institutional weaknesses in Sub-Saharan Africa as compared to countries in other regions of the world. The table provides information on six dimensions of governance and instutional quality, using data from the World Governance Indicators 2011.[2] These dimensions refer to the accountability of the government, political stability, government effectiveness, rule of law, regulatory quality, and the control of corruption. The table shows that, on all six dimensions, Sub-Saharan African countries on average have lower scores than countries in other regions of the world, except for those in South Asia and the Middle East, which both have lower scores for political stability on average, while South Asian countries also score lower on regulatory quality and the control of corruption. Table 2 provides evidence of the underdeveloped nature of financial markets in these countries, based on research by Allen, Carletti, Cull, Qian, & Senbet (2010). According to this table, based on 2007 data for two widely used measures of financial development, i.e. the liquid liabilities to GDP ratio and the private credit to GDP ratio, countries in the Sub-Saharan African region clearly have much less developed financial markets than emerging economies in all other regions. Thus, whereas for Latin America and South Asia the liquid liabilities to GDP ratio in 2007 was around 55%, for Sub-Saharan Africa this ratio was only 30%. With respect to the private credit to GDP ratio, a similar picture emerges: for South Asia and Latin America this ratio was at 34% and 40% in 2007, respectively; for Sub-Saharan Africa, it was only 17%.

Only a few Sub-Saharan African countries have established a corporate governance code during the 2000s. The first corporate governance code was introduced by Kenya in 2002. Nigeria has

[1] "Voice and accountability" refers to "...perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media" (Kaufmann et al., 2010, p. 4).

[2] See Kaufmann et al. (2010) for an explanation of how the World Development Indicators are measured.