Outside directors experience and the effect on company value: - 
A South African study

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Abstract

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Outside directors experience and the effect on company value:-
A South African study

In this thesis I investigate the impact of outside director experience on company value. I do so by looking at a clear event, company delistings, in the time period 2003 to 2011 in South Africa, a country with arguably imperfect institutions. Based on qualitative and quantitative research I am able to establish that director experience is indeed associated with company value. The qualitative analysis is based on semi-structured interviews with over 30 highly experienced, independent non-executive directors who have/had seats on over 150 South African listed company boards. Their responses confirm resource theory dependency and provide information on the nature of experience, its relevance during delisting and under other circumstances, as well as insight into the type of experience lacking on boards in corporate South Africa. The results of this research can be of practical use to nomination committees and has implications for future South African governance code reforms and/or guidelines.
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1 Introduction

Post apartheid South Africa is undergoing social and economic change. Laws have been amended and two successive governance codes, King 2 and King 3 have been issued by the Institute of Directors in Southern Africa during the period 2002 to 2009. Corporate governance is moving towards a stakeholder inclusive approach, where the legitimate expectations of stakeholders in addition to the shareholder, are being recognized. The composition of the board has been affected by changes in company law as well as through the new governance codes. Other drivers of governance are being impacted upon, and are impacting on the performance of the firm. Questions are being asked as to whether the governance developments are positively impacting on companies and the wider economy.

In a country where there is a dire shortage of skills, and where the current social and economic imperative is towards integrating a previously disenfranchised populace through black economic empowerment, the question whether boards are being composed optimally is being asked. Corporate governance history and literature recognizes the value of the board and its role primarily through application of agency and resource theory. This research investigates whether an element of the ‘resource theory’ of the board, namely experience of directors is of relevance and value in the South African context.

Notwithstanding the endemic problems of endogeneity, this research reveals that director experience is a desirable attribute and positively associated with company value. The results are significant, not only because of the paucity of corporate governance research conducted in South Africa but specifically because the methodology links a quantitative measure for director experience with value. It is also supported by qualitative information received from over 30 highly experienced, independent non-executive directors who
individually provide their insights into board operations from over 150 listed and delisted South African companies.

This thesis commences with a review of the corporate governance literature. The drivers of governance are considered from a top-down perspective, namely the historic factors positively impacting economic change, followed by the socio-political determinants of corporate governance in different economies. A sequential survey of the role of the board, the industry in which it operates, firm characteristics and board characteristics provide an understanding of their respective effects on company performance. Thereafter, I consider differences in governance between countries and during different events or circumstances. The literature review concludes with a summary of the corporate governance conditions and requirements in the South African context.

The research question and hypotheses are formulated to direct the research into the impact of governance changes on outside director experience, as well as the effect of director experience on company value. The methodology describes the quantitative and qualitative research methods used. Quantitative techniques include comparison of means, and probit regressions of share price premiums during delisting events over the period March 2003 to the end of 2011 on director experience. Comparison of director experience means, which is largely free of endogeneity problems, is also assessed after each successive governance code/rule change for delisted companies. The qualitative research entails semi-structured interviews with over 30 experienced outside directors who collectively have/had exposure to over 150 listed boards. Their responses cover information on the nature of experience, its value during a delisting event and under other circumstances, as well as insight into experience that is lacking on boards in corporate South Africa.
The results section of this thesis report a statistically significant and positive association for outside director experience and company value using comparison of means and probit regressions. Other statistically significant explanatory variables are company size and profitability as well as the reason for delisting. Director interviews and analysis provide further information on the importance of experience. Results of director interviews reveal their positive opinions on the value of outside director experience, as well as the variation in stories and forces behind different delisting scenarios. The importance of the regulated process governing company valuations and the need for independent, outside directors during delisting, support agency theory. Interviewees contribute substantially by identifying the types of experience that are most valuable and that are lacking on boards in South Africa.

The discussion section of the thesis analyses the results in the South African context and ties back to the literature review. Implications for director experience being positively associated with company value are considered for directors, companies and future governance rules/laws. My thesis conclusion suggests several future areas of research relating to corporate governance in South Africa and for the resource theory of the board in particular.
2 Literature review

2.1 Approach to Literature review

Corporate governance is a broad topic that encompasses the way in which ‘companies are directed and controlled’ (Cadbury, 1992). There are many drivers that influence the way in which companies are governed. They range from external factors such as regulators, shareholders/voters, capital markets, the takeover market, legal system and the press, to the internal drivers being the board of directors (board), management and disclosure (Kirchmaier, T., 2007). McKinsey’s Investor Opinion Survey in 2002 revealed that investors are prepared to pay a premium of 12 to 14% in North America and Western Europe, 20 to 25% in Asia and Latin America, and more than 30% in East Europe and Africa for well-governed companies. More recently Bozec et al (2010) in their research using technical efficiency measures show that better governed firms are more efficient. Arguably, the benefits to good governance have been generally recognized as evidenced by the plethora of governance codes and regulations that have been promoted or enacted globally since the Cadbury Report of 1992. Aguilera and Cuervo-Cazurra (2009) show that codes of governance appear to have improved the governance of companies in the countries that have adopted them. In addition, Gill et al (2009) in ‘Corporate governance mechanisms and firm performance: A survey of literature’ find that one of the governance mechanisms, being increased reporting or disclosure, has a positive relationship with improved company performance.

A central corporate governance question is whether and to what extent, does the board matter in the governance or directing and controlling of the organization. Qiu and Largay (2011) find a positive relationship between board activity and increased firm value.
Despite this, Schultz et al (2010) find no causal relationship between governance and firm performance and that much of the divergent findings are due to poor econometrics.

At this juncture, it is important to note that the whole subject of governance is plagued with issues of endogeneity. The Oxford Dictionary of Politics defines endogeneity/endogenous as ‘Something is endogenous to a system if it is determined within the system, and exogenous if it is determined outside…. The ‘problem of endogeneity’ arises when the factors that are supposed to affect a particular outcome, depend themselves on that outcome.’ In the case of my thesis, endogeneity can arise between the external environment and the firm, or the firm and/or board structure and performance, or indeed between any or all of these components.

Specifically, shareholders can appoint directors as a response to the company performance, but likewise the performance of the company may also be in response to the appointment and/or contribution of an experienced director. Both the variables of company performance and director experience may impact upon each other. Consequently much of the research in governance yields conclusions that refer to ‘associations’ between governance factors and performance, as opposed to attributing causality.

There are however, various methods to overcoming endogeneity. These may include using an exogenous variable linked to an independent variable e.g. Duchin et al (2010) performed governance research largely free of endogeneity by examining how recent regulations requiring an increase in outside directors impacted on independence and firm performance via the effect on the cost of information. Shin-Rong Shiah-Hou and Chin-Wei Cheng (2012) used a two-way fixed effects (FE) regression and managed endogeneity with a two-stage least-least squares regression (2SSLS) when examining outside directors.
experience and outside directors compensation, the latter being the endogenous variable. They found that outside director’s experience and outside directors remuneration to have a positive impact on a firms accounting and market performance. At this point, it is important to identify upfront the endogeneity challenges contained within my thesis. This is because both the quantitative and qualitative approaches and the results thereof are subject to endogeneity, although some mitigation is provided using a similar approach to Duchin et al (2010) where an exogeneous variable i.e. change in governance code is used. The latter however, is a minor part of the overall quantitative results, with the bulk of the quantitative results not lending themselves to other regression techniques due in part to non-linearity of variables.

Notwithstanding the endemic endogeneity challenges, in support of and to inform the research question, I approach the literature review from a top-down perspective and structure it as follows:-

Companies have to organize themselves in reaction to external drivers. I examine the context in which this occurs under section 2.2. This is to provide insight on whether boards are constructed in the manner that they are, because their environment drives them. Given that my research question is bounded in the South African context, this is relevant as it may reveal that boards are not constructed for organizational ends, but because they are reacting to the external drivers.

Much empirical research has been done on the board composition and the impact on company performance. In section 2.3, my literature review summarises the different
theories as to the role of the board. The primary function of the board or its role may be a key determinant as to why boards are composed in the manner that they are.

With more information on the role/s of the board, under section 2.4, I survey the literature on the relationship between the composition or characteristics of the board and firm performance. The literature is extensive and covers many board characteristics and various measures of firm performance. However, the relationship (if any) may be contingent upon country influences, or the role that the board has to fulfill under particular circumstances at a particular time.

In sections 2.5 and 2.6, I examine board composition and the impact on firm performance in different countries and during different events/circumstances e.g. acquisition, merger, takeover, bankruptcy or delisting. This is of relevance to the research question as it has bearing on the methodology used.

Finally in section 2.7, I provide background on the South African governance context, specifically the corporate governance code recommendations from King 2 and King 3, as well as the JSE Stock Exchange requirements. This information is necessary to decide on data variables for quantitative analysis.

2.2 External or environmental factors and the impact on board composition

The research question “Is there a link between director experience and company value, in the South African context?” is not only broad, but is premised on numerous assumptions, i.e.:
• The South African economy is conducive to economic performance in the sense that business entities are able to increase/decrease performance in terms of economic activity or output. In other words, the environment is such that there has been and can be, economic gain through the allocation and utilisation of scarce resources. By this, there is sufficient freedom or support within the constraints of the socio-economic environment and institutional frameworks of the economy.

• Whilst there may be national and institutional constraints, there is still opportunity and choice for the agents/shareholders to control and determine the composition of the board (i.e. a population of eligible value-adding director candidates) and thereby potentially influence organizational or firm performance.

North, D.C., (2005), in his book, “Understanding the process of economic change”, provides a theory on why there is such diverse performance between economies, past and present. North considers economic change to be a process that is dynamic and that is deliberately shaped by the players based on what they perceive or expect to be the outcome of their actions. This is the ‘incentive structure of a society’ and it requires an understanding of the key drivers of economic change being (1) ‘the quantity and quality of human beings; (2) …the stock of human knowledge…. (3) the institutional framework that defines the deliberate incentive structure of a society.’ pg 1. Human beings have sought to control their environments by reducing uncertainty through increased knowledge that is deployed for perceived gain.

North presents statistics of world population growth across the centuries, the most striking feature of which was the increase from 500 million people in 1700 (industrial revolution era) to more than 6000 million people in 2000. This growth in the human species
correlated with a doubling of life expectancy (e.g. in the UK) and a dramatic increase in real per capita GDP in both undeveloped and developed world (600% and 2100% increase respectively). The latter statistics, along with similar trends relating to human capital development and the stock of knowledge increase e.g. number of scientific periodicals, reflect not only the demographic increase in numbers of human beings but also the increase in their quality (drivers 1 and 2 above). ‘Increase in the stock of knowledge has been the fundamental source of increased human well-being’ pg 17.

North explores the institutional frameworks, being the set of rules created by humans to limit the choices available in a changing environment, thus making the world more operable through being more certain. Examples include contract law that enforces cooperative activity, patent law that improves the incentives to innovate, a judicial system that reduces transaction costs by lowered costs of enforcement. His examples of economies that had people with the common belief and educational systems able to adopt, respond and make changes to the institutional frameworks was demonstrated through a look at the history of the rise of the Western World and the rise and fall of the Soviet Union. The institutional architecture of a society, often inherited, is a determinant of how politics and economics with resultant transaction costs’ impacts an economies performance or well-being. Once imbedded, institutions are difficult to change because they are interlocked and impervious to change. North suggests on pg159 that to improve economic performance means lowering production and transaction costs. The key to this is to modify the institutions that can accomplish this. Improving measurement mechanisms and specifications, creating effective judicial systems to reduce transaction costs and developing institutions that integrate dispersal of knowledge for/and monitoring and enforcement of disputes, improves the social, political and economic incentives for
advancement. Ultimately however, in the context of increased demographics, increased stock of knowledge and effectiveness of institutions, it is the intentionality of the roleplayers in their decision-making that will impact upon the prosperity of the roleplayers.

2.2.1 Applicability of North to the research question

Whilst North’s work is an impressive view of the history of economic change, it begs the question – ‘Of what relevance is this to the research question – ‘Is there a link between director experience (a board characteristic) and company performance, in the South African context?’ The answer is not straightforward, but does allow positioning of the stochastic variables for the South African environment i.e. the demographics of the country, the stock of knowledge or intellectual capacity and the effectiveness of the institutions and how business responds to the latter.

In summary, South Africa (SA) was founded in 1652 by Dutch settlers, colonized later in 1820 by British farmers and had other influences from various subsequent European migrations. Yet its demographics being 50.5 million people (per Statistics SA, 2011, Press Statement Mid-year population estimates) of 11 races, comprising 79.5% being African, 9% classified as White, 9% classified as Coloured and 2.5% classified as Indian/Asian is weighted by a majority population that historically are undeveloped by western first-world standards. The majority of the population have, by the previous political regime of apartheid, had poor education and been excluded from involvement in the political, social and economic institutions and environment, until inclusion in the new South African democracy of 1994. Hence, an assessment of South Africa against the factors necessary for economic change can be seen as lacking. There is a large demographic with a relatively ‘poor stock of knowledge’. This is borne out in key statistics reported in Development Indicators 2009 issued by The Presidency, Republic of South Africa, where with a
population of 48.7 million in 2009, the real GDP per capita is $3,075. Unemployment is at 23.9%, over 13 million people receive social grants and adult illiteracy is at 25.9%. South Africa’s competitiveness outlook is reported at 45 and 57 from the World Economic Forum and International Institute for Management global ratings respectively. As a knowledge-based economy, the report collates South Africa’s Economy Index at 55 out of 140 countries, although ease of doing business is 32 out of 181 countries. Importantly, Transparency International shows a deteriorating view of South Africa in the 2011 Corruption Perceptions Index, where South Africa is now below the midpoint of 5 having scored 4.1 having been ranked downwards to number 64 in the world. The United Kingdom and United States are ranked 7.8 and 7.1 or 16th and 24th in the world respectively as less corrupt countries.

Whilst there are relatively sophisticated institutions in SA, e.g. banking, accounting and governance codes, they are becoming increasingly unwieldy due to not only lack of knowledge/skilled workers, but also the political-economic changes that have caused them to become increasingly complex. The increased layers of rules and regulations that the new government and a ‘post financial crises’ world has created, (refer KPMG Confronting Complexity report (2011)) coupled with intentions of improving human/societal welfare (movement towards social democracy), makes the environment more difficult for business to operate in. The consequences of the above may shed light on why South African boards are composed in the manner that they are, as well as any potential relationship between experience and firm value. E.g. for an hypothesis that there is no clear relationship between the ratio of executive to non-executive directors (board composition) and company performance, if there was an inverse or positive relationship found between composition of the board and performance, then it could imply other factors such as agency effects (more
or less directors of a particular category are able to reduce inside directors stealing from shareholders). Alternatively, it may reflect that an increase in directors leads to an increase in the knowledge component of North’s argument, which positively affects company performance, and thereafter South African economic performance; assuming that North’s macro theory can also transfer and hold within the micro firm environment.

*Roe, M.J., (2003) “Political determinants of corporate governance”, Oxford University Press* looks at the impact of politics on the ownership structure of large business. His corporate governance framework shows how capital and labour markets impact shareholding which affects board and management structure. In turn, the capital and labour markets are impacted by product markets and political institutions. His general theory is that the political determinant of strong stakeholder pressure or ‘social democracy’ affects the firm. The power of social democracy brings about concentrated ownership as a counter-balance to employee/stakeholder strength. Roe proceeds to explain this political dimension in context with various theories, namely; ‘coalition building’, agency, micro-economic competition, labour and the corporate law theories’. Each of these is explained briefly below.

‘Coalition building theory’ holds that inside the firm, a tension exists between shareholders/owners and labour/employees, who respectively want profit versus secure pay. In between these two parties, is management whose primary allegiance is competed for by the opposing factions of owner versus labour. Managers must be motivated by shareholders to produce yet not take the wealth for themselves. They must also ensure that the employees’ work and that owners do not lose their investments. Politics often determines the structure of one of the elements of labour, owners or managers. And once
the institutional frameworks formed by politics shape one of these, the structure of the others may have to follow a certain form for social peace to be maintained.

Roe explicates this theory with the German codetermination and Japanese lifetime employment models. In Germany, where as a result of politics, labour has a 50% representation of the supervisory board in their two-tier board structure system, investors have responded by retaining their strength by way of concentrated ownership to balance the power conflict over who influences the management. The net result is that Germany is inclined to businesses with concentrated ownership or block-holdings (by banks and family firms) and codetermined boards balanced between labour and shareholder. In Japan, post-war politics resulted in firms giving lifetime employment to core employees. Internal competition amongst employees has led to a large number of insider-managers being on large boards. The best means by which to balance or ‘monitor’ such strong stakeholder/employee influence was through bank shareholder-creditors who had similar goals in terms of managing credit risk and getting a steady return. The net result is that Japan has firm structures where ownership is concentrated and held by large blockholding banker-shareholders. These two models are contrasted with the United States, where employee rights are not strong or where there is weak social democracy. In this environment, shareholders can coalition-build with managers through more remote means such as remuneration incentives i.e. share options which align managers incentives more with shareholders than employees. Because the coalition is stronger, there is less need for shareholders to manage their conflict with employees by way of concentrated ownership. The result is that in the United States firm ownership is widely dispersed.
Agency theory is the most commonly used and accepted governance theory. It is based on
the premise that owners are separated from the managers of a company and that as a
consequence agency costs arise through managers who wish to appropriate firm benefits to
themselves at the expense of the owners’ returns. These agency costs can take various
forms such as excessive remuneration, management slack and personal benefits such as
power and prestige through large corporate size, inefficiencies such as non-structuring and
use of internal capital, and reduced risk taking that could threaten their careers. What is
less recognized is that employees have many similar goals to the managers’ e.g. higher
wages, improved working conditions, reduced hours and security of tenure through firm
expansion and more employee rights. Strong social democracies favour employees in that
redundancies and downsizing are discouraged, shareholders are not so tightly bound to
managers and transaction costs of collective bargaining are reduced as employees can act
cohesively.

Under the agency model, shareholders have several mechanisms with which to align
managers with their own profit incentives, namely ownership through shares and options,
profit linked remuneration and close monitoring with appropriate measures by non
executive and independent or outside directors. Applying agency theory to Roe’s model,
he argues that strong social democracies raise agency costs in that managers are inclined to
side with employees’ goals and not owners. Owners’ response to this is to try and control
agency costs through increased monitoring and concentrated ownership that allows for
better control over management by way of board representation and consequently more
controlled agency costs. The visible result is that in countries with strong social
democracies the response by owners is concentrated ownership e.g. the blockholdings
prevalent in the organizations in Continental Europe and Japan. Furthermore, other tools to
close the gap between shareholders and managers such as “shareholder value norms, transparent accounting, incentive compensation and hostile takeovers and proxy fights are made harder to employ” pg 38. Roe proceeds to compare the institutional frameworks and impact on concentration of ownership for several countries including the United States, Germany, Japan, France Italy, Sweden and the United Kingdom. He uses regression techniques with political indexes, employment protection, income inequality and size of governmental sector as social democracy variables (arising from politics) which are found to be correlated with country ownership concentrations. In Chapter 15 et seq. Roe describes the political drivers not only in terms of ‘social democracy’ but alternatively as societal power groups that strive for “rent-seeking benefits (agency theory), or as a result of weak product markets, or as a polity craving stability, or as a cultural environment that shapes managers utility functions” pg 109. The more conservative the politics of a country, the more inclined business is towards wide dispersion of ownership or ownership separation.

An alternate theory towards causality of ownership separation is the quality of a nation’s corporate law institutions (legal theory). If minority shareholders are protected i.e. good quality law (reduction in agency costs) then separation will proceed and securities markets will arise. Roe tests this theory using correlation matrixes for political, ownership, legal and competitive variables. The measures used are ownership separation and securities market development measures, plus three political measures (political scientists index, OECD employment protection index and Gini income inequality index), plus two measures of quality of corporate law (qualitative index and one on voting rights) and an index on monopoly power. The results showed that pg 156 “politics persistently correlates with dispersion, - the more conservative, the more disperse is ownership”. It also reveals
that good quality law also correlates with dispersion. Further tests on co-linearity reveal that adding political measures to quality of law measures enhances the explanatory power for dispersion significantly. However, Roe was able to explain that even with good quality legal institutions, dispersion of ownership does not always occur. The reasons for this are that the dispersion decision is ‘based on the sum of private benefits of control and managerial agency costs. Even if corporate law drives private benefits to zero, concentration can persist if managerial agency costs are high’ Managerial agency costs are seen to be both insider thievery from shareholders by managers (which corporate law seeks to protect against) plus managerial agency costs from poor decisions which corporate law does not protect against (business judgment rule). It is the latter which coupled with weak product market competition and strong political pressures can prevent countries with strong corporate legal systems from having widely dispersed ownership. Hence the legal theory cannot be considered as the sole explanation for ownership separation.

2.2.2 Applicability of Roe to the research question
In this section I explain why Roe’s demonstration that politics impacts upon the product markets and capital and labour constituencies of the firm in a way that causes ownership of the firm to be concentrated or dispersed is relevant to my research.

The research question is focused on the inner workings of the firm based on the assumption that performance if impacted by the characteristics of the board, will result in a change and reconfiguration of board characteristics until such time as performance is optimized. By recognizing that there are other external factors, and in particular ownership of the shares, which causes the board to have its characteristics allows scope for explaining why such characteristics may exist, contrary to expected outcomes or hypotheses. Given
that the research question is set in the South African context, Roe’s work elicits the following questions:-

• What is the political orientation in SA that could influence ownership concentration or dispersion? Is it moving towards left-side politics and social democracy and possible concentration of ownership or towards right-side politics and dispersed ownership?

• What is the state of SA product markets? Are they competitive or inefficient and what is the effect on owners profits and employees wages? How does this impact upon agency costs and influence resultant ownership dispersion in reaction to the former?

• How do the political institutions and product markets in South Africa impact upon shareholders and employees? How does the resultant compact with management appear and what is the impact on ownership?

A consideration of these questions in the South African context, shows that the research question is internally focused on the board and the impact on firm performance, and yet both board characteristics and performance may be subject to more external political and macro-economic forces which are necessary to maintain social peace. And ownership of company shares may be a balancing variable or determinant in reaction to these forces, which explains why a board is constituted in the manner that it is.

Finally, the nature of the industry and firm factors are also important when it comes to determining board composition (Minichilli et al (2009)). Lehn et al (2009) over a period 1935 to 2000 in the USA, find that firm size, growth opportunities, merger activity and geographic expansion also influence board characteristics. O’Sullivan, N. (2000) confirms
in his research that the number of non-executive directors is positively impacted by the size of the company.

2.2.3 Summary of external factors and the impact on board composition

In summary, in relation to the external or environmental factors that can influence the determinants of the board, (as opposed to performance being the driver or cause for board composition), the literature reveals the importance of the socio-political-economic and institutional frameworks within countries that will impact upon board composition i.e.

- Demographics (Country population size and wealth impacts politics, societal demands and institutions)
- Stock of knowledge/intellectual capacity (These could impact upon the size and quality of director population)
- Institutional effectiveness (These could impact the efficacy of doing business within the socio-economic rules)
- Politics (A movement from right to leftist orientation i.e. strength of labour and society needs (social democracy) versus shareholder rights)
- Legal system – protection of shareholder rights encourages dispersion of ownership, which could lead to demand for more independent outside directors as opposed to inside directors, and
- Industry and firm factors which could lead to variable influences on board composition.

In summary, whatever conclusion is reached, relating to quantitative or qualitative research into whether there is a link between director experience and company value, has to be tempered by the above considerations in the South African context. i.e. it may not be the performance motivation of a firm that impacts on board composition (or vice versa) but the
environment that is determining board composition, or indeed firm performance. Endogeneity may exist internally between board composition and firm performance, and externally between the environment and firm performance, as well as between the environment and board composition.

2.3 Role of the board

There is a general absence of theory relating to corporate governance, but extensive empirical research has been performed. Adams et al (2010) in their paper *The Role of Boards of Directors in Corporate Governance: A Conceptual Framework and Survey* update the meta-analytic review performed by Dalton et al (1998) on board composition, leadership structure and financial performance. Adams et al (2010) in their literature survey find that there are two most frequently posed questions, namely: what determines board make-up and what determines the boards actions? They report that these matters are jointly endogenous i.e. director selection and board composition is endogenous to board action and performance. This has bearing on the exploration of governance theories on the role of directors because it encompasses both characteristics or features/qualities, and activities or actions/processes by boards.

Hermalin and Weisbach (2001) identify two important issues found in empirical research, that of endogeneity and whether any results are ‘equilibrium or out of equilibrium’ results. The researchers acknowledge that there has been research from a legal and managerial perspective that are important contributors to board composition. They refer to agency theory and regulation as reasons for boards. Importantly, they discuss their model for board functioning as a bargaining game between the CEO and the board. The relationship between the CEO and the board and the respective independence of the latter allows
predictions about events such as per pg 9 Hermalin and Weisbach (2001), that “CEO’s who perform well are less likely to be replaced; CEO turnover is more sensitive to turnover when the board is independent; Board independence declines over the course of the CEO’s tenure; accounting measures of performance are better predictors of management turnover than stock-price performance; there should be long-term persistence in corporate governance; stock-price reactions to changes in management should be negative if the CEO is fired based on private information and positive if its based on public information; a CEO’s salary should be insensitive to past performance at relatively low levels of past performance, but sensitive at relatively high levels of past performance.” They also summarize the board composition and impact on particular tasks and note that this was a worthwhile approach because the research could control for endogeneity (i.e. board behaviour to appointing a new CEO; during takeovers and with poison pills). They discuss briefly the impact of incentives on board activity.

Hermalin and Weisbach (2001) summarized their critique on the research conducted on factors that affect the board’s make-up. Cross sectional analysis was limited because of endogeneity issues. Therefore some work examines the impact of changes in a firm’s characteristics on subsequent changes in board composition. Examples of changes that resulted in changes in the board were poor firm performance and a new CEO, succession of the board and CEO, and bankruptcy and new board members. Hermalin and Weisbach (2001) look at the power-struggle between the board and the CEO as a model and state that whilst this variable is largely unobservable there has been research by Hallock (1997, 1999) on board interlocks (which is too high to be random and because of higher CEO pay shows CEO to have some control over the board) and by Shivdasani and Yermack (1999) who did work on CEOs involvement in the board-selection process (CEO involvement
found to increase the non-independence of the board). All of these examples support the bargaining framework proposed by Hermalin and Weisbach (1998) that the interested parties’ control of the board appears to be a function of their bargaining power. With a bargaining framework in mind, this has bearings on how the board is composed and what sort of role the board will play in the organization.

As regards the role of the board Dalton, Daily, Ellstrand and Johnson (1998) conducted a meta-analytic review of board composition across 54 studies. They identified two dominant theories:- being Agency and Stewardship theories. These and subsequent theories relating to the role of the board are explained briefly below.

2.3.1 Agency theory
Agency theory is a control based theory that explains the role of the directors in relation to management. It was first identified in 1932 by Berle and Means. Essentially, agency theory recognises that there is a conflict of interest between management who run the company and the owners, who being distant appointed managers as agents to manage the company in their absence. The conflict relates to the owner/shareholder desire for profits versus the managers desire for autonomy and discretion, which enables them to reap personal benefit for themselves at a cost to the owners and the company.

This theory remains the most prevalent theory in corporate governance and is widely relied upon and quoted in the literature e.g. Jensen and Meckling (1976), Fama and Jensen (1983), Baysinger and Butler (1985), Ezzamel and Watson (1993), Pearce and Zahra (1992), Rosenstein and Wyatt (1990), Schellenger, Wood and Tashakori (1989), Shleifer and Vishny (1997) to list a few. The presumption of agency theory relevance in practice is evident when one examines board structures and regulator reaction to corporate failures.
Boards are often composed of executive directors who are akin to managers who manage the entity, and independent non-executive or outside directors who are seen to have a primary role in monitoring management and executive directors. After corporate mishaps, regulators and/or the shareholders react by increasing the number of ‘monitors’ or independent, non-executive directors e.g. In the United States post the corporate governance failures of Enron and Worldcom, the Sarbanes Oxley Act, 2002 imposed greater monitoring responsibilities on directors in the USA, (where generally the majority of the board are outside directors).

Agency theory is relevant to the research question because composition of the board in terms of ratio of inside to outside directors is a ‘characteristic’ that has to be considered if one is examining the impact of experience on firm or company performance. The reasons for this are several. If agency theory holds, then inside directors may drive firm performance not only because they are directed to by the rest of the board, but because they have personal vested interests e.g. job security, status, management slack i.e. similar to an employee’s aims. The firm’s performance may be impacted not just by their experience and expertise, but also because they are self-interested. Contrary, but likewise, if directors are aligned to shareholders by virtue of share options or shareholdings/ownership, agency theory would also deem these directors to be conflicted with the overall interests of the company and aligned predominantly with shareowners. Hence inside directors are required to be ‘monitored’ by independent and/or outside monitors in order to optimize the perceived inherent conflict between ‘stealing’ from the company and/or other stakeholders and ‘stealing’ from the shareowners. For the purpose of examining the characteristic of experience, it is then necessary that ‘experience’ as a variable be isolated as much as possible from other board or director characteristics –
hence it is the experience of outside directors, as opposed to inside directors, which is being investigated.

However, outside directors can include both ‘independent’ directors and ‘affiliated directors’, - the latter defined by Daily and Dalton (2004) as “outside board members with professional or personal relationships with the firms or executives on whose boards they serve.” Definitions for outside directors in terms of independence varies from country to country as laid out by Spencer Stuart (2007) in their Governance Lexicon on a “A director’s guide to corporate governance around the world” in Appendix 1 which provides a summary of ‘independence’ for directors across many countries. This is defined later below for South Africa from King 2 and 3 Codes’ for governance and addressed in the quantitative variables researched.

2.3.2 Stewardship theory
Stewardship theory is a contrary theory to the agency concepts. Donaldson (1990) and Davis (1991) describe it in their papers and it is also defined by Davis, Schoorman and Donaldson (1997) as “Maximising shareholder wealth through firm performance, because by so doing, the steward’s utility functions are maximized”. Its development or evolution is described by Abdullah and Valentine (2009) as being one that has its origins from psychology and sociology. It is frequently quoted as a governance theory in the literature when the ‘family firm’ is being analysed i.e. where the major shareholder/s are both family and managers within the organization; e.g. Braun et al (2011); Le Breton-Miller et al (2011); Renato, G. (2010); Braun and Latham (2009); Miller and Le Breton-Miller (2006).

Contrary to agency theory, that concentrates on the monitoring role of the outside director over management and executive directors (in their capacity as managers), stewardship
theory holds that there is no conflict between inside/executive directors and outside directors. Both categories of directors have an alignment of objectives, or motivation, in terms of working together to grow and sustain a company’s wellbeing. To this end, given common and aligned motivations and within an environment of trust, both the outside and executive director input may also be considered a ‘resource’ to the company (Nicholson and Kiel (2004)). From this perspective, it is easy to see how Abdullah and Valentine (2009) in their literature review of the range of corporate governance theories could expand from agency theory to stewardship theory and then on to resource dependency theory. Abdullah and Valentine (2009) develop even further their view of governance theory evolvement, with descriptions of transaction cost theory, political theory and various ethics related theories. However, for the purpose of this thesis, theories beyond resource dependency are not considered as they go beyond the role of the board and directors into the wider organizational structure and economic transacting within the firm, and/or the political and idealistic goals of its stakeholders.

The implications of stewardship theory to the research question are that, if company performance is unaffected by any difference in contributions or roles of inside versus outside directors, and/or extent of ownership by directors, then stewardship theory may be in force. This could become further evident from interviews if outside directors state that there was little distinction in role, behaviours and/or motivations (i.e. no clearly visible conflicts of interest or bad behaviours by the executive directors to be ‘monitored’ in terms of agency theory by the outside directors.). In summary, the operation of stewardship theory may mask potential performance results by not distinguishing between outside and executive director contributions, notwithstanding that both categories of directors may still also be providing valuable ‘resources’.
2.3.3 Resource theory
Resource theory covers the role of the outside director on the board in the context of what he/she can bring to the organization. The Oxford Dictionary of English (2009) defines experience as “practical contact with and observation of facts and events – the knowledge or skill acquired by such means over time, especially that gained in a particular profession…”. The ‘resource’ which the outside director can contribute can be by way of their connections to the outside world, be it in the form of contacts to lenders, relationships with politicians and/or regulators or their reputation. e.g. Kirchmaier and Kollo (2007) examine the contribution of directors who hold titles or are connected to prestigious networks. Resources also encompass the breadth and depth of human and social board capital (Haynes and Hillman (2008)) that may allow a director to contribute through wise counsel/advice and sound decision-making during strategy formulation or monitoring of management, board succession and crises or event management. The research question is directly positioned in resource theory as it is seeks to establish whether there are grounds for a relationship between director experience and an effect on company performance.

2.3.4 ‘Dynamic process’ and/or team functionality
‘Dynamic process’ is a phrase coined from a reading of Roberts, McNulty and Stiles (2005). This paper went beyond agency theory. It was conducted pre the Higgs Report and examines not so much the characteristics of the board, as the process of interaction and the dynamics that takes place within a company. A main theme was that performance can be driven by this process if accountability is properly and clearly established. Roberts et al (2005) report that the agency and stewardship theories polarize the roles of the board, and that the process and dynamics between directors is important to the effective functioning of the board. The research was carried out by interviewing in depth 40 directors for the Higgs Review, and proposes that processes of accountability can be used to explain and develop board effectiveness. This approach has implications for governance reform to seek rather
to enhance actual effectiveness and perceived effectiveness, as opposed to strengthening the independence and control requirements. The implications of this to the research question are that it reflects that the board inter-relationships contingent on levels of transparency and trust, greatly impact board effectiveness and by implication firm performance. The challenge is to find a variable that can proxy for process in the board characteristics-performance relationship, in addition to or in isolation of a director experience variable.

Research by Wan and Ong (2005) ‘Board structure, process and performance: evidence from public-listed companies in Singapore’ reveals and concludes in their abstract that ‘board structure does not affect board process, while board process is related to board performance’. In support of both process and resource theory, Wang and Ong (2005) find that ‘in terms of individual parameters, effort norms, cognitive conflict and presence and usage of skills are positively related to board roles and board transparency.’ Minichelli et al (2009) in researching what makes boards effective examine board task performance. They find diversity, debate and in particular commitment, good predictors of board effectiveness. Dalton and Dalton (2005) show that things other than composition made boards perform effectively i.e. an independent board budget, executive sessions for outside directors, the number of executive committees, no related party transactions as well as certain composition features such as lead independent directors, emeritus directors and no ex CEO’s on the board.

Murphy and McIntyre (2007) examine board of director performance from a group dynamics perspective and find merit in recognizing team dynamics as a performance factor. Previous team effectiveness research by Campion and Higgs (1995) and Ancona
and Caldwell (1992) was referred to, and the latter saw team effectiveness as requiring a level of diversity. Diversity includes skillsets, experience, values, demographics and social connectivity. Corner and Kinicki (1997) find a correlation between firm performance and team members who had a richness of knowledge from experience.

Murphy and McIntyre (2007) consider board of director effectiveness to be influenced by board reflexivity (i.e. ability to self-reflect and modify their role), diversity of the group and outcome interdependence. Other requisites for team functionality mentioned by Murphy and McIntyre (2007) and supported by research include time and planning norms (Janicik and Bartel (2003)), group social capital (Oh et al. (2004)), alignment of reward systems (Orsburn et al. (1990)), degree of power relative to management (Finkelstein and Hambrick (1990)), group efficacy or self belief (Peterson and Behfar (2003)), and individual director satisfaction (Gibson (1999)). Composition of the board was a questionable factor, although personality-types were touched on. Emotional characteristics of conscientiousness, agreeability and openness are considered favourable contributors to board dynamics per Kelly and Barsade (2001). In summary, Murphy and McIntyre (2007) propose that boards are teams, and will be effective as teams based on many of the factors identified in the organizational behaviour literature.

Why this is relevant to the research question is because boards with ‘good’ or ‘poor’ characteristics may have board processes or team dynamics that may be effective and/or ineffective in achieving results. This complicates clear measurement of the link or association between board characteristics such as experience and company performance.
2.3.5 Summary of Board Roles
This section summarizes the board’s role as being the driver for how and why the board is composed, and the effect that this could have on firm performance.

The most dominant theory is agency theory, which proposes that boards have to have outside directors to act as monitors of management to protect the shareholder, employee and/or other stakeholders from executive director/management ‘theft’. This is the primary contribution by the outside directors, and effective discharge of this role will contribute to the prevention of poor company performance, and thereby maintain positive firm performance.

Another theory is the stewardship theory that envisages the board collectively, via discharge of director duties, as being interested in the wellbeing and performance of the firm.

Resource theory, which is of particular relevance to the research question, is premised on the basis that boards and directors bring valuable resources to company’s which allow them to advise wisely based on experience, skillsets etc or improve firm connectivity or goodwill with the outside world through relationships or personal reputations respectively. It is deployment of these ‘resources’ that positively impacts firm performance.

Lastly, boards can be seen as teams that if they exhibit certain organizational behaviour traits, or follow certain ‘good’ processes, can positively impact firm performance. In conclusion, the board can play various roles, and the nature of the role could impact board composition, and this in turn may impact firm performance.

2.4 Composition of the board and performance of the firm
The literature on the board role and performance make frequent references to ‘board characteristics’. These characteristics can be board composition in terms of ratio of executive to non-executive directors, board size, board skills and experience, and
ownership of shares by the board. These are a few characteristics and should not be considered exhaustive e.g. age, interlocking directorships, time spent etc. could all also be considered valid board characteristics.

Up to this point, my literature review relates to broad theories that may apply to board roles, behaviour and how it may impact company performance, as well as to the South African external environment and political context in which the research question is framed. This section of my literature review summarises some of the research as it specifically relates to the board characteristics of:

1) Board composition: the ratio of non-executive to executive directors; or outside directors to inside directors i.e. independence;
2) Board size;
3) Board experience; and
4) Ownership features of the board.

2.4.1 Board characteristic: Independence
There is a great deal of research on whether independence of the board, as represented by the presence or ratio of outside directors to inside directors, positively or negatively impacts firm performance. There is also the hypothesis that there is no clear relationship between the ratio of outside directors to inside directors and company performance. I summarize coverage of research from past to present below.

Dalton, D., Daily, C., Ellstrand, E., & Johnson, J., (1998) analyse 54 empirical studies of board composition and 31 empirical studies of board leadership structure i.e. duality (Chairperson and CEO are not separate). Whilst the latter is not relevant in the South
African context because currently the roles of chairperson and CEO are separated, the results of the former are noteworthy.

Dalton et al (1998) contrast the two dominant theories around governance; - agency theory and stewardship theory. Agency theory is premised on the notion that the separation of ownership and control within firms can lead to managers acting in their own self-interest to the detriment of the owners. It is a ‘control-based theory’ pg 270 in that managers having the expertise and firm knowledge of the organization can control the firm because they are more powerful than the distant shareholders. Because of this power differential, owners react by needing mechanisms to manage this conflict of interest and one of these mechanisms is the ‘monitoring’ mechanism. Outside and independent directors who are not aligned to inside managers or executive directors are best able to perform this monitoring function and proper discharge of this function can result in improved firm performance.

Of interest from the Dalton et al (1998) study is their exploration of the moderators on the meta-analyses of board composition and performance. They identify “three variables – size of firm, nature of the performance indicators (accounting vs. market-based) and four primary operationalizations of the ‘board composition’ – insider director proportion, outside director proportion, affiliated director proportion and independent/interdependent proportion.” pg 272. Size and complexity of the organization also matter as these can also be determinants in why a board composition is changed. If a firm is large and complex then outside directors may be valued for their connection to the external environment as providers of resources (relationships and credibility) and information (advice from experience and/or external market data). But refer below to the size of the board

A question that can be posed is whether any positive relationship between outside directors and firm performance is influenced by the nature of the firm or the context/environment i.e. country. Daily and Dalton (1994) show that in bankruptcy, bankrupt companies had more affiliated directors and less outside or truly independent directors. In banks, de Andre and Valleslado (2008) find an inverted U shaped relationship between proportion of outside directors and board size and firm performance. In a Turkish study, Bozcuk, A. (2011) also shows that firms with outside directors perform better in accounting and market measures i.e. positive association. Feng et al (2005) find ‘good’ boards which are small in size, with majority outside directors and no duality are associated with superior average performance in the REIT (real estate) environment. There is therefore a fair amount of support for the hypothesis that the presence of outside directors is positively associated with firm performance over time, in various contexts and under different circumstances i.e. that agency theory holds true.

Stewardship theory holds that managers are trustworthy and not prone to stealing owners benefits (Donaldson (1990), Donaldson and Davis (1991 and 1994), and that ‘they work diligently to attain high levels of corporate profit and shareholder returns’ pg 271 Dalton et al (1998). Opposite to agency theory, control of firms should be centralized in managers’ hands. There is research that proves that there is a positive relationship between inside directors and higher firm performance: - Kesner (1987) and Vance (1964,1978) But this may also be contingent on type of firm and the circumstances e.g. Alles, M. (2011) reveal
that banks with more outside directors performed worse during the financial crises, reflecting possibly that outside directors are driven to take more risk for shareholders than insider directors.

Whilst there is empirical support for both firm performance being positively correlated to the presence of outside directors as well as inside directors, there are also findings that show no relationship between board composition and firm performance, Dalton et al (1998) pg 281. This is also reported by Chaganti, Mahajan and Sharma, (1985); Daily and Dalton (1992,1993); Kesner, Victor and Lamont (1986); Schmidt (1975) and Zahra and Stanton, (1988); and Bohren and Strom (2010) who find no relationship between firm performance and board independence.

Bhagat and Black (2000), “Board independence and long term firm performance” performed the first large sample, long-horizon study of whether board independence correlates with the long term performance of large American firms. They find that poor performing firms respond by increasing the independence of their boards, but no evidence that this leads to improved profitability. This paper is significant not only for its results but also because it showed how to control for board size, firm size, industry effects, stock ownership by CEO, outside directors and blockholders using OLS and simultaneous equations, robust regression giving less weight to outliers and regressions using dummy variables. Bhagat and Black (2000) have a different way of defining the independence variable that solves for the problem of affiliated directors in Dalton et al (1998) above. The proportions of independent and inside directors were weighted as +1 and -1, and the variable for the ratio was defined as independent minus inside directors (effectively weighting affiliated directors as 0 because they could be either independent or not). Bhagat and Black (2000) also test for entry and exit bias when firms entered or exited the sample.
and found it not to be a significant concern, hence controlling for survivor bias. They use four measures for long-term performance: - Tobin’s q, ROA (return on assets being ratio of operating income to assets), Market adjusted stock price returns and ratio of sales to assets. The problems of endogeneity and model misspecification are addressed through comparing OLS with three stage least squares (3SLS), and finding similar coefficient estimates and t-statistics. Tests for robustness are also carried out.

The alignment between the ‘type’ of director is not found to be relevant to the ‘constituency’ or stakeholder requiring performance and to whom the director might be considered aligned. Hillman et al (2001) show a lack of findings that stakeholder directors are positively associated with stakeholder performance. As regards the environment or context, Pang, M. (2004) show that a greater number of outside directors have a negligible impact on firm performance in China during institutional transitions. Other factors may be the drivers around when and whether outside directors can be effective. Duchin et al (2010) perform research largely free of endogeneity, by measuring performance changes when regulations require increased outside directors on a board, and find that the effectiveness of outside directors is a function of the cost of information about the firm. ‘When the cost of information is low, performance increases when outsiders are added to the board and when the cost of information is high, performance worsens when outsiders are added to the board.’

In summary, the presence or ratio of outside directors to inside directors may or may not be a factor contributing or associated with firm performance in the South African context. What is relevant is that it is necessary to investigate the resource or experience attributable from outside directors and any relationship with firm performance. This is because if
agency theory holds, then for inside directors the possible drivers of performance; - being non-alignment to shareholders and/or resource capability, will not be capable of being distinguished from one another.

2.4.2 Board characteristic: Board ownership and company performance
A factor for consideration regarding firm performance is the extent of ownership of the board – i.e. agency theory may not be applicable if directors hold shares and are aligned to shareholders.

The literature on board ownership and impact on company performance is extensive with mixed findings and influences. Fritz, Foley and Greenwood (2007) review 10 years of data from 34 countries and find that ownership concentration is impacted by minority shareholder protections, block premia and liquidity of stock markets.

A link between positive corporate performance and insider ownership is found in the empirical study conducted by Kaserer and Moldenhauer (2006). Mork, Shleifer and Vishny (1987) find the relationship between management ownership and market valuation to be a nonmonotonic relationship. Tobin’s q increases, then declines and then rises as ownership by the board of director’s increases.

However, a contrasting result was published by Himmelberg, Hubbard and Palia (1999) who report that they can not conclude that changes in managerial ownership affect company performance. Faccio and Lasfer (2000) report ‘a generally weak relationship between firm value and managerial ownership’. Yet Bohren and Odegaard (2003) find that insider ownership is important for economic performance. Andres (2006) examine family ownership and the impact on firm performance and find that family owned firms are more profitable than widely-held firms and those with other blockholders. This is

In summary, it appears that there are mixed findings relating to board ownership and firm performance.

2.4.3 Board characteristic: Board size

The most popular hypothesis is that there is a negative relationship between the size of the board and company performance.

Hermalin B.E. & Weisbach, M.S. (2001) survey the economic literature on boards of directors and are frequently cited. Their paper summarizes the empirical research done on boards. i.e. how board characteristics relate to profitability; how board characteristics affect actions; and the factors that affect the makeup of boards. The main findings from empirical research are that board composition is not related to profitability and that board size has a negative relationship to performance. They refer to Jensen (1993) and the Lipton and Lorsch (1992) research that shows large boards to be less effective than small boards. Yermack (1996) tests this using tobin’s q on a sample of large US firms and this is confirmed by Eisenberg (1998) on small and mid-size Finnish firms. The reasons suggested are that agency problems increase with board size because the board becomes less able to monitor (i.e. more cumbersome) as well as subject to free-rider problems (directors will sit back on the presumption that another director will be monitoring). More recently, Guest (2009) The impact of board size on firm performance: evidence from the UK, reported that UK boards have a weak monitoring effect and that their composition reflects an advisory role. The larger the board size, the worse the firm performance which
supports the argument that increase in board size results in poor communication and decision-making.

But board size and the performance relationship could be argued to be industry specific. A study by Belkhir (2008) investigates the relationship between board size and performance in a sample of banks for the period 1995-2002 using panel data techniques. Contrary results are found in that the smaller the size of the board the more effective it was, and that increasing the number of directors in banks does not undermine performance as measured by a positive relationship with Tobin’s q and return on assets. The paper concludes that calls to reduce the number of directors on bank boards could adversely affect performance. Yet again, other research on banks by de Andres and Vallelado (2008) report an inverted U shape relationship between board size and performance. In the REIT environment, Feng et al (2005) find that good boards were small boards and that these firms have superior average performance.

If it is possible that the board size – performance relationship is impacted by the nature of the industry, it is also conceivable that it can differ depending on the environment or country. Kyereboath –Coleman (2007) Corporate governance and shareholder value maximization: An African perspective find that African boards are not independent. Larger boards add more value and improve performance but it is sector and country specific. Ghosh (2006) Do characteristics affect corporate performance? Firm-level evidence for India report size of the board is negatively related to firm performance in manufacturing companies in India for both accounting and market measures. O’Connell and Cramer (2010) The relationship between firm performance and board characteristics in Ireland find that board size can have a negative impact on firm performance. Abidin et al (2009)
Board structure and corporate performance in Malaysia report that the value add in terms of intellectual measures increases with board size. Uadiale, O. (2010) *The impact of board structure on corporate financial performance in Nigeria* find increasing ROE is a function of increased board size and outside directors.


In summary, whilst there appears more support for smaller boards to be positively associated with good firm performance, there is a body of research showing little relationship. In addition in Africa, where there is limited research, larger boards can be associated with good performance but this may be due in part to a need for resources and
monitors. For the purpose of my research question, it will be necessary for the board to be of sufficient size to be able to supply both independence and resources.

2.4.4 Board characteristic: Resources, including experience
The central theory to the board being a source of resources is that this is positively related to company performance. A review of the literature indicates that there is support for the premise that directors by bringing ‘resources’ to the board are able to positively impact various aspects of the firms performance, be it through advice, decision-making, goodwill, connectivity/relationships with the external world and in different circumstances.

As early as 1997 Corner and Kinicki show the importance of experience as it increases knowledge and leads to improved performance. He and Mahoney (2006) find a board’s ability is positively related to firm’s performance. Maharaj (2009) Corporate governance decision-making model: How to nominate skilled board members, by addressing the formal and informal systems report the importance of choosing directors with knowledge and skills

But resources, and in particular experience can relate to depth and specialism, as well as breadth and/or diversity. In support of breadth and diversity of skills and experience, Haynes and Hillman (2008) The effect of board capital and CEO power on strategic change show the greater the breadth and depth of director human and social capital of board capital, the greater the link to strategic change in an organization. Balta et al (2010) The influence of board of director characteristics on strategic decision-making: evidence from Greek companies report educational level and functional background matter in both financial reporting and hierarchical decentralization in the strategic decision-making process’. Siciliano (1996) analyses diversity of board members in The relationship of
board member diversity to organizational performance: JBE and find the greater the occupational diversity of members the greater the social performance and for their particular performance criteria - fundraising, the more effective are the results.

Notwithstanding the above, McIntyre et al (2007) *The top team: examining board composition and firm performance* reveal the importance of board process and board dynamics in board effectiveness but find value in moderate diversity (resources and capability). Too much diversity can negatively impact performance. Medium tenure and smaller boards are related to better performance and experienced board members add value to the performance equation. Finally, Scarborough et al (2010) *Board composition, process and activism: Evidence within American firms* reveal the importance of functional area knowledge, independence as well as duality and effort norms on the impact on board activism.

Depth of experience is found to be a valuable resource by various stakeholders. Elsaid et al (2011) *Does experience matter? CEO successions by former CEOs* report that stock markets like the hiring of an ex CEO and confirm human capital theory that with greater job specific experience the better the job performance. Additionally, Barroso et al (2010) *Are the BOD effective?* look at the boards efficiency and the financial performance of the company and show that board size, director tenure and board experience in senior management positions is positively related to financial performance.

Appreciation for depth of experience is also confirmed when it comes to the value of industry experience. Kor and Misangyi (2008) *Outside directors’ industry-specific
experience and firms liability of newness show that outside directors can positively influence performance when their experience has to substitute for management’s lack of industry experience. Furthermore, a draft paper by Papakonstantinou (2007) use a 10 year panel dataset of 650 large US corporations to show the marginal affect of experience on firm performance. Their findings are that firms with more experienced independent directors have higher abnormal returns and beat analysts’ forecasts, have a lower probability of bankruptcy and engage in less earnings manipulation. The techniques they use are OLS and fixed effects and Instrumental Variables, with successively deeper lags to cater for endogeneity, selection bias and/or measurement bias.

Experience can be diverse, broad, deep and event or scenario-specific, as evidenced later in this research where I interview highly experienced outside directors. Scenario-specific experience is also found to bring advantages to firms. McDonald et al (2008) *What do they know? The effects of outside director acquisition experience on firm acquisition performance* report that experience and expertise of the directors has a positive effect on the performance of the focal firms acquisitions and that it works best when the board is independent. De Villiers et al (2011) *The effect of board characteristics on firm environmental performance* also supports resource theory by showing environmental performance is positively related to larger boards, presence of CEOs from other firms as directors, and specific professional skills such as lawyers. Hsu (2010) *The relationship between board characteristics and financial performance: An empirical study of United States Initial Public Offerings* examines board characteristics and financial performance at IPO using tobin’s q and reports board independence is negatively related to performance, but that board expertise and educational background (quality) is positively related to performance.
Noteworthy in much of the research, for the benefit of experience and other resources to be deployed, the independence of the board is frequently mentioned. Roy (2009) when linking board types to board roles demonstrates the importance of independent boards and highlights the importance of board expertise for board performance. Musteen et al (2009) Corporate reputation: Do board characteristics matter reports board characteristics significantly influence reputation and a positive relationship between size of board and outside directors and reputation. Work by Guner, Malmendier and Tate (2006), who use firm fixed effects and IV estimation find little evidence that financial expertise matters for specific policies like financing, investment and compensation when conflicts of interest are absent”. Scarborough et al (2010) and McDonald et al (2008) above also refer to the presence of independence when experience is being deployed. However, whilst experience and skills are regarded as positive drivers of firm performance, their deployment is subject to sufficiency of time given by the directors. Multiple directorships and acquirer returns by Ahn et al (2010) show the importance of directors spending time on company affairs. Directors on multiple boards allow value-destroying acquisitions when they are too busy.

In summary, the resources that directors bring to the board by virtue of the depth, breadth and type of experiences, as well as their relationships and reputations is generally seen to be positively associated with the performance of the board and the performance of the company.

2.4.5 Performance measures
Several measures of performance can be used when examining the governance-performance relationship. Generally, they can be categorized into market measures such as
share price and tobin’s q, or accounting measures such as return on assets and accounting profit, or a combination of both. Market measures can be argued as dependent on the efficient market hypothesis and/or expectation theory. Accounting measures can be argued, per Dalton et al (1998) pg 274-275 in their discussion of performance indicators, as being open to manipulation as they are more susceptible to management control (agency theory), inaccurate because the different accounting policies can distort the value of assets making comparability difficult, lack standardization and be difficult to interpret in complex firms that operate in several industries. In contrast, market-based returns reflect risk-adjusted performance and are not impacted by multi-industry involvement. However, they are subject to forces beyond management’s or the board’s control (i.e. efficient market theory and expectation theory). There remains debate in this area and for the purpose of my research any performance noted requires consideration of the above.

2.5 Board composition and firm performance in different countries

My literature review above has covered board role, composition and the firm performance relationship in predominantly first-world countries. In summary, there is no clear association between board size and firm performance, board independence and firm performance, and board ownership and firm performance. There does appear to be a positive association for resource theory i.e. the quality of the board in terms of knowledge, experience and skills is positively associated with firm performance. A question that could be posed, given that socio-economics and politics differs from country to country, is whether the board composition-performance relationship can be different in different countries, and in particular developing economies.

I reviewed recent research across various economies and note the following:-
Claessens et al. (2012) survey and report in emerging markets that better corporate governance frameworks benefit firms through finance, performance and stakeholder management.

Garcia-Sanchez (2010) in a Spanish empirical study show that increasing business technical efficiency is related to increased board heterogeneity, directors who had limited other directorships and companies with larger number of board committees.

O’Connell and Cramer (2010) explore the relationship between firm performance and board characteristics in Ireland and find board size shows a strong negative association with firm performance and a positive association between percentage of non-executives and firm performance. Adjaoud et al (2007) in a Canadian study find that there was no relationship between corporate governance and performance when accounting methods ROI, ROR, EPS and Market to Book ratio are used. However, when using valuation add measures e.g. market value add and economic value add, there is a real link between board quality and performance.

Abidin et al (2009) Board structure and corporate performance in Malaysia show positive association between increased value add efficiency of firms resources and increased board size and outside directors. In India, Ghosh (2006) Do board characteristics affect corporate performance? Firm level evidence report a negative association between larger board sizes and firm performance for manufacturing companies, and for both market and accounting measures.

Bozcuk (2011) Performance effects of outside directors on corporate boards in a study of all firms on the Turkish bourse find that firms with outside directors perform better in terms of accounting and market measures. Significant positive association exists between
independent directors and performance from an optimization perspective i.e. increasing independent outside directors beyond a certain level leads to inferior performance, – reasons for the latter were not researched.

Direct empirical research on the effectiveness of corporate governance in Africa is almost non-existent (Okeahalam, 2004). Williams, S (2001) Corporate governance diversity and its impact on intellectual capital performance in an emerging economy; manuscript, University of Calgary, Canada as quoted by Okeahalam, (2004) indicates a positive association between 84 SA listed company’s intellectual capital performance and presence of female and non-white board directors.

More recently, Fiador et al (2012) How do we explain corporate board structure in sub-Saharan Africa? report that firm size is the only variable that significantly and positively explains board size for all of the four countries studied i.e. Ghana, Nigeria, Kenya and South Africa. Uadiale, O. (2010) in a Nigerian study report a positive association between ROE and ROCE and board size and outside directors. This followed Sanda et al (2007) Do board characteristics affect firm performance? Empirical evaluation of some corporate governance mechanisms in the Nigerian stock exchange who study a sample of 93 listed firms between 1996 and 1999 and find an optimal board size of 10. As regards firm performance, there appears a stronger association for firms that have concentration in ownership as opposed to being diffusely owned. The governance characteristic of non-duality is supported, and director shareholding is found to be insignificant in the firm-performance relationship.
Kyereboah-Coleman and Biekpe (2007) look at Ghana and find that board size and composition (proportion of outside directors) are a function of firm and industry characteristics. Positive relationships appear between firm level risk and board size i.e. less risky firms use smaller board sizes. Risky firms use more inside director and less non-executive directors because the former are more knowledgeable about firm and industry.

Kyereboah-Coleman (2007) Corporate governance and shareholder value maximization: An African perspective analyse data from South Africa, Ghana, Kenya and Nigeria between 1997 and 2001 and find that boards are relatively not independent and this has an inconclusive impact on performance, but that large boards do enhance firm performance. It is also noteworthy in their research that sector and country effects impact on shareholder maximization.

Ho and Williams (2003) International comparative analysis of the association between board structure and the efficiency of value added by a firm from its physical capital and intellectual capital resources between firms in South Africa, Sweden and the United Kingdom look at board composition, inside director ownership, duality and board size with performance defined as efficiency of value add (firms total resources – comprising sum of efficiency of capital employed, human capital efficiency and structural capital efficiency). They find that governance needs vary across firms even under different sociopolitical and economic conditions. There is no one consistent board feature associated with firm efficiency of value performance across all three countries. It appears that the latter finding confirms the above disparate results for the different countries noted above. The relevance to the research question is that it is likely that South Africa may find its own unique country-specific governance-performance relationship for board characteristics.
2.6 Board composition and firm performance during critical events

Given that the board can play several roles, be it as monitors of management, connectivity to the outside world by virtue of reputation and/or relationships with potential funders, or through wise counsel and advice to management, a question may arise as to when this board advisory role is necessary. Generally, it is management and inside directors who better know the inside workings of the firm – its processes and products. Outside directors may contribute in their advisory capacity through knowledge of the external environment, and also potentially when occasions arise that are not routine, or part of ‘business-as-usual’. Notwithstanding those circumstances when inside directors are incapacitated through conflict of interest, these advisory opportunities may arise during a corporate crises or a sudden critical event. Examples of critical events are a crises requiring reputation management e.g. product failure; a health, safety or environmental incident; publicity relating to fraud and corruption and/or regulatory non-compliance. Other critical events where a board, and in particular the outside directors, may suddenly be required to advise and/or direct are the replacement of the CEO, or when the company is faced with a corporate action such as a take-over, merger or bankruptcy.

Given the various inconclusive findings relating to the board characteristic-performance relationship, one may question whether there can be more definite relationships when a firm is undergoing a particular critical event, or indeed, with reference to endogeneity, whether firms with particular governance characteristics are more susceptible to critical events. The research is extensive, but certain findings relating to acquisitions, bankruptcy and delistings are as follows:
2.6.1 Acquisitions
Weir and Laing (2003) *Ownership structure, board composition and the market for corporate control in the UK: an empirical analysis* report that firms with duality (same person as chairman and CEO), higher proportion of non-executive directors, larger institutional shareholdings and higher director shareholdings are more likely to be acquired than a matching control sample. This partly contradicts a portion of earlier research where Weir, C. (1997) *Acquisitions and firm characteristics: the importance of internal monitoring mechanisms* report that ‘acquired firms are more likely to be poor performers…have boards in which non-executive directors constitute a clear minority, have relatively poor quality, non-executive directors’ and duality reflecting failure of monitoring.

Peng (2004) *Outside directors and firm performance during institutional transitions* looks at agency theory, resource dependence and institutional theories relating to appointing outside directors during institutional transition and finds that outside directors make a difference to firm performance if growth is measured, but not so if ROE is the measure. They distinguish between outside directors as all ‘non-management members of the board’ (Johnson, Daily and Ellstrand 1996) and note that outside directors may not be independent if they are ‘affiliated’ i.e. have family and/or professional relationships.

2.6.2 Bankruptcy
Daily and Dalton (1993) show that most research on corporate governance focuses on large firms and that smaller firms have less independent governance structures. One can then consider that if smaller firms are more likely to go bankrupt, that this may be the relationship with less independent governance structures as opposed to presuming causality. Yet, Daily and Dalton (1994) study bankrupt firms and find that there are differences between bankrupt and matched firms in their governance structure. Bankrupt companies have more proportions of affiliated directors.
Fick and Slezak (2008) report firms are better at avoiding bankruptcy once distress is indicated, when there are smaller boards with greater proportion of independent directors and a greater ratio of non-inside directors and greater ownership by inside directors. This is supported by Chang (2009) in research on Taiwanese firms who reports that board independence is a characteristic of financially distressed firms. Boards with a larger percentage of outside directors are less likely to fall into distress than boards with a smaller percentage. He also finds a positive correlation between board size and financially distressed firms.

2.6.3 Delisting
Charitou et al (2007) *Boards, ownership structure and involuntary delisting from the New York Stock Exchange* show that the likelihood of delisting is related to board governance characteristics. They analyse 161 firms from 1998 to 2004 and match them to similar firms by way of industry and size and find firms with more independent boards and greater insider ownership are less likely to delist.

Mangena and Chamisa (2008) *Corporate governance and incidences of listing suspension by the JSE Stock Exchange of South Africa: An empirical analysis* compare 81 matched-pairs company’s for time, size and industry between 1999 and 2005 and find that suspension is likelier for company’s with smaller proportion of non-executive directors, no audit committee, greater block-share ownership and higher gearing. Board size, duality, director share ownership and return on assets do not appear to be associated with suspension.
In summary, it appears that there is a positive relationship in that company’s with more independent boards are less likely to delist or go bankrupt. Again, the issue of causality as opposed to association is relevant, and also whether results are due to superior outside director advice, or as a consequence of protecting shareholders against management.

2.7 South African governance requirements

*Corporate governance in South Africa: JBE* (2002) by Rossouw et al provides an overview of corporate governance in South Africa. In 1994 South Africa, through the King Committee on Corporate Governance, was the first developing country to issue a corporate governance code through the Institute of Directors in Southern Africa (Mallin, 2004). It borrowed extensively from the UK Cadbury Committee of 1992, was revised effective 1 March 2002 (referred to as King 2) and again in 2009 (King 3, effective 1 March 2010). Ntim, C.G et al (2012) in a recent South African study on governance reforms show that disclosing good corporate governance practices impacts positively on firm value.

A distinguishing feature of the King Codes and Reports is that South Africa encourages firms to follow a stakeholder approach to governance as opposed to focusing primarily on the needs of the shareholder (i.e. shareholder wealth maximization). South Africa, by virtue of its exclusionary economic and political past during the pre-1994 Apartheid era recognises that to maintain social peace and to thrive (Roe’s thinking above), all stakeholders need to be accommodated or recognized as legitimate. This has now been codified in the Companies Act, no.61 of 2008 through sections requiring Social and Ethics Committees, and the potential for personal civil liability by directors to any stakeholder (not just shareholder) who can show causation and loss as a consequence of a director not following codified directors duties.
Whilst the King Codes and Reports are not law, but voluntary, the JSE Stock Exchange Listings Requirements requires firms listed on the Johannesburg Securities Exchange to apply King and to disclose in their annual reports the extent of compliance with King and the reasons for non-compliance. This, in conjunction with the effective manner in which the JSE regulates its members, provides a sound basis for extracting data for empirical research. “The latest World Economic Forum (WEF) Global Competitiveness report ranks South Africa first out of 142 countries for its regulation of securities exchanges.” JSE (2011). For companies listed on the JSE Stock Exchange suspensions can be made for a number of reasons, namely: 1) noncompliance with listings requirements, 2) when a company is placed under liquidation or judicial management, 3) at the request of the company, 4) during takeovers or 5) if the JSE believes it to be in the public interest (JSE Listings requirements, 2005). The JSE Stock Exchange has extensive reporting requirements and public SENS announcements (Stock Exchange News) are required whenever there is a matter that may affect shareholders interests, including dividends, changes in profit forecasts, appointment and resignation of directors and corporate actions such as acquisitions, mergers or disposals.

The King principles and recommendations on board composition between King 1, 2 and 3 have changed over time as regards the minimum number of independent non-executive directors. Whilst King 2 recommends a majority of non-executive directors with sufficient independent non-executives, this information was not always clearly disclosed in the annual report (i.e. the distinction between independent, non-executive directors (referred to as outside directors) and non executive directors who are not independent (affiliated directors)) is not always clear, or in some cases is not disclosed. With the advent of King 3, this problem resolved because King 3 principle 2.18 recommends a majority of non-
executive directors on the board, of whom the majority should be independent. The Companies Law Amendment Act of 2007 also requires SA listed companies from November 2007 to have at least three independent non-executive directors on the board and audit committee. However, it is noteworthy that the latter’s definition of independent non-executive director is not fully aligned to the King Codes in that the law does not include being a representative of a major shareholder as a disqualifying characteristic.

There are numerous recommendations within King 2. Those relating to the board are quoted from KPMG’s Toolkit for the Company Director pg 13 et seq and are summarized as follows:

• “A unitary board is appropriate for South Africa;
• The majority of directors should be non-executive with sufficient independent
• Chairperson and CEO are to be separated
• The chairperson should be an independent non-executive
• The board should have a charter
• There should be a minimum of quarterly meetings
• There should be no unfettered power on the board
• There should be a balance and authority to prevent one block from dominating the board
• Non-executives should have sufficient skill, experience and independence to assess strategic performance and adequacy of resources
• CV’s of directors standing for elections should be included with the AGM notice
• Shadow directors are actively discouraged
• The board composition should consider the demographics of the country
• The chairman of the audit committee should be independent and not the chairperson of the board.

• An independent non-executive does not represent a significant shareholder, has not served in an executive capacity for last 3 years (nor is a family member), not a professional advisor to the company, not a supplier, customer or contractor of the company and is free from any business or other relationship that could be seen to interfere materially with the individual’s capacity to act in an independent manner”.

• Disclosure requirements include details of the directors in terms of executive, non-executive and independent, committee membership, remuneration, number of board and committee meetings held and attendance.”

King 3 expanded on King 2 recommendations and it is important to note that the definitions relating to independent non-executive director did not deviate materially from King 2. The King Report on Governance for South Africa, 2009 (King 3) section 67 defines an independent non-executive director as someone who:

“67.1 is not a representative of a shareholder who has the ability to control or significantly influence management or the board;

67.2 does not have a direct or indirect interest in the company (including any parent or subsidiary in a consolidated group with the company) which exceeds 5% of the group’s total number of shares in issue;

67.3 does not have a direct or indirect interest in the company which is less than 5% of the group’s total number of shares in issue, but is material to his personal wealth;

67.4 has not been employed by the company or the group of which it currently forms part in any executive capacity, or appointed as the designated auditor or partner in the group’s external audit firm, or senior legal adviser for the preceding three financial years;
67.5 is not a member of the immediate family of an individual who is, or has during the preceding three financial years, been employed by the company or the group in an executive capacity;

67.6 is not a professional adviser to the company or the group, other than as a director;

67.7 is free from any business or other relationship (contractual or statutory) which could be seen by an objective outsider to interfere materially with the individual’s capacity to act in an independent manner, such as being a director of a material customer of or supplier to the company; or

67.8 does not receive remuneration contingent upon the performance of the company”.

In summary, whilst there may be institutional weaknesses in South Africa such as corruption; complex, unwieldy regulatory frameworks; inefficient state infrastructure; there are also particular strengths such as sophisticated, governance guidelines; a sound banking system; a well regulated stock exchange; consistent adoption of IFRS by corporate South Africa, and good company auditing and reporting, particularly for companies listed on the JSE Stock Exchange. The above information is relevant to the research question as it provides the definitions and ‘rules’ by which the board characteristics in South Africa are mandated and consistently applied, thereby allowing for comparability in methodology application.
3 Research questions

The literature review reveals that the following can impact board and company performance:

• The macro socio-economic and political environment
• The extent of shareholder dispersion and legal systems
• Industry and firm characteristics
• Board characteristics e.g. size and composition
• Stakeholder motivations i.e. agency, stewardship, resource and dynamic process theory of firm behaviour
• Governance rules/laws

Given the paucity of literature on South African corporate governance, but that there have been so many changes in the socio-political environment in recent years, compounded by a move towards increased social democracy as evidenced by new laws and changing governance codes i.e. the stakeholder model of governance, I am interested whether board characteristics, and in particular director ‘experience’ matter in creating company value. Hence, the main research question is ‘In the case of South Africa, does the experience of a director impact on company value?’

The whole area of governance is plagued with endogeneity problems, where each of the above can interact amongst each other, and with the overall performance objective of the firm.

If any form of quantitative research is undertaken, then for the variable of experience to be isolated and measured, has to take place in an environment where there are no conflicts of
interest which could nullify identification of experience coming into play in board deliberations. Experience to be effectively deployed needs to be displayed through the independent non-executive director or outside director only.

3.1 Changes in codes/laws/JSE rules and the impact on director experience

I attempt to mitigate the endogeneity problem in part by measuring effect on level of average outside director experience whenever a governance change (an exogenous event) requires an increase in the number of outside directors on the board. i.e. Over the period from 2002 there were two governance codes in South Africa (King 2 from 1 March 2002 and King 3 from 1 March 2010), and whilst the definitions for the independent director did not change substantially, the minimum composition requirements for the board did. For King 2, the board must be balanced between executive and non-executives, preferably with a majority non-executive directors, and have ‘sufficient’ independent non-executives. For a least conservative application of King 2, this could be a board with an equal number of executives and non-executive directors, with only one non-executive director.

With King 3, the board has to have a majority of non-executive directors of whom the majority are required to be independent. This is tantamount to a higher degree of independence required on boards and more relevantly a larger board. Note however, that the board may still not be truly independent because the sum of the executive directors and affiliated directors (non-executive directors) could still be greater than the number of independent or outside directors. Hence for any examination of experience applied by independent directors, the research has to compare and contrast different scenarios of board independence and size in terms of the King Code changes above.
In addition the Corporate Laws Amendment Act came into force between King 2 and King 3 on 14 December 2007 and required the board to appoint at least two independent non-executive directors to the audit committee for the following financial year.

There are therefore 3 points in time, based on legal or code amendment events that necessitated board changes and an increase in the number of outside directors. It is at these points in time where I can attempt to observe whether experience is valued by the board, and the shareholders. It is the board through the nomination committee who put potential directors to the shareholders for consideration and election, and the shareholders who ultimately appoint the directors. The hypothesis is that, if the experience of directors is valued by shareholders, one would expect to see that the average experience level of the independent directors increases every time there is a requirement by code, law or listings requirement to increase the size of the board. The hypotheses can be stated as follows:

- With each successive code/legal/JSE rule change the size of the board increases;
- With each successive code/legal/JSE rule change the total level of board experience increases as new outside directors are appointed to the board, ceteris Paribas;
- With each successive code/legal/JSE rule change the average director experience level increases, ceteris paribus or not.

If all the hypotheses above are fulfilled, then this is evidence that shareholders value the characteristic of director experience, based on the premise that the shareholders objective is always to increase company performance and value.

3.2 Outside director experience and the effect on company value

The research question ‘In the case of South Africa, does the experience of a director impact on company value?’ is analysed further. i.e. Firm value is positively associated with
outside director’s experience, assuming all companies are measured at the same point of
time and under the same circumstances. For the assumptions to hold requires controlling
for industry cycle and firm differences. This can be achieved if performance is defined and
measured for companies when they undergo a common event or crises, and are required by
law to follow a standardised process e.g. delisting from the JSE. At this point in time, the
premium or discount to ruling market share price can be a comparable measure of
performance between companies. Under these circumstances and at this point in time, the
following hypotheses are proposed;

• On delisting, companies with more experienced outside directors achieve a greater
  value than companies that have less experienced directors. However, this is based on
  the assumption that some value is obtained on delisting e.g. an acquisition of shares.

• Where companies that delist and there is no value or zero premium/discount e.g.
  companies that are bankrupt, suspended or voluntarily go private, then these
  companies have boards with less experienced directors than those companies that
  achieve a premium.

Company value is impacted by numerous variables, and outside director experience is a
likely variable to positively impact any premium achieved on delisting.

Whilst the above hypotheses are formulated for a particular point in time i.e. the delisting
event, it is important to note that a delisting is not an exogenous event that would mitigate
the endogeneity issue. The exception to this is where performance is compared when there
are changes in the corporate governance rules (as discussed above). However, in my thesis
this is only a minor and partial examination of endogeneity mitigation, because it is
considered at delisting and does not cover the entire JSE listed company population. A
more comprehensive control for endogeneity would require a full examination of
performance (however so defined) for all listed companies, (and not just delisted companies) and the impact on outside director experience for each successive governance rule change. Notwithstanding the above, using the delisting event is relevant to my thesis to the extent that it is a point of time where data on the outside directors experience can be identified, gathered and compared. Directors are likely to remember and recount such a significant occasion if qualitative research methods are used. Notwithstanding this approach, the endogeneity problem remains.

The above hypotheses reflect a predominantly quantitative measurement approach to the research question. Other hypotheses include:

- Outside directors are of the opinion that experience is a positive attribute/contributor towards company value, based on their personal accounts or experiences.

I research the main question and its associated hypotheses as set out in the methodology below.
4 Methodology

I use a combination of quantitative and qualitative research methods to get a more holistic view on whether in the South African context, the experience of outside directors affects company value. The reasons for this are as follows: - Quantitative research seeks relationships between a limited number of variables and can cover potentially a large number of observations. Patterns and the strength of these associations can be measured statistically. Qualitative research can provide a ‘richness’ of data as to real life scenarios and possible explanations/understandings that are not bounded by the limited variables used in quantitative research.

Having been informed by the literature review, I commence my research with a quantitative analysis of companies, their boards, director experience and company value. Following on the findings from the quantitative research, I conduct qualitative research to further inform the empirical results and validate or explain the findings. Detail on methods, data, collection and analysis techniques is provided below.

4.1 Quantitative approach:

The quantitative analysis involves identifying an appropriate population to analyse; identification of sub-populations; selecting, extracting and manually coding relevant data variables and choosing analysis techniques.

4.1.1 Population for data selection

In order to identify any possible relationship between directors’ experience and the effect on company value it is necessary that the data being examined have certain common
characteristics. For this reason, I select companies that have been listed on the JSE Stock Exchange. These companies are all regulated by a set of listing rules which requires them to disclose and report information in a consistent and therefore comparable manner e.g. the use of IFRS or generally accepted accounting practices and the requirement to be audited and report to shareholders a set of annual financial statements within a set timeframe. However, despite companies being regulated by a common set of listing rules, differences in disclosure and reporting between companies can arise depending on such things as economic and industry cycles which would result in non-comparable data. Therefore, I select a particular event (critical event), which being common to all the companies in a population, would reduce the effect of economic and industry cycles. I select the ‘delisting’ event as being the trigger point in time, where all boards and directors have certain common experiences and are required to take certain decisions. i.e. no matter the size, profitability or nature of the industry or company, all directors at a delisting event are required to consider the company’s future and shareholder value. In particular, where there are minority shareholders involved, the director’s fiduciary duties to act in the company interest are particularly visible.

The McGregor BFA and the Who’s Who databases provides a list of all companies that have delisted from the JSE Stock Exchange. These lists were obtained for all companies that delisted from March 2003 to the end of 2011. The reason I select this timeframe was that there were progressive changes in the South African governance code (King Codes), JSE listing requirements and laws that impacted upon the composition of the board. Each of these changes required more independent directors to be added to the boards and/or disclosed i.e. sub-populations (refer below).
4.1.2 Data variables
The cases I extract are companies that delisted from the JSE from March 2003 to the end of 2011 when King 2 and then King 3 are in effect and disclosed. The variables are coded as:

- Company name
- Delisting date
- The governance ‘regime’ under which the delisting company is configuring its board and disclosing information i.e. King 1, King 2, JSE Listing rules, King 3
- Delisting reason – there could be numerous reasons for delisting, so the reasons were also summarized into a ‘short reason’ variable being ‘Desired’ companies/‘Failed’ companies/’Other’ reasons for delisting
- Industry in which the company operates
- Size of company – by market capitalization
- Size of company – total assets and net tangible asset variables
- Profitability of company – EBIT, EBITDA and profit to ordinary shareholders
- Number of employees (although this was not frequently disclosed as it is non-mandatory disclosure)
- Premium/discount to market price for companies acquired; or zero for ‘Failed’ companies or companies delisting for ‘Other’ reasons e.g. going private
- Board size
- Number of executive directors
- Number of non-executive directors
- Number of affiliated directors
- Number of independent, non-executive directors (outside directors). Two variables were coded – (i) actual number of independent directors including missing fields for non-disclosure (Disclosure depends on the applicable governance disclosure rule prevailing
at the time), and (ii) actual number of independent directors as adjusted to zero when disclosure was not provided – with the rationale that poor disclosure is a proxy for the presence of no outside directors

- Pure independence of the board (being independent directors as a percentage of total board size)
- King independence (being non-executive directors as a percentage of total board size)
- Board total experience factor (sum of outside directors experience) and board total experience factor ((adjusted) includes the zero experience factor as a proxy for non-disclosure of the outside director)
- Binary coded board experience factor (1 if experienced and 0 if not experienced)
- Average outside directors experience factor (sum of outside directors experience divided by number of outside directors) and average outside directors experience (adjusted)
- Average age experience factor of all outside directors
- Average number of degrees factor of all outside directors
- Average number of other listed company boards on which the outside directors have/had seats.

4.1.3 Sub-populations of data
King 2 came into effect during 2002 and King 3 came into effect in 2010. Specifically

King 2 section 1.6 required affected companies i.e. JSE listed companies, to apply King 2 for financial year commencing on or after 1 March 2002 (or for financial year ends ending on or after 1 March 2003). However King 2 was not law and companies merely had to disclose the extent of their compliance to King 2. On 15 May 2003, the JSE published its new Listings requirements (effective from 1 September 2003) that made it mandatory for listed companies in compliance with King 2 to have audit and remuneration committees
that were comprised of a majority of non-executives of which the majority are independent directors. This was transitioned in for audit and remuneration committees up to 1 January 2004, but disclosure was required from 1 September 2003. In addition, the Corporate Laws Amendment Act came into effect in 2007, which also required mandatory minimum two independent non-executive directors. Following on this, the JSE Stock Exchange listing requirements for disclosure also changed so that companies were required from 1 March 2010 to have and identify and disclose their independent non-executive directors in terms of King 3. Consequently, there are several sub-populations of company boards within the timeframe 2003 to 2011. (Note the difference between King 2 and King 3 is that the latter requires a board to be comprised of a majority of non-executive directors of whom the majority should be independent. King 2 merely refers to a balanced board with ‘sufficient’ independent non-executive directors.) The sub-populations of delisted companies based on the different codes/rules allows for variable coding of board independence, and a comparison of average outside director experience under each new code/rule regime as I explain below.

Given the changes between 2002 and 2011 in governance codes, JSE listing requirements and Companies Act/legal requirements in South Africa, each change will be incorporated into the board structures of the companies that delist. This is reflected in each company's disclosure as and when the disclosure requirements take effect. Consequently for delistings from 2002 to 2011, the annual reports should reflect the following sub-populations.

• King 2 sub-population, which requires a balanced board with a majority of non-executives and sufficient independent non-executives (i.e. therefore a minimum of 1 independent director) will be on the board and possibly disclosed in annual reports from 1 March 2003. Therefore the delisting population to be selected for analysis should
commence with all companies delisting from 1 March 2003 onwards. i.e. King 2 independence rules of at least one independent director on the board will be in place, although the detail/s of such director/s may or may not be specifically disclosed.

- JSE rule changes require disclosure of King 2 compliance and Audit Committees and Remuneration Committees to have a majority non-executive of which a majority should be independent (i.e. therefore a minimum of 2 independent directors), to be disclosed in annual reports from 1 January 2004 onwards. Therefore, for delisted companies with annual reports from 2004 onwards there is a sub population of at least 2 independent directors to be disclosed.

- The Corporate Laws Amendment Act, 2007 requires a minimum of 2 independent non-executives on Audit Committee from 1 January 2008. This will have already been incorporated into the 2004 JSE Listing requirements and therefore listed companies disclosure is unlikely to be impacted.

- King 3 sub-population requires 3 independent non-executive directors from 1 March 2010 and the JSE requires this to be disclosed in annual reports ending after 1 March 2011. This also became law with the new Companies Act from 1 May 2011.

Considering the above, I expect to see an increasing number of independent directors being placed on boards as the governance code/rule changes over the timeframe. I also expect to test the hypotheses above relating to director experience i.e.

- With each successive code/legal/JSE rule change the size of the board increases;

- With each successive code/legal/JSE rule change the total level of board experience increases as new outside directors are appointed to the board, ceteris paribus

- With each successive code/legal/JSE rule change the average director experience level increases, ceteris paribus or not.
4.1.4 Comparability of data cases and a common event
To test the research question and hypotheses relating to director experience and value requires identifying a common event i.e. delisting, understanding the delisting process and extracting relevant data as described below.

The process of delisting which occurs through a scheme of arrangement under Section 311 of the Companies Act, 1973 where offers are made to all the shareholders and creditors requires listed companies to go through a formal process. The then Securities Regulation Panel had a Securities Regulation Code on Takeovers and Mergers and rules. This process occurs where an independent committee of the board is formed to consider the offer from the potential acquirer of the shares, and who then put the ‘fair and reasonable’ offer to the board for approval before it is submitted to shareholders to decide. Notwithstanding this process, which is performed by independent directors using professional advisors (lawyers and accountants for valuations), it is ultimately the board that has to concur or not concur before submitting the offer to shareholders for acceptance. Hostile takeovers are not common in South Africa although the environment favours the bidders. For this reason, I select the board of directors as disclosed in the most recently published annual report prior to delisting to be the directors who should be measured for independence and experience (and not the independent directors who sat on the investment sub-committee and who make the recommendation to the board). But this may be arguable if the investment sub-committee of the board has to be specially constituted with new directors prior to a transaction. In any event, the latter would not be considered to have the experience variable of ‘knowing’ the company that is being analysed in this thesis.

4.1.5 Industry/sector variable
The JSE classifys shares into 41 industry sectors. This has changed over the course of 10 years. To facilitate analysis, I manually analyse and judgementally categorize the delisted
companies into the groupings below which aggregate the 41 industry sectors. The categorization is performed by googling the listed name of the company and reviewing the mbendi information services websites at www.mbendi.com/orgs/… for each of the companies. In those infrequent instances where the mbendi information services is not available, then the ‘securities’ website or other internet information is used to identify the company sector. The industry sectors are aggregated and coded as follows:

- **ENR** – Energy and natural resources (includes mining companies) comprises the sectors of Oil and Gas, Chemicals, Forestry and Paper, Industrial Metals and Mining, Coal, Diamonds and Gemstones, General Mining, Gold Mining, Platinum and Precious Metals
- **Financial Services** – Banks, Insurance, Investment Companies and Financial Services
- **IT** – Software and Computer Services, Technology Hardware and Equipment
- **Electronics, telecoms and media** – Electronics and Electrical Equipment, Telecommunications, Media,
- **Construction and Materials**
- **Property Companies** – Real Estate and Development, REITS. Many of these companies are linked income funds i.e. the security is in the form of majority loan debenture and a minor fraction being equity. The underlying basis of valuation is a valuation of the annuity rental income and hence the nature of this ‘share’ is more akin to loan stock.
- **Health** – Health care equipment and Services, Pharmaceuticals and Biotechnology
- **Industrial** – General Industrials, Industrial Engineering, Industrial Transportation, Automobiles and Parts
- **Food** – Food Producers, Beverages, Tobacco
4.1.6 Director data variables

From the most recent annual report published prior to the delisting, which I source from MacGregor BFA (library module) I manually extract data about the boards. The data variables are the total size of the board at financial year-end, the number of executive directors, the number of non-executive directors and the number of independent non-executive directors. Where disclosure on the distinction between non-executive and independent non-executive directors is poor or not easily apparent, then this absence of data is coded as ‘non-disclosure’. Note that prior to King 3 and listing requirement changes, this non distinction or non-disclosure was common and not illegal.

I manually extract the size of the board and the characteristic of the individual directors from various parts of the annual reports namely, from information on directors and office bearers; and/or the corporate governance statement; and/or the remuneration disclosure; and/or the directors report; and/or curriculum vitae of directors coming up for re-election in the notices; and/or other parts of the annual report. Where information about the director in the annual report is given relating to experience such as age, qualifications and seats on other boards, this is noted for cross-referencing with director experience data sourced from McGregor BFA on director details. The main reason I source director data from the most recently available published annual report prior to delisting is to be able to identify those boards which could be considered both independent and experienced in the period up to the time when corporate action was going to occur. Whilst holding for independence, it is hoped that I will observe any relationship for experience, based on the premise that experience can best be observed on the independent board as opposed to a board that may
have conflicting interests. Furthermore, if experience is indeed a variable in company value, then it is the experienced directors who have experience of their particular company who may be best placed to argue for the board additional premiums in a corporate action that leads to delisting.

4.1.7 Director experience variable
In order to assess experience, I extract for the independent non-executive directors the available personal details from BFA McGregor held under Director Search, Director List and their surname and first names. The data that BFA McGregor provides includes the name of the director, date of birth (which is used to estimate age at delisting if not disclosed in the annual report), nationality, qualifications and directorships with appointment dates and status (active or resigned). Extracts of curriculum vitae from the most recently published annual reports of listed companies is also often provided. I extract or calculate the following data fields to code the experience variable;

• I calculate the director’s age with reference to the delisting date if it is not already disclosed in the annual report.

• I record the director’s qualifications. Only degrees are noted and not non-university qualifications. If a director is either an admitted attorney, advocate or chartered accountant then the underlying qualifications are calculated as two degrees irrespective of the number of underlying degrees disclosed. e.g. a CA (SA), or chartered accountant, is counted as 2 degrees. The reason for this is because these professionals write the same professional entrance examinations. Where more advanced studies are recorded for an individual e.g. Doctorates or additional, unrelated degrees these are counted as additional qualifications. The justification for this is that it can proxy for more varied experience.
• I extract data relating to the other listed companies on which the independent non-executive directors had sat on the boards. This includes both currently listed companies and previously delisted companies on the JSE Stock Exchange. I exclude companies listed on other international bourses; the reason being that this information is not provided in BFA McGregor which lists South African companies registered by CIPC (Companies and Intellectual Property Commission which is the SA equivalent to the Companies House in the UK). I exclude non listed company or private company’s because the experience of being on a listed board is both relevant and secondly comparable between independent non-executives. Furthermore, the demands on a director from an unlisted or private company are often different depending on the size of the company and the reason for the director being on the board e.g. executive director, being the owner of the shares, passive investment etc. The names of the listed company are noted on the data extraction spreadsheet and the total number of listed companies on which the director sat or had sat are calculated. I took care to exclude from the number of directorships those listed companies to which the director had been appointed subsequent to the delisting of the company being analysed in the delisting population. (e.g. a director has been in the past and in the present on five listed boards. However at the time of delisting of company X, which took place in say 2005, he/she had yet to be appointed to two of the boards which BFA McGregor states that he/she sits/has sat on. On this basis at the time of delisting of company X, this director had experience of being on only three boards and this is the number that is recorded.)

I extract and code the different types of director experience as follows:
Age of the director is seen as wide general business experience, ‘having been around’ or ‘exposure to the lessons of life’. This is consistent with descriptions provided from the director interviews. I code ‘Age’ as a scale variable for regression purposes as follows:

<table>
<thead>
<tr>
<th>Age of director</th>
<th>Score</th>
<th>Reason and assumptions (correlates to interview answers on definition of experience)</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;40</td>
<td>0</td>
<td>The director is not likely to have had any exposure to many business cycles, life lessons, nor to have achieved a high degree of management experience in an executive capacity on another listed company in South Africa</td>
</tr>
<tr>
<td>40-49</td>
<td>1</td>
<td>The director may have had more ‘life experience’, exposure to business cycles and exposure to managing a business</td>
</tr>
<tr>
<td>50-59</td>
<td>2</td>
<td>The director has lived longer, experienced more business cycles, change, and has probably had some executive management experience (possibly recent experience and from a company/s of material size and complexity).</td>
</tr>
<tr>
<td>&gt;59</td>
<td>3</td>
<td>This group of directors has lived through the most business cycles, periods of change, life experiences and most probably had more extensive management experience than his/her younger peers</td>
</tr>
</tbody>
</table>

Degrees that the directors have been awarded may be seen as a proxy for application of skills and ‘depth’ of experience in a particular area that the company values. This again correlates with director interviews, where there was frequent mention of experience
relating to a particular profession e.g. chartered accountant, lawyer and engineer. I extract and code ‘Degrees’ as an experience variable as follows:

<table>
<thead>
<tr>
<th>Number of degrees</th>
<th>Score</th>
<th>Reason and assumptions</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>0</td>
<td>A director who has no degree is perceived to have less experience to one who has studied, trained and gained experience in say a professional capacity</td>
</tr>
<tr>
<td>1</td>
<td>1</td>
<td>A director who has one degree has some formal training and possibly experience based on getting formal employment post university</td>
</tr>
<tr>
<td>2</td>
<td>2</td>
<td>A director who has two degrees is likely to have more depth of knowledge and consequently opportunity to get post qualification experience in a particular field or profession. He/she is more likely to have more specialist than generalist knowledge and experience than the former directors</td>
</tr>
<tr>
<td>&gt;2</td>
<td>3</td>
<td>A director who has 3 or more degrees either has deep specialist knowledge or a greater variety of knowledge than the former. The limit is a score of 3 points because an increasing number of degrees tends to weigh in favour of academic experience as opposed to business experience</td>
</tr>
</tbody>
</table>

I consider the number of South African listed company boards on which the director has been exposed to, as indicators of experience in leading listed companies as well as possibly the number of critical events where an independent director may be required to exercise
judgment in difficult or unusual circumstances e.g. corporate actions, replacement of CEO, crises management etc. It correlates to the descriptions obtained in interviews about experience being ‘having done it before’ or ‘lessons learnt’. I code the experience factor of number of degrees as follows:

<table>
<thead>
<tr>
<th>Number of boards of listed companies (excluding the company on which the director is presently sitting, or future seats on other boards)</th>
<th>Score</th>
<th>Reason and assumptions</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>0</td>
<td>The director has no experience with listed companies or the events that have to be uniquely managed in this context</td>
</tr>
<tr>
<td>1</td>
<td>1</td>
<td>The director has limited experience of listed company requirements and environment.</td>
</tr>
<tr>
<td>2-3</td>
<td>2</td>
<td>The director has moderate experience of listed companies</td>
</tr>
<tr>
<td>4-5</td>
<td>3</td>
<td>The director is experienced in the listed company environment</td>
</tr>
<tr>
<td>&gt;5</td>
<td>4</td>
<td>The director is highly experienced in listed company requirements and the type of events that have to be directed through.</td>
</tr>
<tr>
<td>Total maximum score</td>
<td>4</td>
<td></td>
</tr>
</tbody>
</table>

I calculate an overall ‘experience’ attribute score for each individual outside director by adding the scores for his/her age, degrees and number of other listed boards. Hence the most experienced director could score a maximum of 10 if he/she were older than 59, had
3 or more degrees, and had been/was seated on more than 5 other listed boards. The least experienced director would score zero, being younger than 40, holding no degrees and not sitting on any other boards.

I calculate the aggregate experience score for all the outside directors on the board by summing the experience score of each outside director. I also calculate the average experience score of the individual outside director, by dividing the board experience score by the number of outside directors on that board. Finally, I code a binary variable for director experience where if the sum of the board experience is ≥ 10, then experience = 1; and if the sum of the board experience is < 10, then experience = 0. The rationale for the binary coding is that 10 is equivalent to one very highly experienced outside director, or at least 2 or more moderately experienced directors.

**4.1.8 Value variable and reason for delisting variable**  
JSE listing rules require a company to make a cautionary announcement when a transaction is being considered that could materially affect the share price. When negotiations or discussions are finalized, then a formal announcement is made. Thereafter, a circular containing details of any transaction or scheme offer, as well as the fair and reasonable valuation from independent advisors is sent to shareholders to position them to vote in favour or against an offer. For quantitative research purposes, value is defined as the excess price offer to shareholders over the ruling market price i.e. the premium or discount on delisting. I extract the premium value data from SENS announcements and/or the circular for each company where there was an offer to shareholders.

Different types of offers can be made to shareholders. The most common corporate action is the scheme of arrangement where a proposal is made to shareholders and approved by the court. There is also a Section 440 offer to minority shareholders. This is a mandatory
‘come-along’ provision of the Companies Act of 1973 where shareholders who own in excess of 90% of the shares can force the remaining 10% to sell their shares at fair value to the majority shareholder. The ‘Who’s Who’ database provides the list of delisted companies from the end of 2002 to 2012 along with the reason for delisting. The reasons for delisting were stated as ‘scheme of arrangement’ which is the most common cause; offer to minorities; S440 forced take-out of minorities; liquidation of company (voluntary or bankruptcy although these details are not specified); delisting at the request of directors/shareholders; failure to comply with the JSE rules. The premiums can be stated or calculated on various dates; namely the premium of the offer over the share price at the date of the first cautionary, or/and the premium of the offer over the share price at the date of the firm announcement. In addition to the premiums that can be disclosed on the cautionary and/or announcement date, premiums can also be disclosed on a 30 or 60 day moving average prior to the first cautionary or firm announcement. I extract the premium at the date of the first cautionary as this is both the most frequently obtainable/calculable and the date where there is the least likelihood of insider trading. Where this is not disclosed, either because it was not provided on SENS or in the circular as in instances where a firm announcement was made before a cautionary was required, then I use the premium at announcement date or the 30 day or 60 average moving day, whichever is available.

Numerous companies delisted because they failed to meet the JSE listing requirements, or failed to comply with the rules, or which appeared to delist because they changed their name, or who were involved in a reverse listing. For the purposes of this research, where shares delisted due to liquidation, failure to comply, not meeting the listing requirements they are regarded as weak or unsuccessful companies and I code the premium as zero.
4.1.9 Quantitative analysis techniques
I commence the quantitative analysis by extracting summary data of the variables and observing potential relationships between variables using graphical representations. Thereafter, I perform comparative analysis of means on director experience for companies that delisted at a premium versus those that delisted at a discount or zero premium. I also perform comparative analysis of means on individual director experience after each governance/listing rule change. I complete the empirical research by performing multivariate regressions using a probit model. I interpret the results and position them for the qualitative research analysis.

4.2 Qualitative research approach
For the qualitative component of my research I conduct semi-structured interviews with outside directors who have been through a delisting event. I select the sample of outside directors from the population of directors used in the quantitative research. Access to these highly experienced, busy directors was facilitated through my firm’s network of professional relationships. In most cases, I conducted the interviews face-to-face, in a few cases telephonically due to geographic/logistic impediments, and in one instance across skype. Prior to the interviews, the directors were assured of confidentiality of information and identity.

I construct the interview questions to elicit information on the director’s opinion on the value of experience, the relevance of independence, the role of the board and directors and the process followed. Each of these areas corresponds to the literature review themes above i.e. experience and resource theory; independence and agency theory; role of the board and stewardship theory and the delisting process and ‘dynamic process’ and/or team theory.
Several questions on each of these areas are asked so as to obtain consistency and clarity of meaning. The questions are:

1. How do you define experience?
2. How did you get appointed as a director?
3. What experience of the outside director was most valued?
4. What was the role of the board during the critical event – i.e. Delisting?
5. What was the role/contribution of the different directors during delisting i.e. executive versus non-executive versus independent directors?
6. What was the style and behaviour of board interactions?
7. How did the board operate as a team?
8. How did the board react to information put to them?
9. What advice would you give boards and directors who may go through a delisting event?
10. What experience are directors most lacking in, in South Africa?
11. Do you have any other views or comments about outside director experience and the impact on company value?

Interviews generally last between one and two hours, and over 200 pages of interview notes were recorded from 31 directors.

From the quantitative research, I extract for each director interviewed his/her age, degrees and number of listed board seats variable codes, as well as the reason for or type of company delisting. I use this data to frame the context for interview results and analysis.
5 Quantitative research results

The objective of my quantitative research is to establish whether outside director experience as defined and coded is associated with company value. I commence my approach with a description of the data variables and summary statistics. Thereafter, I graphically view the data for any anomalies before exploring potential relationships between variables using comparison of means and a probit regression.

5.1 Summary statistics

In general, I observe that the variables are widely diverse in value and widely dispersed as evidenced by the high-low range and standard deviations. This may be indicative of skewed populations.

5.1.1 Delisted company population size and industry sector

The table below reflects the population of 242 delisted companies dispersed across all industry sectors.

<table>
<thead>
<tr>
<th>Delisted Companies by Industry Sector</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction and materials</td>
<td>7</td>
<td>2.9%</td>
</tr>
<tr>
<td>Electronics, telecoms, media</td>
<td>13</td>
<td>5.4%</td>
</tr>
<tr>
<td>Energy</td>
<td>33</td>
<td>13.6%</td>
</tr>
<tr>
<td>Financial services</td>
<td>36</td>
<td>14.9%</td>
</tr>
<tr>
<td>Food</td>
<td>11</td>
<td>4.5%</td>
</tr>
<tr>
<td>Health</td>
<td>4</td>
<td>1.7%</td>
</tr>
<tr>
<td>Industrial</td>
<td>24</td>
<td>9.9%</td>
</tr>
<tr>
<td>Investment holding company</td>
<td>14</td>
<td>5.8%</td>
</tr>
<tr>
<td>Information technology</td>
<td>29</td>
<td>12.0%</td>
</tr>
<tr>
<td>Property</td>
<td>27</td>
<td>11.2%</td>
</tr>
<tr>
<td>Retail</td>
<td>31</td>
<td>12.8%</td>
</tr>
<tr>
<td>Support services</td>
<td>13</td>
<td>5.4%</td>
</tr>
<tr>
<td>Total</td>
<td>242</td>
<td>100%</td>
</tr>
</tbody>
</table>
Over a period of nine years there is a spread of delisted companies across all industries, with the most delistings occurring in the Financial services sector with 14.9%, and the least from the Healthcare sector with 1.9%.

5.1.2 Reasons for delisting
There can be numerous reasons for delisting ranging from the most common – scheme of arrangement in a take-over, to non-compliance with JSE listing requirements, to liquidation. The frequency statistics in the table below reflect the variety of reasons (a ‘long’ reason which explains more fully the nature of the delisting, and a ‘short’ reason which summarises the nature of the delisting – refer pg87) for companies to delist.

<table>
<thead>
<tr>
<th>Reason for delisting (long)</th>
<th>Short reason for delisting (refer next table)</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-compliance</td>
<td>Failed</td>
<td>24</td>
<td>9.9%</td>
</tr>
<tr>
<td>Director request</td>
<td>Other</td>
<td>2</td>
<td>0.8%</td>
</tr>
<tr>
<td>Failure to meet JSE listing requirements</td>
<td>Failed</td>
<td>8</td>
<td>3.3%</td>
</tr>
<tr>
<td>Liquidation</td>
<td>Failed</td>
<td>20</td>
<td>8.3%</td>
</tr>
<tr>
<td>Merger</td>
<td>Desired</td>
<td>4</td>
<td>1.7%</td>
</tr>
<tr>
<td>No longer meets JSE listing requirements</td>
<td>Other</td>
<td>1</td>
<td>0.4%</td>
</tr>
<tr>
<td>No longer qualify for listing</td>
<td>Failed</td>
<td>13</td>
<td>5.4%</td>
</tr>
<tr>
<td>Offer made to minorities</td>
<td>Desired</td>
<td>20</td>
<td>8.3%</td>
</tr>
<tr>
<td>S440K (mandatory take-over of minority)</td>
<td>Desired</td>
<td>5</td>
<td>2.1%</td>
</tr>
<tr>
<td>Sale of company</td>
<td>Desired</td>
<td>7</td>
<td>2.9%</td>
</tr>
<tr>
<td>Scheme of arrangement</td>
<td>Desired</td>
<td>113</td>
<td>46.7%</td>
</tr>
<tr>
<td>Suspension</td>
<td>Failed</td>
<td>2</td>
<td>0.8%</td>
</tr>
<tr>
<td>Voluntary delisting</td>
<td>Other</td>
<td>2</td>
<td>0.8%</td>
</tr>
<tr>
<td>Winding up (voluntary)</td>
<td>Other</td>
<td>21</td>
<td>8.7%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>242</strong></td>
<td><strong>100%</strong></td>
<td></td>
</tr>
</tbody>
</table>

There was one incident of delisting that did not have a reason and it relates to an asset backed security arising out of an unbundling and which delisted shortly after unbundling.
The reasons for delisting are further classified into three broad categories (‘short’ reason) – companies that delisted because they were ‘desired’ by another party; companies that ‘failed’ because they were suspended, liquidated, non-compliant etc; and companies that fell into neither of these categories (Other) but which may have volunteered to go private, or dispose of assets and wind up. The table below reflects the frequency of the short reason for delisting derived from the table above.

<table>
<thead>
<tr>
<th>Short reason for delisting</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Desired</td>
<td>149</td>
<td>61.6%</td>
</tr>
<tr>
<td>Failed</td>
<td>67</td>
<td>27.7%</td>
</tr>
<tr>
<td>Other</td>
<td>26</td>
<td>10.7%</td>
</tr>
<tr>
<td>Total</td>
<td>242</td>
<td>100%</td>
</tr>
</tbody>
</table>

5.1.3 The governance code/rules under which delisted companies reported
At different times over the nine years surveyed, the delisted companies reported under different governance/disclosure regimes, namely King 1, King 2, JSE rules and King 3. There were 4 cases (Other) where the delisted companies did not report under any specific or clear code and this appears because they had dual listings on other international bourses and may not have followed local South African governance and disclosure requirements.

<table>
<thead>
<tr>
<th>Governance code or JSE rule</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Other</td>
<td>4</td>
<td>1.7%</td>
</tr>
<tr>
<td>King 1</td>
<td>70</td>
<td>28.9%</td>
</tr>
<tr>
<td>King 2</td>
<td>32</td>
<td>13.2%</td>
</tr>
<tr>
<td>JSE rule</td>
<td>126</td>
<td>52.1%</td>
</tr>
<tr>
<td>King 3</td>
<td>10</td>
<td>4.1%</td>
</tr>
<tr>
<td>Total</td>
<td>242</td>
<td>100%</td>
</tr>
</tbody>
</table>

5.1.4 Financial data: Company characteristics
The size and profitability of the population are reflected below. It was extracted from BFA
MacGregor’s database module of summarized financial data at 31 December each year in the year preceding delisting. The negative numbers for Net Tangible Assets are due to intangible assets being written off Net Assets. Profit to Ordinary and Preference shareholders reflects income attributable to shareholders after repayment of loan interest. Market Capitalization is a reflection of both size and profitability, being number of shares in issue multiplied by the market price at the calendar year-end before delisting. There is high variability in size and profitability for companies that delisted.

Financial Data - Firm Characteristics: Summary Statistics

<table>
<thead>
<tr>
<th>Variable</th>
<th>mean</th>
<th>st.dev.</th>
<th>min</th>
<th>max</th>
<th>n</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Assets</td>
<td>483,389</td>
<td>1,384,575</td>
<td>-803,929</td>
<td>15,029,000</td>
<td>233¹</td>
</tr>
<tr>
<td>Total Assets</td>
<td>2,659,293</td>
<td>16,745,817</td>
<td>23</td>
<td>220,067,000</td>
<td>233¹</td>
</tr>
<tr>
<td>Profit before Interest and Tax (EBIT)</td>
<td>141,255</td>
<td>410,880</td>
<td>-334,852</td>
<td>4,519,000</td>
<td>233¹</td>
</tr>
<tr>
<td>EBITDA</td>
<td>174,265</td>
<td>457,098</td>
<td>-325,834</td>
<td>4,841,000</td>
<td>233¹</td>
</tr>
<tr>
<td>Profit to Ordinary and Preference Shareholders</td>
<td>49,327</td>
<td>238,346</td>
<td>-1,280,800</td>
<td>1,512,000</td>
<td>233¹</td>
</tr>
<tr>
<td>Market Capitalisation</td>
<td>1,262,104</td>
<td>3,223,066</td>
<td>375</td>
<td>25,933,818</td>
<td>241²</td>
</tr>
</tbody>
</table>

Note 1 - Total population of companies (242) minus companies where BFA MacGregor database did not provide summarized financial data (8), minus the asset backed security that arose out of an unbundling and which delisted because it did not meet JSE listings requirements (1) = 233 above.

Note 2 – Total population of companies (242) minus company that did not have market capitalization data (1) = 241 above.

5.1.5 Company characteristics: Board data

Descriptive statistics about the boards of the delisted companies appear below. The number of independent directors (adjusted) relates to all the delisted companies that disclosed their number of outside directors and also includes those boards where there was no disclosure of outside directors and which is proxied as zero (due primarily to absence of disclosure rules on governance disclosure at time of delisting, notwithstanding the governance rule requirement which recommended the presence of outside directors on boards).
Firm Characteristics - Board Data: Summary Statistics

<table>
<thead>
<tr>
<th>Variable</th>
<th>mean</th>
<th>st dev</th>
<th>min</th>
<th>max</th>
<th>sum</th>
<th>n</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board size</td>
<td>7.29</td>
<td>2.91</td>
<td>2</td>
<td>16</td>
<td>1691</td>
<td>1692</td>
</tr>
<tr>
<td>Non–executive directors</td>
<td>4.50</td>
<td>2.29</td>
<td>0</td>
<td>14</td>
<td>1007</td>
<td>2242</td>
</tr>
<tr>
<td>Independent directors (adjusted)</td>
<td>1.64</td>
<td>1.99</td>
<td>0</td>
<td>8</td>
<td>380</td>
<td>2323</td>
</tr>
<tr>
<td>Independent directors</td>
<td>2.88</td>
<td>1.84</td>
<td>0</td>
<td>8</td>
<td>380</td>
<td>1324</td>
</tr>
<tr>
<td>Executive directors</td>
<td>2.80</td>
<td>1.46</td>
<td>0</td>
<td>8</td>
<td>628</td>
<td>2242</td>
</tr>
</tbody>
</table>

Note 1 – Total population of companies (242) minus companies that did not disclose their board size nor any information on the category of their directors in terms of executive, non-executive or independent director, in their annual reports (9) minus the asset backed security that arose out of an unbundling and which delisted because it did not meet JSE listings requirements (1) = 232 above.

Note 2 – Total population of companies (242) minus companies that did not disclose their board size nor any information on the category of their directors in terms of executive, non-executive or independent (9), minus the asset backed security that arose out of an unbundling and which delisted because it did not meet JSE listings requirements (1) minus companies that did disclose their board size but did not disclose information on the category of their directors in terms of executive, non-executive or independent director (8) = 224 above.

Note 3 – Total population of companies (242) minus companies that did not disclose their board size nor any information on the category of their directors in terms of executive, non-executive or independent, in their annual reports (9) minus the asset backed security that arose out of an unbundling and which delisted because it did not meet JSE listings requirements (1) and where no information has been disclosed on the number of independent directors, this has been proxied as 0 = 232 above.

Note 4 – Total population of companies (242) minus companies that did not disclose any information on the number of independent directors on the board (110) = 132 above.

Information on the independence of the board is reflected below. Pure independence relates to the percentage of outside or independent directors on the board as a whole i.e. outside directors divided by board size.

King independence relates to the percentage of the board that are non-executive directors, whether affiliated or independent, as a percentage of board size.

Firm Characteristics – Board Independence Data:

<table>
<thead>
<tr>
<th>Variable</th>
<th>Mean %</th>
<th>st dev</th>
<th>min</th>
<th>max</th>
<th>sum</th>
<th>n</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pure Independence</td>
<td>35%</td>
<td>0.20</td>
<td>0</td>
<td>80%</td>
<td>46</td>
<td>1321</td>
</tr>
<tr>
<td>King Independence</td>
<td>60%</td>
<td>0.20</td>
<td>0</td>
<td>100%</td>
<td>135</td>
<td>2242</td>
</tr>
</tbody>
</table>

Note 1 - Total population of companies (242) minus companies that did not disclose any information on the number of independent directors on the board (110) = 132 above.

Note 2 – Total population of companies (242) minus companies that did not disclose their board size nor any information on the category of their directors in terms of executive, non-executive or independent (9), minus the asset backed security that arose out of an unbundling and which delisted because it did not meet JSE listings requirements (1) minus companies that did disclose their board size but did not disclose information on the category of their directors in terms of executive, non-executive or independent director (8) = 224 above.
5.1.6 Company characteristics: Director experience

Descriptive statistics on director experience is tabled below. The experience of the board (sum) relates to the sum of all the outside directors’ experience factors for their age, degrees and number of other listed boards on which they serve/d. This variable relates only to those delisted companies where there is disclosure on outside directors i.e identifiable directors with curriculum vitae in either the annual report or BFA McGregor.

The experience of the board (sum adjusted) relates to all the outside directors experience factors as above, but the mean calculation includes all those delisted companies where no data is disclosed on the presence of outside directors i.e. proxied/interpreted as an absence/zero outside directors.

The experience of the average director relates to the sum of the board experience factors divided by the number of outside directors. Likewise, the experience of the average director (adjusted), is the average director experience but where the mean includes computation of where delisted companies have not disclosed their outside directors.

The remaining variables in the table relate to the average experience factor for individual directors as they pertain to age, number of degrees and number of other listed board seats.

| Firm Characteristics - Director Experience: Summary Statistics |
|-------------------|-------|-----|-----|-----|-----|
| Variable          | mean  | st dev | min | max | n  |
| Experience of board (sum) | 14.42 | 10.83 | 0   | 54  | 130  |
| Experience of board (sum adjusted) | 8.15  | 10.84 | 0   | 54  | 230  |
| Director experience average | 4.59  | 2.08  | 0   | 9   | 130  |
| Director experience average (adjusted) | 2.60  | 2.76  | 0   | 9   | 230  |
| Director average age category | 1.94  | 0.84  | 0   | 3   | 130  |
| Director average degree category | 1.41  | 0.77  | 0   | 3   | 130  |
| Director average board seats category | 1.24  | 1.05  | 0   | 4   | 130  |

Note 1 - Total population of companies (242) minus companies that did not disclose any information on the number of independent directors on the board (110) (including the 9 companies which did not disclose any details on board size and the unbundled asset backed security) minus companies that did disclose board size and number of independent directors but then did not reveal identity of independent directors with curriculum vitae for coding of experience (2) = 130 above.

Note 2 - Total population of companies (242) minus companies that did not disclose their board size nor any information on the category of their directors in terms of executive, non-executive or independent director in their annual reports (9), minus companies that did disclose board size and number of independent directors but then did not reveal identity of
independent directors with curriculum vitae for coding of experience (2), minus the company which was unbundled into an asset based security and then delisted (1) = 230 above

5.1.7 Premiums/discounts on delisting

The summary statistics for the premium or discount to market price at the time of delisting is tabled below. This variable is also binary coded as; - 0 for discounts or zero premium; and 1 where a positive premium is achieved.

<table>
<thead>
<tr>
<th>Variable</th>
<th>mean</th>
<th>st dev</th>
<th>min</th>
<th>max</th>
<th>n</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premium</td>
<td>16.62</td>
<td>34.48</td>
<td>-65.5</td>
<td>329</td>
<td>240</td>
</tr>
<tr>
<td>Premium (binary coded)</td>
<td>0.52</td>
<td>0.50</td>
<td>0</td>
<td>1</td>
<td>240</td>
</tr>
</tbody>
</table>

Note 1- Total population of companies (242) minus those companies where there was insufficient data to determine the premium on delisting (2) = 240.

Graphical view of the population and the variables

The above summary statistics reveal that the company population is highly varied and diverse. Scatterplots are scanned for any obvious patterns i.e. looking specifically at dispersion, number of outliers and concentration of data. The graphical results reflected below are for the total population of delisted companies where results for all cases, including where there is no disclosure of outside directors and which is proxied as zero experience (hence the existence of so many cases reflecting zero experience). Wide divergence in results appears, and at first glance a picture that experience and premiums may not be related.
A second graph of the population, excluding companies that do not disclose their outside directors, is reported below and again there appears to be little or very slight relationship between experience and premium.
Based on the above, it appears that the concept of a proxy of zero experience for companies that do not disclose their outside directors may not be appropriate. I investigate later by stratifying the population into companies that obtain positive premiums and those that obtain zero or negative premium.

**5.2 Hypotheses testing**

To establish whether there is an association between outside director experience and company value, I investigate whether;

- there is a positive relationship between value and outside director experience where value is defined as the dependent variable of premium to market price on delisting
Given the high variability in population results displayed above, I stratify the delisted population further into:

- Companies that achieve a positive premium on delisting versus those that obtain a zero or negative premium on delisting
- Companies that are driven to delist for different reasons i.e. ‘desired, failed or other’ reason for delisting
- Delisting values/premium of companies and how they are related to the nature of the industry in which they operate.

In each of the above different sub-populations, the outside director’s experience may feature differently in any potential relationship.

Additionally, as the different governance codes/listing rules change over the timeframe, companies were forced to have and disclose an increasing number of independent non-executive directors. The hypothesis is that if experience is valued by boards and shareholders, then the experience factor of the average outside director should increase as the number of outside directors on the board increases, as and when the governance codes and listing rules change. This is premised on the logic that if experience is not considered a valued attribute, then the experience factor of the average outside director remains the same, or even decreases as outside directors are added to the board.

**5.3 Empirical results**

I compare the means between the independent variable of both board and average individual director experience (for outside directors) as it relates to the two sub-populations of companies that delist with a positive premium versus those that delist with zero premium or negative premium. The hypothesis is that ‘better’ companies have ‘better
or more experienced’ outside directors. The results also show statistics about central tendency and dispersion.

It is also relevant to compare means between the two sub-populations of premium delisted versus zero/discount delisted companies to see whether larger companies or more profitable companies and those with greater market capitalization have different means of board and director experience, i.e. bigger companies and/or more profitable companies attract good directors and/or vice versa. If the results are consistent with the average means test above, it could point to covariance between possible independent variables i.e. company size, profitability and experience all move in the same direction and are related to value i.e. premiums on delisting.

If the comparison of means testing above yields expected results, a contributing factor could be the nature of the industry e.g. financial institutions may want more experienced directors than say IT companies. The average experience level by board and director should be considered for differences as this could point to an uncoded variable in director experience i.e. director industry experience as an important experience characteristic (and which would also support Papakonstantinou (2007).

Comparison of board and director experience means (for outside directors) as the changes in governance code or JSE listing requirements for board composition takes place over the nine years will also yield information on whether companies value experience.

Given that the above data has been stratified into two sub-populations i.e. companies that achieved a positive premium (1) on delisting and those that achieved a zero or discount on
delisting, the data results in two categories of binomial dependent variable. This lends itself to probit regression which is most appropriate when you want to estimate the effects of one or more independent variables on a binomial dependent variable.

5.3.1 Comparison of means (for premium companies versus zero/discount delisted companies)

The means of total board experience for the two sub-populations of companies that delist with a premium and those that delisted at zero/discount are compared as follows:

### Analysis of Means for Experience of Boards, between Premium Companies and Zero/Discounted Delisted Companies

<table>
<thead>
<tr>
<th></th>
<th>Premium 0 = zero/discount</th>
<th>Premium 1 = premium</th>
</tr>
</thead>
<tbody>
<tr>
<td>Variable</td>
<td>mean</td>
<td>st dev</td>
</tr>
<tr>
<td>Board size</td>
<td>5.98</td>
<td>2.48</td>
</tr>
<tr>
<td>Experience of Board (sum)</td>
<td>8.97</td>
<td>8.20</td>
</tr>
<tr>
<td>Experience of Board (sum adjusted)</td>
<td>3.19</td>
<td>6.49</td>
</tr>
<tr>
<td>Board size</td>
<td>8.37</td>
<td>2.80</td>
</tr>
<tr>
<td>Experience of Board (sum)</td>
<td>16.67</td>
<td>11.03</td>
</tr>
<tr>
<td>Experience of Board (sum adjusted)</td>
<td>12.68</td>
<td>11.97</td>
</tr>
</tbody>
</table>

Note 1 - Total population of companies (242) minus companies that did not disclose their board size nor any information on the category of their directors in terms of executive, non-executive or independent director in their annual reports (9), minus companies that did disclose board size and number of independent directors but then did not reveal identity of independent directors with curriculum vitae for coding of experience (2), minus the company which was unbundled into an asset based security and then delisted (1) = (107+123) = 230 above, and which cross-references to section 5.1.6 above.

Note 2 - Total population of companies (242) minus companies that did not disclose any information on the number of independent directors on the board (110) (including the 9 companies which did not disclose any details on board size and the unbundled asset backed security) minus companies that did disclose board size and number of independent directors but then did not reveal identity of independent directors with curriculum vitae for coding of experience (2) = (38+92) = 130 above, and which cross-references to section 5.1.6 above.

Note 3 - Total population of companies (242) minus companies that did not disclose their board size nor any information on the category of their directors in terms of executive, non-executive or independent director in their annual reports (9), minus companies that did disclose board size and number of independent directors but then did not reveal identity of independent directors with curriculum vitae for coding of experience (2), minus the company which was unbundled into an asset based security and then delisted (1) minus companies where premium/discount information was not available (2) per section 5.1.7 above = (107+121) = 228 in table above.

Companies that achieve a positive premium on delisting have a higher mean board experience of 16.67 compared to companies that delist at zero or a discount which have a total board experience of 8.97. The result is consistent for when companies (adjusted) that
have not disclosed their outside directors and where non-disclosure is proxied for no
outside experienced directors; i.e. Premium achieving delisted companies have a higher
mean experience level of 12.68 compared to 3.19. Also noteworthy is that the maximum
experience of a board (54) for premium companies is considerably higher than the
maximum score (35) for zero or discounted companies. This is likely due to the board size
being on average higher (8.3 directors) for premium companies than zero/discount
companies which have 5.9 directors. However, the large standard deviations also indicate
that experienced boards can be present on weaker companies, a fact that was borne out in
the director interviews. The conclusion to the above analysis of board total experience
between premium or better companies and zero/discount companies, is that there appears
to be a relationship where more experienced boards (with outside directors) are positively
associated with higher valued companies.

Whilst there appears a clear difference in the experience of the board between companies
that achieve a premium and those that do not, it is necessary to test the data to determine if
the differences are sufficiently large. I use two sample t tests with equal variances (refer
table results below). The null hypothesis is that there is no difference between premium
companies and discount companies. Using the two-sided test, I get t-statistics that are
clearly outside the acceptance range of +/- 1.96 from the t-distribution. This occurs for
both boards sum and boards sum adjusted with t-statistics of -3.882 and -7.307
respectively. Both of these are outside the +/-1.96 threshold and therefore board experience
is significant at a 1% level. As indicated above, this is also likely due to the positive
association of board experience to size of the board as indicated by the board size, which
has a significant t-statistic of -6.805.
Two-sample t test with equal variances for experience of board_sum by d_premium/discount

<table>
<thead>
<tr>
<th>d_premium/discount</th>
<th>n</th>
<th>mean</th>
<th>std err</th>
<th>std dev</th>
<th>95% confidence interval</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 = zero/discount</td>
<td>38</td>
<td>8.974</td>
<td>1.329</td>
<td>8.195</td>
<td>6.280 - 11.667</td>
</tr>
<tr>
<td>1 = premium</td>
<td>92</td>
<td>16.674</td>
<td>1.149</td>
<td>11.025</td>
<td>14.391 - 18.957</td>
</tr>
<tr>
<td>combined</td>
<td>130</td>
<td>14.423</td>
<td>.950</td>
<td>10.833</td>
<td>12.543 - 16.303</td>
</tr>
<tr>
<td>diff</td>
<td>-7.700</td>
<td>1.984</td>
<td></td>
<td>-11.625 - 3.775</td>
<td></td>
</tr>
</tbody>
</table>

Diff = mean (0) – mean (1)
Ho: diff = 0
Ha: diff < 0
Ha: diff ≠ 0
Ha: diff > 0
Pr(T<t) = 0.0001
Pr(|T|>|t|) = 0.0002
Pr(T>t) = 0.999

Degrees of freedom = 128

Two-sample t test with equal variances for experience of board_sum (adjusted) by d_premium/discount

<table>
<thead>
<tr>
<th>d_premium/discount</th>
<th>n</th>
<th>mean</th>
<th>std err</th>
<th>std dev</th>
<th>95% confidence interval</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 = zero/discount</td>
<td>107</td>
<td>3.187</td>
<td>.627</td>
<td>6.485</td>
<td>1.944 - 4.430</td>
</tr>
<tr>
<td>1 = premium</td>
<td>121</td>
<td>12.678</td>
<td>1.088</td>
<td>11.969</td>
<td>10.523 - 14.832</td>
</tr>
<tr>
<td>combined</td>
<td>228</td>
<td>8.224</td>
<td>.719</td>
<td>10.859</td>
<td>6.807 - 9.641</td>
</tr>
<tr>
<td>diff</td>
<td>-9.491</td>
<td>1.299</td>
<td></td>
<td>-12.050 - 6.931</td>
<td></td>
</tr>
</tbody>
</table>

Diff = mean (0) – mean (1)
Ho: diff = 0
Ha: diff < 0
Ha: diff ≠ 0
Ha: diff > 0
Pr(T<t) = 0.0000
Pr(|T|>|t|) = 0.0000
Pr(T>t) = 1.000

Degrees of freedom = 226

Two-sample t test with equal variances of board size by d_premium/discount

<table>
<thead>
<tr>
<th>d_premium/discount</th>
<th>n</th>
<th>mean</th>
<th>std err</th>
<th>std dev</th>
<th>95% confidence interval</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 = zero/discount</td>
<td>107</td>
<td>5.981</td>
<td>.240</td>
<td>2.484</td>
<td>5.505 - 6.457</td>
</tr>
<tr>
<td>1 = premium</td>
<td>123</td>
<td>8.374</td>
<td>.253</td>
<td>2.803</td>
<td>7.873 - 8.874</td>
</tr>
<tr>
<td>combined</td>
<td>230</td>
<td>7.261</td>
<td>.192</td>
<td>2.911</td>
<td>6.883 - 7.639</td>
</tr>
<tr>
<td>diff</td>
<td>-2.393</td>
<td>.352</td>
<td></td>
<td>-3.085 - 1.699</td>
<td></td>
</tr>
</tbody>
</table>

Diff = mean (0) – mean (1)
Ho: diff = 0
Ha: diff < 0
Ha: diff ≠ 0
Ha: diff > 0
Pr(T<t) = 0.0000
Pr(|T|>|t|) = 0.0000
Pr(T>t) = 1.000

Degrees of freedom = 228

The above analysis considers the total value of experience for all the outside directors on the boards. I reperform the same analysis of mean experience as it pertains to the average individual outside director experience effect i.e. eliminating the number of outside directors or size of the board as being an influence on quantum of experience.
## Analysis of Means for Experience of a Director, between Premium Companies and Zero/Discounted Delisted Companies

<table>
<thead>
<tr>
<th>Premium</th>
<th>Variable</th>
<th>mean</th>
<th>st dev</th>
<th>min</th>
<th>max</th>
<th>n</th>
</tr>
</thead>
<tbody>
<tr>
<td>0=zero/discount</td>
<td>Experience of Director</td>
<td>3.53</td>
<td>2.42</td>
<td>0</td>
<td>8.5</td>
<td>38</td>
</tr>
<tr>
<td></td>
<td>Experience of Director (adjusted)</td>
<td>1.25</td>
<td>2.22</td>
<td>0</td>
<td>8.5</td>
<td>107</td>
</tr>
<tr>
<td>1=premium</td>
<td>Experience of Director</td>
<td>5.03</td>
<td>1.75</td>
<td>0</td>
<td>9</td>
<td>92</td>
</tr>
<tr>
<td></td>
<td>Experience of Director (adjusted)</td>
<td>3.82</td>
<td>2.64</td>
<td>0</td>
<td>9</td>
<td>121</td>
</tr>
</tbody>
</table>

Note 1 - Total population of companies (242) minus companies that did not disclose any information on the number of independent directors on the board (110) (including the 9 companies which did not disclose any details on board size and the unbundled asset backed security) minus companies that did disclose board size and number of independent directors but then did not reveal identity of independent directors with curriculum vitae for coding of experience (2) = (38+92) = 130 above, and which cross-references to section 5.1.6 above.

Note 2 - Total population of companies (242) minus companies that did not disclose their board size nor any information on the category of their directors in terms of executive, non-executive or independent director in their annual reports (9), minus companies that did disclose board size and number of independent directors but then did not reveal identity of independent directors with curriculum vitae for coding of experience (2), minus the company which was unbundled into an asset based security and then delisted (1) minus companies where premium/discount information was not available (2) per section 5.1.7 above = (107+121) = 228 in table above.

Again the result is that the mean experience of an outside director for a premium company is higher 5.03 and 3.82 versus 3.53 and 1.25 respectively, of a zero/discounted delisting company. Standard deviation is less than the means test above for the total board experience and the range between the maximum outside director experience differs only by 9 versus an 8.5 experience factor.

Whilst there appears a clear difference in the experience of the outside director for companies that achieve a premium and those that do not, it is again necessary to test the data to determine if the differences are sufficiently large. I use two sample t tests with equal variances (refer table results below). The null hypothesis is that there is no difference between premium companies and discount companies. Using the two-sided test, I get t-statistics that are clearly outside the acceptance range of +/- 1.96 from the t-distribution. This occurs for both the experience of the director and experience of the director (adjusted)
with t-statistics of -3.952 and -7.900 respectively. Both of these are outside the +/-1.96 threshold and therefore experience of a director is significant at the 1% level.

**Two-sample t test with equal variances for experience of a director by d_premium/discount**

<table>
<thead>
<tr>
<th>d_premium/discount</th>
<th>n</th>
<th>mean</th>
<th>std err</th>
<th>std dev</th>
<th>95% confidence interval</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 = zero/discount</td>
<td>38</td>
<td>3.529</td>
<td>.393</td>
<td>2.423</td>
<td>2.733 - 4.326</td>
</tr>
<tr>
<td>1 = premium</td>
<td>92</td>
<td>5.030</td>
<td>.183</td>
<td>1.751</td>
<td>4.667 - 5.393</td>
</tr>
<tr>
<td>combined</td>
<td>130</td>
<td>4.591</td>
<td>.182</td>
<td>2.078</td>
<td>4.231 - 4.952</td>
</tr>
<tr>
<td>diff</td>
<td></td>
<td>-1.501</td>
<td>.380</td>
<td>-2.252</td>
<td>-0.749</td>
</tr>
</tbody>
</table>

Diff = mean (0) – mean (1)
Ho: diff = 0
Ha: diff < 0
Pr(T<t) = 0.0001

Degrees of freedom = 128

**Two-sample t test with equal variances for experience of a director (adjusted) by d_premium/discount**

<table>
<thead>
<tr>
<th>d_premium/discount</th>
<th>n</th>
<th>mean</th>
<th>std err</th>
<th>std dev</th>
<th>95% confidence interval</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 = zero/discount</td>
<td>107</td>
<td>1.253</td>
<td>.215</td>
<td>2.220</td>
<td>.828 - 1.679</td>
</tr>
<tr>
<td>1 = premium</td>
<td>121</td>
<td>3.824</td>
<td>.240</td>
<td>2.641</td>
<td>3.349 - 4.300</td>
</tr>
<tr>
<td>combined</td>
<td>228</td>
<td>2.618</td>
<td>.183</td>
<td>2.765</td>
<td>2.257 - 2.979</td>
</tr>
<tr>
<td>diff</td>
<td></td>
<td>-2.571</td>
<td>.325</td>
<td>-3.212</td>
<td>-1.930</td>
</tr>
</tbody>
</table>

Diff = mean (0) – mean (1)
Ho: diff = 0
Ha: diff < 0
Pr(T<t) = 0.0000

Degrees of freedom = 226

Whilst the above still shows an association between more experienced outside directors and company value, eliminating the effect of number of outside directors could indicate that size and profitability of the company are possible drivers in getting experienced directors on the board. Therefore, I look at the difference in size, profitability and market capitalization between premium companies and zero/discounted companies as reflected in analysis of means below.
Analysis of Means for Company Financial Characteristics, between Premium Companies and Zero/Discounted Delisted Companies

<table>
<thead>
<tr>
<th>Premium</th>
<th>Variable</th>
<th>mean</th>
<th>st dev</th>
<th>min</th>
<th>max</th>
<th>n</th>
</tr>
</thead>
<tbody>
<tr>
<td>0=zero discount</td>
<td>Market Capitalisation</td>
<td>585,254</td>
<td>2,699,277</td>
<td>394</td>
<td>25,933,818</td>
<td>115</td>
</tr>
<tr>
<td></td>
<td>Total Assets</td>
<td>2,488,908</td>
<td>20,882,917</td>
<td>23</td>
<td>220,067,000</td>
<td>111</td>
</tr>
<tr>
<td></td>
<td>Profit before Interest and Tax (EBIT)</td>
<td>87,956</td>
<td>457,519</td>
<td>-334,852</td>
<td>4,519,000</td>
<td>111</td>
</tr>
<tr>
<td>1=premium</td>
<td>Market Capitalisation</td>
<td>1,849,453</td>
<td>3,525,646</td>
<td>375</td>
<td>22,084,880</td>
<td>124</td>
</tr>
<tr>
<td></td>
<td>Total Assets</td>
<td>2,832,964</td>
<td>11,928,996</td>
<td>637</td>
<td>128,697,000</td>
<td>121</td>
</tr>
<tr>
<td></td>
<td>Profit before Interest and Tax (EBIT)</td>
<td>189,239</td>
<td>359,805</td>
<td>-332,723</td>
<td>2,004,000</td>
<td>121</td>
</tr>
</tbody>
</table>

Note 1 – Total population of companies (242) minus company that did not have market capitalization (1) per 5.1.4 above minus companies where the premiums could not be calculated (2) per section 5.1.7 = (115 + 124) = 239 in table above.

Note 2 - Total population of companies (242) minus companies where BFA MacGregor database did not provide summarized financial data (8) per 5.1.4 above minus companies where the premiums could not be calculated (2) per section 5.1.7 = (111 + 121) = 232 in table above.

The results reflect high dispersion and range in assets, profitability and market capitalization for both premium and zero/discount companies that delist.

I test the data to determine if the differences are sufficiently large using two sample t tests with equal variances (refer table results below). Using the two-sided test, I get t-statistics that are not within the acceptance range of +/- 1.96 from the t-distribution for both total assets at $t = -0.156$, and profit after interest and tax (EBIT) at $t = -1.882$. However, for market capitalization the t-statistic is within acceptance range and significant at -3.095.

Two-sample t test with equal variances for company financial characteristics for market capitalisation by d_premium/discount

<table>
<thead>
<tr>
<th>d_premium/discount</th>
<th>n</th>
<th>mean</th>
<th>std err</th>
<th>std dev</th>
<th>95% confidence interval</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 = zero/discount</td>
<td>115</td>
<td>585,254</td>
<td>251,708.9</td>
<td>2,699,277</td>
<td>86,620.69 – 1,083,887</td>
</tr>
<tr>
<td>1 = premium</td>
<td>124</td>
<td>1,849,454</td>
<td>316,612.4</td>
<td>3,525,646</td>
<td>1,222,739 – 2,476,168</td>
</tr>
<tr>
<td>combined</td>
<td>239</td>
<td>1,241,157</td>
<td>207,743.8</td>
<td>3,211,641</td>
<td>831,905.3 – 1,650,408</td>
</tr>
<tr>
<td>diff</td>
<td>-1,264,200</td>
<td>408,486.3</td>
<td></td>
<td></td>
<td>-2,068,927 – -459,471.8</td>
</tr>
</tbody>
</table>

Diff = mean (0) – mean (1)  
$t = \mathbf{3.095}$

Ho: diff = 0  
Ha: diff < 0  
Ha: diff > 0  
Degrees of freedom = 237

Pr(T<t) = 0.0011  
Pr(|T|>|t|) = 0.0022  
Pr(T>t) = 0.9989

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Two-sample t test with equal variances for company financial characteristics for total assets by d_premium/discount

<table>
<thead>
<tr>
<th>d_premium/discount</th>
<th>n</th>
<th>mean</th>
<th>std err</th>
<th>std dev</th>
<th>95% confidence interval</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 = zero/discount</td>
<td>111</td>
<td>2,488,909</td>
<td>1,982,119</td>
<td>2.09e-07</td>
<td>497,576</td>
</tr>
<tr>
<td>1 = premium</td>
<td>121</td>
<td>2,832,965</td>
<td>1,084,454</td>
<td>1.19e-07</td>
<td>685,820.8</td>
</tr>
<tr>
<td>combined</td>
<td>232</td>
<td>2,668,352</td>
<td>1,101,756</td>
<td>1.68e-07</td>
<td>497,576</td>
</tr>
<tr>
<td>diff</td>
<td></td>
<td>-344,055.9</td>
<td>2,210,235</td>
<td></td>
<td>-4,698,953</td>
</tr>
</tbody>
</table>

Diff = mean (0) – mean (1)  \( t = -0.156 \)
Ho: diff = 0  Ha: diff < 0  Ha: diff > 0
Pr(T<t) = 0.4382  Pr(|T|>|t) = 0.8764  Pr(T>t) = 0.5618

Degrees of freedom = 230

Two-sample t test with equal variances for company financial characteristics for profit before interest and tax (EBIT) by d_premium/discount

<table>
<thead>
<tr>
<th>d_premium/discount</th>
<th>n</th>
<th>mean</th>
<th>std err</th>
<th>std dev</th>
<th>95% confidence interval</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 = zero/discount</td>
<td>111</td>
<td>87,956.27</td>
<td>43,425.79</td>
<td>457,519.1</td>
<td>1,896,548</td>
</tr>
<tr>
<td>1 = premium</td>
<td>121</td>
<td>189,239.3</td>
<td>32,709.55</td>
<td>359,805.1</td>
<td>124,476.7</td>
</tr>
<tr>
<td>combined</td>
<td>232</td>
<td>140,780.6</td>
<td>27,029.73</td>
<td>411,704.5</td>
<td>87,524.31</td>
</tr>
<tr>
<td>diff</td>
<td></td>
<td>-101,283.1</td>
<td>53,814.43</td>
<td></td>
<td>-207,315.3</td>
</tr>
</tbody>
</table>

Diff = mean (0) – mean (1)  \( t = -1.882 \)
Ho: diff = 0  Ha: diff < 0  Ha: diff > 0
Pr(T<t) = 0.305  Pr(|T|>|t) = 0.0611  Pr(T>t) = 0.9695

Degrees of freedom = 230

So the question is whether large, profitable companies are associated with more experienced directors i.e. covariance of possible independent variables.

The scatterbox diagram for market capitalization (which links both size and profitability) against all companies that disclose their outside directors based on the summarized reason for delisting i.e. ‘desired’ (taken over), or ‘failed’, or ‘other’ reason e.g. voluntary delisting or voluntary winding up. The scatterboxes below reflect that for companies that are desired (acquired or taken over) there does appear to be experienced boards broadly positively
related to market capitalization size.

For failed companies, i.e. where there was non-compliance or insolvency, the results are much less frequent and far more dispersed. However, the X axis scale range reaches a highest limit around aggregate board experience of 15 for failed companies, compared to the above where the X axis range of board experience is vast; – between 0 and 54 experience scale. This suggests that the independent variables of size, assets, market capitalization are related to the experience of the board and that there is quite likely to be correlation between independent variables when performing probit analysis. This consideration aligns consistently with the endogeneity problem identified in the literature, and mentioned by directors during interviews that good directors sit on the boards of good companies and vice versa.
The last scatterbox below reflects that board experience can vary considerably for other delisting reasons and that the number of these cases in the population is far fewer in occurrence compared to failed and desired companies.
Another independent variable that may be associated with director experience to varying degrees is the nature of the industry. The bar graph below reflects that the average board experience of outside directors does indeed vary depending on the industry that the company operates in. E.g. the aggregate board experience of outside directors in Electronics, media and telecoms, as well as Financial Services is higher than in Food or Support Industry services industries. I.e. that the extent of director experience as a contributing factor to company value is driven by the nature of the industry. This links in to the resource theory of the literature that the value of outside directors advice can be industry related.
In summary, the analysis of means indicates there is a positive association between company premium/value and director experience (in aggregate on the board or on average per outside director). However, there is also likely to be covariance between independent variables of market capitalization, size and profitability and experience. Finally, the nature of the industry appears to impact on the quantum of experience on the board and this lends support to the literature that industry experience matters, although this is not a director experience variable that was gathered for the purpose of this thesis.

5.3.2 Analysis of means when codes/rules change
Another analysis of means investigation is into how the advent of different codes or regulations over time has impacted the demand for director experience. i.e. The
experience factor of the average outside director increases on the board increases due to
countries/regulation that requires more outside directors on the board. The
hypothesis is that if director experience is not valued by shareholders, then as outside
directors are added to the board, the average experience level of the outside director will
decrease or remain static. With every change in code or regulation that requires an increase
in number of outside directors, if the average experience level increases then this may
indicate that outside director experience is valued by shareholders who elect directors to
the board.

The analysis of means results are tabled below. There were 4 companies that did not
follow a King or JSE governance code i.e. ‘None’ below; – these relate to foreign/dual
listed companies and where the disclosure was not clear.

<table>
<thead>
<tr>
<th>Code/Rule</th>
<th>Variable</th>
<th>mean</th>
<th>st dev</th>
<th>min</th>
<th>max</th>
<th>n</th>
</tr>
</thead>
<tbody>
<tr>
<td>None</td>
<td>Experience of Director</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>4²</td>
</tr>
<tr>
<td></td>
<td>Experience of Director (adjusted)</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>4²</td>
</tr>
<tr>
<td>King 1</td>
<td>Experience of Director</td>
<td>3.65</td>
<td>2.48</td>
<td>0.00</td>
<td>7.00</td>
<td>9¹</td>
</tr>
<tr>
<td></td>
<td>Experience of Director (adjusted)</td>
<td>0.55</td>
<td>1.60</td>
<td>0.00</td>
<td>7.00</td>
<td>60²</td>
</tr>
<tr>
<td>King 2</td>
<td>Experience of Director</td>
<td>4.45</td>
<td>2.61</td>
<td>0.00</td>
<td>8.50</td>
<td>20¹</td>
</tr>
<tr>
<td></td>
<td>Experience of Director (adjusted)</td>
<td>0.55</td>
<td>1.60</td>
<td>0.00</td>
<td>7.00</td>
<td>60²</td>
</tr>
<tr>
<td>JSE</td>
<td>Experience of Director</td>
<td>4.69</td>
<td>1.95</td>
<td>0.00</td>
<td>9.00</td>
<td>91¹</td>
</tr>
<tr>
<td></td>
<td>Experience of Director (adjusted)</td>
<td>3.44</td>
<td>2.67</td>
<td>0.00</td>
<td>9.00</td>
<td>124²</td>
</tr>
<tr>
<td>King 3</td>
<td>Experience of Director</td>
<td>4.87</td>
<td>1.68</td>
<td>2.75</td>
<td>7.71</td>
<td>10²</td>
</tr>
<tr>
<td></td>
<td>Experience of Director (adjusted)</td>
<td>4.87</td>
<td>1.68</td>
<td>2.75</td>
<td>7.71</td>
<td>10²</td>
</tr>
</tbody>
</table>

Note 1 - \(\sum (0+9+20+91+10) = 130\) companies that disclosed information on independent directors (agrees to 5.1.6 above).

Note 2 - \(\sum (4+60+32+124+10) = 230\) companies including the proxy for no director experience (agrees to 5.1.6 above).

The resulting analysis of experience means above, is reported in ascending order or timing
of change in code or regulation i.e.

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• King 1 where there was no specific guidance on number of outside directors, followed by

• King 2 which required ‘sufficient’ outside directors i.e. at least 1 outside director, followed by

• JSE listings requirement which endorsed King 2 and required ‘sufficient’ outside directors but at least 2 outside directors disclosed for audit and remuneration committees, followed by

• King 3 which requires at least 3 outside directors.

The outcome in mean average director experience, with each code or regulatory change, has been an increase in the average director experience level i.e. the mean experience for a director under King 1 was 3.65; for King 2 it was 4.45; for the JSE amendment the average experience increases to 4.69 and for King 3 it increases to 4.87. The same trend also occurs where there is absence of disclosure and a proxy for no experience i.e. a more conservative perspective that the average board director experience also increases with every new code or regulatory change.

The above results are consistent with the hypothesis and could mean that experienced directors are valued by shareholders, because as and when more are required to be added to a board the average experience level increases. Hence on this premise, outside director experience is perceived to be positively correlated to company value. The limitation to this analysis of means is however, the small sub-population size of delisted companies reporting under each new code or rule.
5.3.3 Probit regression

To assess the likelihood of a delisting resulting in a positive premium versus a negative or zero premium, under different variable configurations, I use the following probit regression model which reports marginal effects:

\[
\text{Likelihood ( } y_i = 1 \text{ )} = \Phi (x_i \beta),
\]

where \( y_i \) is the indicator variable that takes the value of 1 where a delisted company obtains a positive takeover premium, \( x_i \) is experience and the other independent variables, \( \beta \) are the variable configurations to be estimated and \( \Phi \) is the standardized normal cumulative distribution function. Using the marginal effects probit model we estimate our coefficients and read out of the table how a unit change of an independent variable affects the likelihood of positive premium - in percentages.

My right-hand side variables are company size and profitability, experience (adjusted), board size, independence, industry, code/governance rule and reason for delisting. In general, if there is a positive coefficient, it implies a positive association between the variable and the dependent y-variable i.e. a positive premium.

Probit regression – Table 1

Table 1 shows the results of a marginal effects probit regression of delisted company premium dummy on board experience which I code by adding/including no experience as zero if there was no information available on a director; size of the company as proxied by the natural log of net assets; the reason for delisting; board independence as measured by non-executive directors over board size (King independence), EBITDA, and code rule dummies. Robust z-statistics are in brackets. Asterisks indicate significance at 0.01(***), 0.05 (**) and 0.1 (*) levels.
Table 1 above shows that board experience has a positive and statistically significant impact on the likelihood of a positive premium. Further unreported probit regressions, using a non-binary board experience variable are consistent with the above. The reason for delisting is positively associated with delisting premium and is significant at the 1% level. Profitability (Ebitda) and company size (log of Net Assets) are also positively significant contributors.

Board size, the change in code or rule and independence appear not to be important variables as contributors to a changing marginal effect on premium. However, it is important to recognize that the delisting process requires independent directors to be

<table>
<thead>
<tr>
<th>Independent Variable</th>
<th>Dependent variable: Positive Premium Dummy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board experience dummy (adjusted)</td>
<td>0.230** 0.262*** 0.237** 0.254** 0.279** 0.348**</td>
</tr>
<tr>
<td></td>
<td>[2.387] [2.584] [2.133] [2.255] [2.278] [2.475]</td>
</tr>
<tr>
<td>Net Assets (log)</td>
<td>0.031*** 0.035*** 0.034*** 0.042*** 0.040*** 0.046***</td>
</tr>
<tr>
<td></td>
<td>[3.024] [3.304] [3.170] [3.616] [3.279] [3.302]</td>
</tr>
<tr>
<td>Delisting Reason 2</td>
<td>-0.721*** -0.721*** -0.716*** -0.723*** -0.744*** -0.774***</td>
</tr>
<tr>
<td>Delisting Reason 3</td>
<td>-0.425*** -0.413*** -0.410*** -0.423*** -0.424*** -0.396***</td>
</tr>
<tr>
<td>King Independence</td>
<td>-0.215 -0.199 -0.172 -0.183 -0.349</td>
</tr>
<tr>
<td></td>
<td>[-0.721] [-0.657] [-0.555] [-0.576] [-0.910]</td>
</tr>
<tr>
<td>Board Size</td>
<td>0.011 0.018 0.018 0.018 0.020</td>
</tr>
<tr>
<td></td>
<td>[0.568] [0.916] [0.907] [0.932]</td>
</tr>
<tr>
<td>Ebitda_10-9</td>
<td>-0.184*** -0.199*** -0.232***</td>
</tr>
<tr>
<td></td>
<td>[-2.007] [-2.080] [-2.084]</td>
</tr>
<tr>
<td>Code/rule 2</td>
<td>0.064 0.139</td>
</tr>
<tr>
<td></td>
<td>[-0.461] [0.926]</td>
</tr>
<tr>
<td>Code/rule 3</td>
<td>-0.183 -0.232*</td>
</tr>
<tr>
<td></td>
<td>[-1.455] [-1.670]</td>
</tr>
<tr>
<td>Code/rule 4</td>
<td>-0.124 -0.121</td>
</tr>
<tr>
<td></td>
<td>[-0.616] [-0.573]</td>
</tr>
<tr>
<td>Industry effect</td>
<td>No No No No No No</td>
</tr>
<tr>
<td>Observations</td>
<td>221 214 214 214 212 212</td>
</tr>
</tbody>
</table>
involved and this is possibly reflected in the premium variable outcome. Similarly, the changes in codes and rules relate mainly to increasing the presence of outside or independent directors on the boards and this may also be embodied in the premium variable.

*Probit regression – Robustness Test (Table 2)*

Table 2 below shows the results of a marginal probit regression of delisted company premium dummy on board experience; size of the company as proxied by the natural log of company Net Assets; the Reason for delisting; Board Independence as measured by non-executive directors as a percentage of the board (King independence). In this table (unlike above), I code experience as missing if I could not find any information about a director. Robust z-statistics are in brackets. Asterisks indicate significance at 0.01(***), 0.05 (**), and 0.1 (*) levels.

<table>
<thead>
<tr>
<th>Independent Variable</th>
<th>Dependent variable: Positive Premium Dummy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board experience (dummy)</td>
<td>0.224***</td>
</tr>
<tr>
<td></td>
<td>[2.640]</td>
</tr>
<tr>
<td>Net Assets (log)</td>
<td>0.012</td>
</tr>
<tr>
<td></td>
<td>[1.350]</td>
</tr>
<tr>
<td>Delisting Reason 3</td>
<td>-0.652***</td>
</tr>
<tr>
<td></td>
<td>[-2.781]</td>
</tr>
<tr>
<td>King Independence</td>
<td>0.010</td>
</tr>
<tr>
<td></td>
<td>[0.034]</td>
</tr>
<tr>
<td>Industry dummies</td>
<td>No</td>
</tr>
<tr>
<td>Observations</td>
<td>113</td>
</tr>
</tbody>
</table>

The probit regression table 2 above, shows that there are statistically significant results for positive marginal effects on premium when the company has at least one highly experienced director on the board. The reason for delisting is also a statistically significant contributor to a company achieving a premium. Board independence and size of company
do not appear to be significant effect contributors.

5.3.4 Summary of regression model results
The overall results from probit regressions’ reveal that there is a statistically significant positive association between board experience and premium on delisting. Other variables such as size of company, profitability and the reason for delisting are also significant contributing variables associated with a premium on delisting.

The implications of these results to the research hypothesis are several namely:

- Company value is positively and significantly associated with outside director experience
- Company value or premiums at delisting are also significantly associated with company size, profitability and the reason for delisting. How and if the outside directors experience is brought to bear at the time of delisting is gleaned through further investigation of a qualitative nature (i.e. interviews with experienced outside directors).
6 Qualitative research results

6.1 Overview of directors interviewed

I interviewed 31 directors, including one director who claimed not to have been involved with the company at delisting but who nonetheless commented on the process. Several directors had been involved in more than one delisting and provided input and contrasting of their different delisting experiences. Where more than one director had been involved in the same delisting this is noted below and information, where obtained from both directors, is used to corroborate events and responses. There were also instances where some highly experienced directors who had been through numerous delistings confined their answers to a select number of delisted companies being examined.

To protect confidentiality of director identity, a blind table of the directors interviewed, their experience, their companies and the premium is provided to the University of Manchester, but not within the body of this thesis.

Overall, the directors interviewed are highly experienced individuals with an average age of 57 i.e. a possible indication of real life experience in duration. The average interviewee holds 2 degrees, so is highly educated and frequently professionally trained (chartered accountant, lawyer, engineer). The average number of listed companies served on was 6 boards (excluding non-listed or subsidiary companies), which shows that the average director interviewed was knowledgeable about company structures, local governance codes, listing requirements etc. In total the directors interviewed collectively have exposure to over 150 listed companies across industries over a period of 10 years or more.
Hence any common statements or reflections are quite possibly or likely to be representative of listed corporate South Africa sentiment, values and behavior from senior people who have been exposed to the myriad complexities of the SA business environment and are confident in what they are talking about.

6.2 How do you define experience?

The interviews began with the question as to how the interviewee defined experience. The reasons for this question were several; setting the tone for the remainder of the interview; assessing any common attributes of experience to correlate with delisting events and the quantitative research variables; and also to detect any unusual or non-experience factors that are considered important or necessary for experience to be brought to bear in any given situation.

As per the literature review above, experience is defined by the Oxford Dictionary of English (2009) as ‘practical contact with and observation of facts and events – the knowledge or skill acquired by such means over time, especially that gained in a particular profession…’. Most directors answered the question directly, although there were nine who replied indirectly via their personal history being what they considered experience. There were many varied descriptions of experience and much of it related to the sources of experience, as well as the consequences or outcomes of having experience.

Those that defined experience used common phrases such as ‘Been there…done it’; ‘accumulation of knowledge over time’; ‘breadth’ / ‘matrix of inputs’ ‘relevant to business’; ‘practical and professional exposure’ and derivations thereof.

In describing sources of experience, reference was made frequently to having run a business, gone through difficult situations/crises/problems, being exposed to a large variety
of events, circumstances and business cycles that are relevant to business and the environment, and having sat on many boards. The variables for experience in the quantitative analysis includes age and number of boards that directors sit on, so there appears to be consistency in terms and variables between the interview research and the quantitative research.

In defining experience, directors frequently described the evidence of, or outcomes from having gained experience. These included increased understanding, impact on quality of judgment and decision-making (being able to contribute positively and problem-solve), the link between confidence and experience, and experience being necessary for dealing with conflict situations. The latter outcomes would be considered appropriate for an outside director to exhibit when going through a delisting.

Some added and unsolicited comments from several directors, that are relevant in the South African context was that with the need for black economic empowerment (BEE) there is an anomaly created in that inexperienced directors are being put on boards. One director went so far as to say ‘Experience required in the western world differs from that in the developing world because of the latter’s requirement for board diversity.’ These comments appeared throughout the interviews and the likely effect of this is that board sizes may be larger or growing over the time considered, and the average experience factor in the quantitative analysis may also possibly be affected adversely i.e. reduce as BEE (black economic empowerment) is implemented. This is because BEE directors who are classified as racially black would have been excluded from the mainstream education and the economy during the apartheid era. The predicted consequences of BEE director appointments for quantitative analysis are that positive effects of experience may be
neutralized by this socio-economic development. i.e. the positive relationship between experience and company value may be masked because boards are reacting to the socio-political changes.

In summary, whilst there were many descriptions of causes, outcomes and definitions of experience, in all cases the phrases used denoted that experience was considered a positive attribute for the workings of the board, input from a director and the welfare of the company.

**6.3 How did the outside director get appointed?**

This question was asked to establish how experienced directors are identified for boards and to assess how and if independence features.

Out of the 31 directors interviewed, there were only 4 occasions mentioned relating to over 60 delisted companies where a ‘headhunter’ or search company approached the interviewee about a prospective director position. In all other appointments, a major shareholder, chairman or an executive director knew the director. Phrases that were frequently heard was ‘he/she was ‘known’ from workings on another board’, or ‘known’ because they had worked together’, or had ‘been seen’ or ‘had a relationship with…’.

One of the two most experienced directors interviewed and who had had the benefit of over 40 years of director experience, said that South Africa has gone through a “‘bad patch’ when it comes to appointing independent directors. From the middle of the last century it was about ‘jobs for pals’ and positions were only ever offered to people you liked and knew. It was ‘never about experience, qualifications and abilities – you would never have been allowed in on this basis...it was about friends and connections. This has
stayed a problem for many boards, right up to the end of the 20th century. It is less so now when appointing non-black players.’

My interpretation of these responses on how directors were appointed is as follows:

• There has been gradual historical change as to how directors are appointed, moving from comfortable relationships to attributes such as experience and independence. This development is supported by the changing governance codes, company law amendments and JSE rules, all of which since 2002 have required increasing numbers of independent directors to be put on boards and/or serve on mandatory audit committees.

• The pool of potential independent, experienced non-executive directors in South Africa is small and limited.

• The South African business environment is closed and insular which supports the notion of weaker institutions compared to first world economies. It may be for this reason that board composition has to be regulated for the presence of independent non-executive directors.

• As most of these directors interviewed are highly experienced individuals, experience is valued as evidenced by it being recognized and desired by the company on whose boards they served.

• Experience of seats on the boards of other listed companies is valued.

• The other ‘resource components’ being an individual directors reputation/goodwill, relationships and connections/networks that goes with being a recognized director is prized by companies as an asset.

• The process theory of board operation dynamics emanates from people who know one another and may be relevant to adding company value.
However, there is another matter for consideration. If people are nominated to boards because they are known to a shareholder, have relationships with other directors already seated on the board, then there may be a question over their true independence, notwithstanding the changes in laws and codes requiring and defining independence. To what extent can these directors be free to add value by giving their unfettered advice to the company without fear or favor to their own personal reputations and relationships? Various directors, who are skeptical about ‘independence’ and whether it can ever truly exist, raised this matter several times during interviews. The implications for the research are that independence may or may not be a contributing factor for outside directors in the deployment of their experience to add to company value. Independence may also be contingent on the delisting scenarios noted below and where the sources of conflicts of interest arise. This is covered in the questions and answers that follow.
6.4 What experience of the outside director was valued?

This question was asked to ascertain the resource deficiencies on the boards and what would be considered value adding to the company.

The replies from the 31 directors could be classified into 5 main experience needs, being:

• Audit Committee – to serve as an independent non-executive director on the Audit Committee and which also necessitates accounting/financial knowledge – a recommendation from King 2 in 2002 and a JSE Listing requirement from 2003 and then a legal requirement from 2007

• Independence – A recommendation from King 2 in 2002 and then required by law from 2007. The above two requirements of independence and serving on the audit committee are inextricably linked and both requirements flow from governance codes and laws and regulations

• Experience. The categories of experience referred to by directors were largely threefold being: - Industry experience; Board experience; and Business/executive experience.

• Another category which was noted but which was not experience related pertained to BEE characteristics

• Other experience considered valuable but less frequently mentioned by the 31 directors was regulatory/legal experience and merger and acquisition experience (3 mentions). This correlates well with directors’ comments throughout the interviews that legal and technical expertise can be ‘bought’ in by a company.
The above responses from interviewees are summarized in the table below:

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<th>Directory</th>
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<th>Audit Committee</th>
<th>Experience Board</th>
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Interestingly, the top half/15 of the directors (i.e. with experience ratings of 8 and above) all mentioned that they were valued for their audit committee experience and/or independence. There were 3 exceptions in this top 15 directors and that was 1 director who spoke of his ‘international and big business’ experience, another of his industry and board experience and the third who was a BEE director who had had executive experience running his own businesses. The other noteworthy characteristic of the top 15 directors was that they all, (with the exception of 1 director who was a retired audit partner and recruited to run the audit committee) spoke about their ‘experience’ that was valued. This experience originated across the spectrum from industry experience and/or business experience and/or other board experience.

Of the remaining 16 out of 31 directors interviewed, their experience that they considered valuable was also linked foremost to the need to fulfill regulatory and governance codes pertaining to audit committees and independence requirements, with 9 of these directors fulfilling this requirement. For the remaining 7 directors, their experience attributes were seen by 4 of them as board, business and industry experience. The last 3 directors stated that they were appreciated mostly for their ‘governance’ experience; for being a BEE or transformation director and one director stated that he/she was not valued but appointed in the hope that government contracts could be won.

Of the total population of 31 directors, 7 of these directors could be classified as BEE appointees. Of these 7 directors, 2 fell into the top 15 most experienced directors, one by virtue of having been a professional non-executive director and exposed to many boards, and the other by virtue of having been an executive plus exposure to other boards. Of the 5 less experienced BEE directors, they considered their value to emanate from in one case
running a successful business, two cases of industry and professional exposure, one case of independence and the least experienced director for government connections. It is noteworthy at this point to mention that whilst almost all interviewees were appreciative of the legacy issues from apartheid and saw the economic and moral needs for this to be redressed i.e. in North’s language – ‘to keep the social peace’, there were several unsolicited comments from this question and other questions about BEE directors not contributing at board meetings and not being sufficiently experienced to do so.

I assess the above experience attributes that was sought after by companies as follows:

• The directors interviewed are generally highly experienced and that they were sought after for the attributes of experience and/or independence. In addition, for the quantitative analysis the director attribute coding for number of boards and qualifications is correct. However, two experience variables for industry experience and business experience may be missing. It is possible that the age variable recorded could proxy for business and variety of experience, but not so for industry experience.

• It is legal and regulatory changes that are likely to have caused the appointment of these directors for the purpose of independence and audit committee functioning, and the benefits to be derived from experience may have been a secondary consideration. However, it must also be noted that there was a natural bias in the directors interviewed to be members of audit committees because access to interviewing outside directors relied heavily on the researcher using her auditing firms relationship base.

• There is further qualitative information that appointment of BEE directors can weaken the board’s resource base for advice.
6.5 Background to and reasons for delisting

One of the features of a semi-structured interview method is that interviewees can provide additional information. Although no reason was asked for delisting (as the quantitative research provided a description), most directors wanted to provide an explanation and context for the delisting. These were noted and summarized as they may reveal consistency or inconsistencies in what experience is considered relevant or other pertinent factors.

In South Africa there is numerous legislation impacting public company mergers and acquisitions. The law firm Edward Nathan Sonnenbergs published a guide as part of The International Comparative Legal Guide to Mergers and Acquisitions 2009 that contains information relating to mergers and acquisitions of public companies and extracts are summarized below. In general these are the Companies Act, 61 of 1973 (thereafter the Companies Act, 71 of 2008 effective from 1 September 2011), the Securities Regulation Code on Takeovers and Mergers (the SRP Code), the JSE Listing requirements (Listing Requirements), the Securities Services Act, 36 of 2004 and the Competition Act, 89 of 1998.

The Companies Act scope is vast and covers the laws relating to acquisitions by way of share buy-back, level of shareholder approval where a company disposes of most of its assets, court sanctioned schemes of arrangement for acquisitions, shareholder meetings, and prohibitions against oppression of minorities. The SRP Code regulates shareholder protection in takeovers and is very similar to UK City Code on takeovers and mergers e.g. all shareholders are treated fairly and equally, and that all shareholders are exposed to competing offers. The SRP is also enforceable through the South African courts.
There are alternate mechanisms for an acquisition. The Schemes of Arrangement in terms of section 311 of the Companies Act, 1973 requires support of the target company, acceptance of the offer by 75% of scheme members present and voting at the scheme meeting, and court approval. Under section 440 of the Companies Act a takeover offer/general offer can be made to every shareholder and without approval from the board. No shareholder meeting is required to approve the s440 offer. Where the offer is accepted by 90% of the shareholders it is binding, and the bidder can but is not obliged to acquire the remaining 10% shares. Under section 228 if a company sells the majority of its assets or enterprise it must get 75% shareholder approval (pre 2008 - 50%) in general meeting.

Based on these mechanisms, it can be seen that friendly take-over’s with the support of the board are done via scheme of arrangement, and hostile bids use the s440 route. It is also apparent that under the latter mechanism, voter apathy works against the bidder, but will work in favor for an acquirer under a s311 scheme of arrangement offer.

The JSE requires whenever a delisting is proposed that there are protections for the minority shareholders. As per the Deloitte summary of JSE listing rules, “In addition to the circular to shareholders, the issuer must seek shareholder approval for the delisting. While the process is simply via a general meeting of shareholders, at least half of the votes cast (excluding those of the controlling shareholder) must be in favor of the delisting. Further, an “appropriate” offer must be made to all shareholders. Such an offer is required to be supported by a Fair and Reasonable Opinion. This requirement allows the minorities to dispose of their shares at a reasonable price. The price must be certified as being fair by an independent expert”. The Fair and Reasonable opinion is usually provided by independent advisors appointed by the boards sub committee (Investment Committee) who are constituted to oversee the offer process before it reaches the board for approval and
prior to submission to shareholders for approval. It is interesting to note that Edward Nathan Sonnenberg commented that a difficult question which has never been decided in court is whether “directors could undertake not actively to seek alternative offers if they believed that the target company would lose an attractive offer if they failed to do so.”

From the JSE rules it appears then that a role for the independent non-executive serving on the Investment Committee at the time of offer is to ensure that the proper governance process is followed i.e. appointment of advisors, proper process followed and presenting the advisors ‘fair and reasonable’ valuation report to the board for approval. The experience of the outside director may facilitate the process, but ultimately the decision rests with the board and the shareholders. There appears to be no onus on the independent non-executive director to negotiate or seek a more favorable price for minorities, but merely to ensure that the protections are properly in place. Legally this is correct, as a director’s role and duties entails acting in the interest of the company, and not for any class or group of shareholder (whether it be a major shareholder, minority shareholders or staff share scheme). This matter is relevant to the research because it clarifies that the outside director’s primary duty is to the company and only thereafter to ensure that minorities are not being prejudiced against by other shareholders, or management. From the quantitative perspective, it may or may not be the outside directors experience at the time of negotiating that is being analysed but also the relationship he/she has had during his/her appointment period and how it has added value to the company up to the point where the board collectively accepts or rejects an offer. The simplest relationship that we are seeking is that quantitatively those companies that are taken over at a premium have more experienced outside directors, than those who do not. Or those companies that failed did not have experienced non-executive directors compared to those companies where value was seen and a premium was paid for control. From an interview perspective, we are
looking for sentiments that affirm the positive factor of experience in enhancing company value.

In general, the outside directors interviewed faced several reasons, mechanisms and circumstances for delisting and many referred to the conflicts of interests that had to be managed in different scenarios i.e.

- The listed companies shares were acquired through private equity and/or management buy-out.
- An existing majority shareholder (greater than 50% holding), or a major shareholder (less than 50%) wanted to divest/sell its investment for whatever reason e.g. non-core, cash required etc to another company who do not want minority shareholders.
- An existing majority or major shareholder wanted to acquire the shares held by the other and/or minority shareholders.
- Two listed companies wished to merge their businesses, retain one listing and delist one of the entities.
- The board or shareholders wanted to delist the company for some or other reason and become private e.g. the high costs of staying listed, trading at a discount to NAV (underperforming company), unbundling and not having a buyer of the company.
- The company has had problems and needs to be liquidated or wound up, or is delisted following non-compliance to JSE rules, or following continuous suspensions.

The interviewees spoke about delisted companies that spanned all of the above mechanisms and circumstances of delisting; - private equity, scheme of arrangement, buy-out of minorities, delisting for other reasons such as listing costs, unbundling of under-performing assets and liquidations. There were 4 examples of failed companies and these included two cases of executive director fraud, one case of insolvency, and another of a run
on a bank. Interestingly, in two delisted companies where there was executive director fraud/misdemeanor the outside directors were highly experienced. The outside director from the bankrupt company was very inexperienced, by his/her own admission.

6.6 The roleplayers, process and behaviors at delisting

The process of conducting semi-structured interviews revealed interesting and varied observations from the directors. What became apparent was that each delisting event was a ‘story’ in its own right. The questions relating to the role of the board, the contributions by the different types of directors, style and behavior of board operations, reactions to information presented and board teamwork, yielded replies that were interlinked, contingent upon the reasons for delisting and the context (i.e. environment, company characteristics, shareholders and board individuals) in which the delisting occurred. i.e. multi-faceted. For this reason, all the results from the above questions have been summarized into the individual directors ‘stories’ and the key observations and learnings extracted from each. Where similar types of transactions took place, they have been grouped together i.e.

- Private Equity (PE);
- Management buy-outs (MBO);
- Delistings initiated through sale/disinvestment by an existing major shareholder to a third party (DI);
- Acquisition/Buy-out of minority shareholders by an existing shareholder under Section 311 (Acq);
- Forced buy-out of minority shareholder under Section 440 (Hostile);
- Failed listings due to liquidation and insolvency, contravention of JSE rules or following continuous suspensions;
• Mergers (M);
• Other delisting reasons- e.g. unbundlings, and preemptive shareholder takeover rights

Thereafter, commonalities, themes and unusual matters are identified, commented on and related back to the literature and quantitative results. The directors interviewed, companies concerned, type of delisting and premiums obtained are summarized in a blind table presented to the University of Manchester, but is not reported here so as to protect director confidentiality.

6.6.1 Delistings: Private equity (PvtE)

Amongst the directors interviewed, there were at least 5 delistings as a result of a private equity buy-out of shareholders. The distinguishing features of private equity are that management is usually retained after the take-over, and gearing is high because management do not have the funding to achieve a management buy-out, particularly where it is a large company. The directors interviewed and nature of the private equity companies are summarized in a blind table presented to the University of Manchester. To protect confidentiality of director identity this table is not reported in this thesis.

Private Equity Delisting 1 (PvtE1)

At Private Equity Delisting 1 (PvtE1), one of the most experienced directors in the interview group, explained how after retiring, he was approached by his previous employer to be a non-executive director of a large enterprise where the group/his previous employer had a major but not majority shareholding. He was tasked with ensuring that the subsidiaries and investments were ‘responsibly put to bed’. This included ‘putting together the board’ by selecting via interview and screening appropriate director candidates for the company. One of the criteria for the board was that it had to be balanced in terms of colour
and gender. A ‘good’ board was formed after headhunting an international CEO with industry expertise, and choosing the appropriately experienced chairman of the audit committee (who was also interviewed and corroborated what was said in this interview), as well as the best possible mix for diversity requirements i.e. previously disadvantaged black individuals and women. The latter were chosen based on their business and industry experience, or legal knowledge, or leadership in civil society. The director interviewed said that they had a good board but that there are too few experienced directors to satisfy all the boards who need them. He also mentioned that experience in merchant banking, mergers and acquisitions is valuable experience because it gives a good rounding to the boards mix of competencies.

Everything went well at the company (Pvt E1), but they did not have a ‘shareholder of reference’ i.e. a majority shareholder to turn to for advice, support and funding, and the shares were widely dispersed. The board looked at various private equity options as well as a management buy-out (which management could not afford as it was a large company). There was a focused process and a special committee of the board was formed to deal with the options. The role of the board was ‘one of support and getting access to a major shareholder’. The interviewee stated that the independent directors played an important role in probing and questioning the information. They played a significant role in discussions and decisions and carried a lot of responsibility. The executive directors also played a large role, and allegedly did not act in a self-interested manner. They also probed and questioned the information. The amount of time and effort that was spent by the non-executive directors was ‘ridiculous’ compared to the fees they earned. The interviewee said that non-executive directors are ‘not remotely rewarded’ for the risks and
responsibilities they shoulder. In summary, the delisting occurred because the company wanted a 100% shareholder.

A second director from PvtE1 was also interviewed. His interview corroborated the above experienced directors information. Some added comments were that; ‘the board was talented and independent’. During the process, one ‘could not distinguish between the executive, non-executive and independent directors’. ‘Assuming there is integrity on the board, skills and experience are more important than independence. ‘This is becoming increasingly relevant with BEE appointments where the skillsets and experience are not that good, and this is the era we are moving into.’ The interviewee also stated that notwithstanding skills and experience, a non-executive director is only as good as the information that he/she is provided with, and also needs the opportunity to question and discuss information. ‘In this delisting it was a great deal for the shareholders (greater than 50% premium on market price) because the market subsequently turned against private equity after the take-over’.

*Private Equity Delisting 2 (PvtE2)*

At Pvt E2, another experienced director spoke of the take-over of a company by a private equity firm. He was an independent director but approached to be on the board by a group of which he was a non-executive director, and which held a minority shareholding. This director remarked that at a listed company it is useful to have several outside directors including one or two who understand the business.

An offer was made and the process was relatively simple for the board. An independent sub committee was formed and the auditors were used to get an independent ‘fair and reasonable’ opinion on the valuation and price. There were conflicts in that the executive
directors were involved and would retain a small shareholding in the delisted company. There was reliance on the independent non-executive directors to apply their minds and have their own independent view. There was a discussion on offer price, net asset value and market price. It was as though the independent directors were acting for the minority shareholders. But because of the process involved (sub committee and independent valuations) and the fact that it was a listed company, ‘the role of the board was largely done’. It was noted that the offer was concluded at a premium in excess of 40% to market price for the shareholders.

*Private Equity Delistings 3 and 4 (PvtE3 and PvtE4)*

The third and fourth private equity (Pvt E3 and PvtE4) transactions, as evidenced by another outside director were also in the era of private equity, where buy-outs with management were involved. ‘The boards had to fill the gap on objectivity and independence when evaluating the offers and were very active.’ ‘They had sub-committees’ of the board comprised of independent directors. The role of the executive directors was ‘huge in that they had to put together the numbers, evaluate, liaise and look at the sustainability of the organization and report to the sub-committees’. The non-executives had to interrogate the outcomes and compare it to third party evaluations.’ The interviewee stated that; ‘The problem is that the executive directors know the numbers intimately and you do rely on managements views. Third party independent valuations and advice is needed as management have the upper hand.’ ‘Independent non-executives are crucial as they have no financial interest. Their views hold and sway the board’s decision. They have the determining vote. There are always conflicts and you have to be aware of them.’ Pvt E3 was the ‘friendliest of the lot as the executive directors were getting money and being paid out. However, in the end the final decision by the board was unanimous. By
the time you go through all the arguments you come to a common view in the end. ‘A strong chairman is important and strong directors with experience helps a lot.’ The interviewee stated that the delisting involving Pvt E4 ‘did not have experienced directors and this was a hindrance. Board experience is important’.

Delisting Private Equity (Pvt E5)

The last example of a private equity transaction was with a small, IT company where shares were held by the founders and executives. The interviewed director relayed his story as follows: The company had successfully expanded internationally. The company was prosperous overseas, but the local operations failed and were shutdown. Attempts were made to delist the company locally but the JSE Ltd would not agree. In addition, ‘the local investors did not understand the business’. There were two other institutional investors, one South African and the other foreign, who each held a major but not controlling percentage of the shares. The foreign shareholder tried unsuccessfully to take over the company and failed and disinvested. The South African investor did not want to increase their shareholding unless they could put two more members on the board. The CEO found two international private equity firms who were interested in buying the company. There were 2 independent directors on the board who interacted extensively with the executive directors and were respected by the executives. The board was very active and worked extremely closely during the various corporate actions. During the delisting the independent directors were acting for all the shareholders, particularly the minorities. Management were ‘fair and realistic. The whole board was aligned’. The transaction concluded at a more than 100% premium to shareholders and the company continues to be successful today.
Comments on delisting due to Private Equity take-overs

The private equity buy-outs in these interviews all resulted in the minority or other shareholders getting substantial premiums. The interviewees generally distinguished between the roles of the executive and non-executive directors, but less emphatically the differences in the roles between the independent non-executive and the affiliated non-executive director. This may be attributable to the fact that in private equity transactions it is the executive directors and management who are conflicted, and not the affiliated non-executive who is likely to have similar vested interests and goals as the outside independent non-executive directors. The role of the executive directors and management and the reliance on them for the correct information in a conflicted position was nonetheless noted.

The characteristic of experience was mentioned as important e.g. business and industry experience as well as the necessity to constitute a ‘good board’ with the right skills and experience as in Pvt Eq1, or the difficulties that arise when outside directors are not experienced as in PvtE4. Concern over the lack of experience arising due to BEE appointments was also noted.

The characteristic of independence was identified as less important than experience and also as not being clearly distinguishable in one case. However, it is noteworthy that in two of the companies, the independent director, whilst being independent by definition, did in fact represent a particular shareholders interests. This was again noted in Pvt E5 where further investment in the company did not take place because non-executive directors could not be appointed to the board. These events point to the importance of non-executive directors as opposed to purely independent outside directors.
In all the delistings, it appeared that the outside director played an important role in the investment sub-committee as required by the JSE rules as well as in board deliberations, notwithstanding the commonality of purpose and alignment with affiliated directors interests. There was also the example of the JSE being a vigilant and well regulated exchange, and the relevance of the valuation process to protect other shareholders from the executive directors and management.

Other observations from these interviews are that:

- Non-executive directors are poorly paid. This begs the question whether their value in terms of experience and independence is appreciated by boards and shareholders
- The role of the independent advisors for the valuations is significant and this is a primary governance protection, other than the shareholders right not to support a transaction.

**6.6.2 Delistings: Management buy-out’s (MBO)**

From interviews with outside directors, there were at least 3 delistings due to management buy-outs (MBO) of the shareholders. The distinguishing feature about a MBO is that management use their own money to fund the acquisition. As a consequence, unless management has substantial wealth, many MBO targets are relatively small companies compared to private equity acquisitions. The blind table presented to the University of Manchester summarises the directors interviewed and their respective companies. To protect confidentiality of director identity, it is not reported here.
**Delisting MBO1**

The outside director described a scenario where he was the only independent director on a small board at an IT company. The board was conflicted – there being 4 executive directors, 3 non-executive directors and himself as the only independent director. He said that there were clear grounds to delist, being the expense of listing and the poor market conditions. The process of getting an independent opinion on the valuation by a reputable advisor was followed. There was ‘no team’ as the independent director was negotiating. He said that ‘all the information comes in and you do not really know… people forget that a non-executive director is not an executive director. You meet four times a year which is just short of never’. He would never take a position where there were greedy or dishonest top executives. The outside director said that the CEO was a ‘good, no-nonsense guy’ who had his views and had to be argued down. The board took the moral high ground, which was why there was a change in offer price to a premium of above 15% of market value. ‘And if everyone is somewhat unhappy it probably is a good transaction’.

**Delisting MBO2**

The second MBO2 took place in a scenario where the holding company held two subsidiary companies, one of which was a private equity business and not valued by the market at all. The board decided to delist the holding company and list the one subsidiary that had market acceptance. The interviewee relayed the delisting event as follows: The board’s role was to recommend to the shareholders the offer as being either a ‘right or a wrong offer’. The board structure was such that there were executive, non-executive and two independent directors. The ‘role of the executives was to propose an offer and for the independent directors to decide’. They underwent the standard process of setting up an investment committee comprised of the two independents, one of whom was invaluable
‘because he was so highly experienced’. They got two to three independent valuations because of the conflicted position of the executive directors. The style of the board was professional throughout, they were well prepared and the proceedings clear and transparent between executives and the independent directors. The executive directors behaved ethically throughout, were not involved in discussions and recused themselves from meetings. The non-executives views did not differ from the independent directors in terms of advice or valuations. The least favorable price in terms of valuations (premium of 19% to market price) was taken back to the executives who accepted the valuation, before it was put to shareholders. ‘The MBO was not contentious’.

**Delisting MBO3**

The company was a small entity in the financial services industry and executive management/family held over 90% of the shares. The interviewee said that the board decided to delist because there was little trading, no institutional shareholders, the high costs of remaining listed and no need to raise further capital. Other factors were the increasing regulations and BEE pressures. It was by ‘unanimous decision’ that the board decided to delist by allowing the existing executive directors to buy back the shares at a premium no greater than 10% of the 5 day weighted market price prevailing at the time of purchase. The biggest concern of the board was how to treat the minorities and for this they used advisors for a fair and reasonable opinion on the valuation. They did the valuation together, had important deliberations and made an offer that they thought fair relative to the market value. The final discount was at approximately 4% to market price at the time of the cautionary. Discussions with the outside director revealed that the company was small and did not have a sustainable business model.
Comments on delistings through MBO’s

It appears that MBO’s have similar features to private equity transactions in that it is the executive directors/management who are conflicted, and the non-executives and independent non-executives who are aligned in terms of objectives. The reliance on executive directors for information and the necessity for honesty and trust were again observed.

Experience was mentioned as valuable in one of the MBO’s, and the role of the independent directors for the investment committee and the process was also noted. Again, the process of relying on outside advisers for the valuation and fair and reasonable opinion appears to be the primary governance mechanism to protect minority or other shareholders. Independent directors are needed for the process and board deliberations.

6.6.3 Delistings: Sale of major shareholding by an existing shareholder (DI – Disinvestment)

Many delistings occurred through use of section 311 scheme of arrangements when an existing major shareholder, often with non-executive director representation on the board, sold their investment (disinvestment) to a third party and the third party made an offer to the other shareholders and minorities. In these circumstances, the reason for the shareholder to disinvest was relevant e.g. distressed selling, need for cash, non-core, political etc. The position of management in terms of conflict is often dependent on any share schemes and vesting rights or their future employment with a new shareholder – hence the executive directors may or may not be in favor of the transaction, but will certainly be impacted. That leaves the independent director to be the guardian of minority shareholders and possibly at odds with the affiliated non-executive directors on valuations. In the interviews, there were at least eight section 311 transactions where a major
shareholder disinvested or sold its stake to another party. Six of the companies operated in the financial services sector (insurance and banking) where human capital is important and retention of people relevant to the ongoing value of the company concerned. The other two companies were a construction company and an IT company. A blind table is presented to the University of Manchester which summarises the directors interviewed and the features of the delisted companies. To protect director confidentiality it is not presented in this thesis.

Ten of the independent directors interviewed had been exposed to a disinvestment and relayed their experiences. All of the delistings followed the required process of a sub-committee of the board obtaining expert, independent valuations. The key features and comments from interviewees for each delisting disinvestment is recorded below with commentary at the end.

*Delisting - Disinvestment 1(D1)*

The outside director interviewed explained that the insurance/financial services company was experiencing economic hardship with a failed American expansion. ‘It was too small to trade out of its problems and the shareholders had lost faith. The board had to find a way out of the impasse. The board played a large role. The executive directors were competent but conflicted as they were concerned about their jobs. The executive directors play a large role in getting the information, the non-executives have to interrogate it and the independent directors are crucial as they have no financial interest. The experience of the board is important. In this company the independents did not have the determining vote as the non-executives had a large say. But in the end the final decision was unanimous.’ The premium to market price was 1%.
Delisting - Disinvestment 2 (DI2)

The interviewee explained that the company had a major shareholder who did not see its shareholding in the insurance company as core business. They went to the market to assess offers. Another large insurance group wanted 100% of the company and made an offer. The board decided that the company would be better off with a stable shareholder who held a long-term view. ‘Companies these days are at the mercy of the asset managers. The major shareholder ‘did a deal with the offeror company’. The interests of the outside directors were minor other than safekeeping. Incumbent management had shares, jobs and vested interests. There was a process conducted by the independent directors, and a sequence of events followed. The committee of independent directors monitored the process and looked after the minority shareholders. The interaction was ‘fine’ and they reported to the board. All conflicted parties i.e. non-executive directors who represented the selling shareholder did not come to the board meetings. The price had to be negotiated, but there were not a lot of issues with a company of this nature, and because it was a shareholder decision and they were satisfied. ‘The final premium was 15% above market price.

Delisting- Disinvestment 3 (DI3)

Two directors provided their commentary on the third disinvestment. The company was a small financial services firm and considered too small to warrant a listing and there was not enough funding for a management buy-out. They wanted shareholders to get value and the staff not to be prejudiced. The first director said that in a delisting, the board’s role varies from company to company and is dependant on the requirements and the knowledge of the individual directors involved. Skills are more important than independence, because
conflicted parties e.g. management are taken out of the process. The first director said that in this transaction the independent directors pushed the process through, the ease of which depends on the directors and how affected they are at the time i.e. acting for the shareholders or themselves. The final premium was between 15 and 20% to market price.

The second director, who provided more insight into the conflicts and dynamics, corroborated the above experience. However, the teamwork was described as ‘dysfunctional’ and ‘messy’ because of an ‘involved chairman’ who had to be removed coupled with resignations by executives. It was a long process because they had to get the ‘corporate governance right’. There were conflicts between the staff and the shareholders – ‘so both infighting and outfighting’. As regards the non-executive directors there was resistance because they would lose their directorships, money and prestige. The director said that the independent committee cannot negotiate or approve the offer because it is the responsibility of the board. So the fair and reasonable valuation is the ‘safety net’ because independent advice cannot be influenced. ‘So long as you get within the valuation parameters it is ok.’ In this case the board initially rejected the information because ‘the fair and reasonable was split’ i.e. the offer was reasonable (relates to the non-quantitative factors) but the price was not fair (relates to market pricing). So the board also did its own ‘fair and reasonable’ and on the basis that they thought the company did not have a future, negotiated it into the right range.

As regards independence the director stated he did not think there was such a thing. He took legal advice at the time and in a transaction you cannot leave midway. One ‘will be judged as to how you applied your knowledge and experience and the simple test is;- can you explain it (but not in terms of the law)’. This was said in the context of a previous
comment ‘that people drifted towards compliance whether this made sense or not, and they think they can use this as a defense.’

**Delisting - Disinvestment DI4**

The interviewee explained that the company, which was in the financial services industry, was not looking to be bought. They had had ‘nibbles’ before and the industry was consolidating. Then they got a serious approach. The executives were conflicted with shares, jobs and potentially exiting with cash. The BEE shareholding directors were also conflicted, as was another trust director. It was only the three independent directors who were not conflicted and they formed the investment committee which was fully supported by the board, although did not make the decision. The director said that he was impressed by the integrity and behavior of the executive directors who were not in favor of the transaction. There was strong trust between the executive directors and the non-executive directors. The affiliated non-executive directors were supportive of those times when they were excluded from getting information even though it was frustrating for them to wait. The board operated well as a team, but found the length of the process and the number of regulatory requirements frustrating. Apart from the independent directors, no other directors had any relevant experience about the laws and complexity involved. It was very complex and the board appreciated that all three of the independent directors had had substantial mergers and acquisitions experience, and one of them extensive regulatory experience. They also appreciated that the lead independent director was well experienced to fill the role of the conflicted chairman. The director said that he thought they did well for the company, the shareholders, clients and staff – ‘it was an unimpeachable process’. The premium to market price was in the range of 4 to 20%.
**Delisting - Disinvestment DI5**

The director interviewed said that the delisting was driven by cost factors, increasing regulation and the South African Reserve Bank encouraging delisting by the smaller financial institutions. The board operated as a team and took the unanimous decision to delist as ‘it made sense’ to sell to another financial institution. It was ‘straightforward as a process was followed. There was a ‘fair and reasonable’ opinion from independent advisors. The independent non-executive directors ‘knew what they were doing and watched what was going on – you have to keep an eye on management’. The premium was 29% greater than market value and was considered the fair value at the time.

**Delisting - Disinvestment DI6**

One of the most experienced directors in the interview group spoke of his experiences at a bank where there was a run on the deposits (the institution had mismatched the timing of its deposits and lendings). The crises was described as ‘dramatic’ and that ‘seldom thereafter does an institution recover from suspicion.’ The directors were personally exposed in terms of section 424 of the Companies Act – trading whilst insolvent. The interviewee described the board as a strong board that realized the organization would not survive in the future, and that the sentiment from the South African Reserve Bank was not supportive of small banks. The decision was taken to either merge or sell to another financial institution. The director spoke about experience being very important under the scenario because they had to ‘keep cool’ and ‘take the appropriate steps so that with hindsight it would be seen as impeccable behavior’.

This is what occurred and there was no opposition on price by any shareholders and, in fact in the directors opinion, the acquiring company may have overpaid.
As regards delisting disinvestment DI6, another of the most experienced of director also shared his views on this particular delisting. All the information provided above was corroborated. However, he expressed some additional interesting perspectives on director duties, board composition and operations within the South African business environment. Whilst saying that any critical event must involve the board, he also spoke of the need for the board to meet quickly, establish good communication channels between parties and that the role of the chairman was critical.

On independence he added the following – ‘There are natural conflicts between executive, non-executive and independent directors. Some independent directors are both experienced and independent. Some directors are independent in name only but are not independent. ‘Can someone be independent in their thinking if they are representing a constituency, and what is the rationale for being there if it’s by gender, race or regulation?’ He added that today there is no such thing as a small board and that the smallest a board can be is twelve members because you do not want to put people on too many committees.’ Political determinants are affecting board structures and ‘South Africa is moving towards socialism.’

As regards the delisting disinvestment DI6, he said that that the board had to act in an independent fashion and in the best interest of the company. ‘Some of the directors cannot act in an independent manner because they ‘belong to other companies’. All directors can declare their interests and conflicts but this does not change their motivations and behavior. One of the challenges is when does a director leave or recuse himself from a meeting, and then do you have enough people for a quorum? ‘The problem is a challenge
for objectivity, not skills. People come with beliefs and this is greater than reason or objectivity. There are always conflicts.’

As regards the board meetings to discuss the transaction the conflicts become apparent – and ‘conflicts are natural’. Different directors act differently; -some are subdued, some are not frightened and speak up. It is possible then to see and respect what dominates the thinking e.g. BEE or a major shareholder interest. The CEO plays a vital role and there is a lot of responsibility on the independent director. ‘There are so few genuine independent directors (even in England).’

This particular highly experienced director stated that he had never been through a corporate transaction that was a ‘done deal’. It always came to the board for a decision. Shareholders may talk, and a CEO may ‘test’ a deal with a shareholder and how it could change the risk profile, but it does come to the board to approve and submit to shareholders. This director saw no difference with private equity take-overs – ‘just that management want guarantees’.

_Delisting - Disinvestment DI7_

The interviewee provided information on the company that operated in the construction industry. Management approached the main shareholder about a MBO which was declined. The main foreign shareholder then engaged with other entities in the industry and found a buyer. The transaction was done between the shareholders, and all the board had to do was follow the process and get the independent fair and reasonable opinion for minority shareholder protection. Other processes also took place at the same time, including the exit of the CEO. But ‘there was no decision for the board as it was a shareholder decision.’
The director who was interviewed was of the opinion that the major shareholder sold too cheaply. The premium to market price was 18%.

**Delisting - Disinvestment DI8**

The interviewed director gave information about the delisting of a company that was in the IT industry and although profitable battled to make its quarterly profit forecasts. A dispute arose between the independent non-executive director and the CEO about early revenue recognition on a transaction, the outcome of which was the departure of the CEO. ‘The non-executive directors decided to put the company up for sale’ and several offers were received. The board was involved but independent, and the final offer was a 22% premium to the market price. The director interviewed said that the ‘there is no way a non-executive can pick up something in a company unless told by an executive. So the real job of the non executive and the independent directors is to choose a good CEO and ‘if you get that right most of the job is done’’. The director was also of the view that too much time is being spent on corporate governance and not enough time on the business. He saw the governance trend of putting people on the boards as harming companies; ‘the power of the non-executive is diminished if there is a reduced voice for industry and business’. To his mind the good independent director is the one ‘who can speak his/her mind (which cannot be written into a governance code)’ and these are individuals who have been in the industry and have the knowledge and confidence. Independence should also be financial independence, so that the loss of director’s fees would be of no concern. This would allow the independent director to be more challenging of management if he/she chose to be.’
Comments on delisting through sale/disinvestment by an existing major shareholder

The interviews from the ten directors revealed some common perspectives and certain relevant insights. All interviewees were aware of and spoke of the conflicts that arose when an existing shareholder wished to sell or divest of their shares and which led to a delisting. Conflicts were described as ‘natural’ and high in relation to the executive directors and the affiliated non-executive directors. Furthermore, the nature of the shareholding structure and the reason for divesting were both considered relevant drivers of board behavior e.g. ‘it was a shareholder decision and therefore the process was easy’, or the risk of ‘personal liability’ galvanised the board to decide on a course of action.

Whilst independence and the role of the independent director was raised by interviewees, several of them commented that it was not so much of a problem because conflicted parties could be removed from the ‘process’. Indeed, the process was seen as important and the need was for the ‘independent’ director to be a part of, or roleplayer in the process i.e. sub-committee that oversees the obtaining of an independent expert ‘fair and reasonable’ opinion on the valuation and offer. This was described as the ‘safety net’. Problems seemed to arise when conflicts were not managed out of the process, or when the chairman did not play an effective role. Several directors questioned whether there was such a quality as ‘independence’ or even a truly independent director, and comments were made that independence did not equate to objectivity, and that it depended on the character or values of each individual director. An example was given of a conflicted affiliated director who was able to act impartially and support the process. Integrity of individual directors, specifically the executive directors who provide information was again mentioned as being necessary.
The vast majority of interviewees stated that experience of the outside directors was important. Some directors said that experience and skills was more important than independence because conflicts could be removed and there was the process that had to be followed. The last director interviewed lamented that boards had become too big and that this was harming business because too much time was being spent on ‘governance’ and not enough time was devoted to the business by people who had industry and business experience to contribute more valuable input. This thought correlated with sentiments expressed on the impact of BEE developments and affirmative action on board composition and the move generally towards a more socialist environment in South Africa.

6.6.4 Delistings: Acquisition of remaining shares by an existing shareholder (Acq)

One of the ways in which companies can delist is through a court sanctioned s 311 scheme of arrangement process where an existing shareholder wishes to buy out the shareholders. Eight outside directors were interviewed covering eight transactions where an existing shareholder made an offer and bought out the remaining shareholders. A blind table is presented to the University of Manchester that reflects the directors experience, industry in which the company operated and the premium to market value on take-over. To protect confidentiality of director identity it is not reported here.

Delisting – Acquisition of shares by existing shareholder (Acq1)

One of the two most experienced directors in the interview group and a person who was identified by other interviewees as being ‘truly independent’ and who ‘looked out for the minorities’ provided his input into two delistings to which he was party. He spoke of a manufacturing company where he had been involved with a weak board and where he was the sole independent non-executive on the board. Notwithstanding this isolated position, he
referred to the whole delisting process as being simple and not complex. He attributed this to the controlling structure of the company where there was a majority shareholder who wanted to sell because it was a ‘small company with no future’. There were also no conflicts of interest in the transaction. The process involved an investment sub-committee and fair and reasonable valuations. He stated that ‘if a majority shareholder does the deal, then the minority shareholders nine times out of ten go along with it’. And indeed in this delisting there was no minority shareholder opposition to the price that was at a premium of over 35%.

Acq1 is interesting because it confirms that a majority shareholder can still decide what to do with the company. The protections for other shareholders remain the investment committee and the ‘fair and reasonable’ opinion on the valuation. Why this delisting is noteworthy is because it is evidence of a sole independent, experienced non-executive director on a weak board being of sufficient caliber to be party to the delisting i.e. in this instance it was not necessary for large numbers of independent experienced directors to be involved. This corresponds directly to the probit regression results. Admittedly, this was also a friendly take-over by an existing foreign shareholder with no conflicts.

Delisting – Acquisition of shares by existing shareholder (Acq2)

Another experienced director relayed the story of several attempts by a major shareholder to obtain control of a company that was a major financial institution and reliant on its human capital. An offer was proposed. The company constituted an investment committee, followed a process and obtained independent valuations. An offer was made for the minorities, but at too low a price. It was contested by one of the independent non-executive directors and the board did not support or recommend the offer to the shareholders. The
independent director being interviewed stated that the ‘most important thing to him was his reputation and he would never want to compromise that.’

Another take-over attempt was made by another offeror but it also failed. Management became demoralized following another shadow process conducted by an international financial institution, and the organization started becoming unstable. The first shareholder then re-approached the board and said they wanted to ‘do a deal that would work for the minorities’. There were four independent non-executive directors on the sub committee and a reputable external advisor. There were many meetings, and according to the director interviewed, ‘unfortunately no policy for the payment of extra fees for extra tasks undertaken by the outside directors’. The director stated that midway a transaction, you cannot change this and you cannot leave during a critical event. In this transaction the stance of the board was that there had to be value or there would be no deal. The director said that they did the right things and the shareholders got a good price. ‘Independent directors are there to look after the minorities’. The interviewee considered it fortunate that they had a good chairman and the board operated as a team. Whilst the board activity was collegial, there was negotiation in an environment of mutual respect. But the circumstances were such that ‘there was board backing for the shareholder, independent directors who had no conflict issues and those directors with divided loyalties stood back. The rules are simple’.

This delisting appears to be an example of how a buy-out of minorities can work. It is noteworthy that the independent directors had previously not supported offers and that their views had prevailed at the board. From the recounting of the story it seems as though all the roleplayers (executive, non-executive, independent directors, advisors and
shareholders) understood their respective roles and duties. This may be indicative of both experience and independence coming into play.

Other observations from Acq2 include the following;

• In a competitive environment, i.e. where the target company is desired and offers are available, a take-over of minorities can be simple and the process can work smoothly.

• There is evidence that the independent directors can influence the boards decision-making such that offers are not supported i.e. the regulated sub-committee, independent valuations and exercise of minority support by outside directors.

• One of the control mechanisms in the offer process is the reputation of the independent non-executive director i.e. an individuals fear of reputational damage.

• A policy for outside director remuneration for special purpose committees and tasks should be agreed before any potential transaction begins, as independent directors can spend a lot of time attending to the process.

• The outside director made little mention of the need for experience during the take-over, but that may be because of the general high experience level of the board.

Conceivably because this company was a desirable and successful company it could have benefited from the years of outside directors experience and advice – although this was not specifically mentioned.

Delisting – Acquisition of shares by existing shareholders (Acq3 and Acq4)

One of the most experienced outside directors in the interview population, spoke of his experiences with two separate companies, the first being a financial services company and the second in heavy manufacturing, where they were both acquired by an existing shareholder. The transactions did not proceed smoothly and there were ‘valuation issues’
with both transactions. This could be attributed in part to the inherent conflict of interests of the existing shareholder.

The outside director who was interviewed emphasized the importance of having independent non-executive directors for the sub committee that deals with the transaction and the fair and reasonable valuation opinion obtained from independent experts. He spoke of the critical importance of appointing the correct professional advisor for the valuation. He reflected on the difficulties that can arise e.g. “What do you do if the offer is not fair and reasonable? You have to think about getting competing bids. The cautionary announcements may trigger this. But it is very difficult if the major shareholder is the bidder.” The interviewee stated that in these circumstances, “the role of the independent non-executive is to look after the minority shareholders. But the question is do all independent non-executive directors look after minorities?” After considering this matter, the interviewee explained how the valuation problems were resolved in acquisitions 3 and 4.

At Acq3 there was a large board, but the 3 independent non-executive directors on the sub-committee were given a free hand to consider the shareholders offer. ‘The independent directors can question the valuation report, but the advisors are ultimately the experts.’ It was a difficult balance as the executive directors, who were conflicted, knew a lot about the company, yet it is the independent advisors who have to express their opinion. With Acq3, the ‘executive directors can get vociferous especially if they have shareholdings’ and none of them thought the final share price was fair. The executive directors wanted to pitch the offer price at the lower end of the valuation range to the board for acceptance, and they ‘attacked’ the independent advisors valuation report. Interestingly, it was another
non-executive director who was not independent, but who was of great help to the independent directors, in particular the independent director being interviewed. The director interviewed was challenged on the offer being a ‘sell-out’. Because he kept notes and acted on the advice of lawyers and the non-executive, he was able to defend himself easily by submitting his papers and an affidavit to court.

The situation in Acq3 resolved itself when “another shareholder did a clever thing – they bought shares/did a share swap and got more votes. It was a case of the non-executives usurping the role of the chairman’. ‘It was the shareholders who got the price into the right range.’ The interviewee said there were 3 key people involved; - the independent advisors for the fair and reasonable opinion; the legal advisors and the other shareholder who managed to get more votes and talk the CEO into increasing the offer into the middle of the price range. The interviewee summarized the various positions of the different directors by saying that ‘the independent directors had to protect the minorities; the executive directors were not impartial; and the non-executive directors can be conflicted because of their relationship to the shareholders – so it is best that they keep out of the process.

Sometimes the investment committee has to talk to the major shareholder. But the independent director cannot be part of the negotiating committee, he/she would lose his/he independence if they did. Invariably problems come from staff share schemes’.

In Acq4, the CEO was also conflicted. Despite the independent non-executive directors preferring an alternate offer which they believed would be a better partnership for the company in the future, they had to present all offers to the board and shareholders and any bid that passes the ‘fair and reasonable’ test. In this acquisition, the less preferred shareholders offer was accepted.
Observations from Acq3 and Acq4 include the following: Where an existing shareholder makes an offer to buy the company, many more conflicts of interests arise can arise when compared to the other scenarios above, especially if the executive directors have shares. It is the shareholder who has the ultimate power to accept or ‘fix’ an offer, although in Acq3 it happened internally. The experience and independence of the independent non-executive director is most needed in ‘unfriendly’ offers, and the depth of experience of the director being interviewed was clearly apparent. Notwithstanding the quality of the outside director, it was also interesting to hear that whilst the independent directors have to shoulder the responsibility for protecting the minority shareholders, they still have to be subject to a process and follow the rules. These may not always yield the best price for the minority shareholder, or even be believed to be in the best interest of the company (if that is what the shareholders decide), but is nonetheless the primary mechanism for protection of minority interests. Notwithstanding the takeover rules, the process can still be challenged, and the independent director may need legal advice. He/she should keep detailed records of the process and workings to protect his/her reputation if challenged.

*Delisting – Acquisition of shares by an existing shareholder (Acq5)*

One of the younger and less experienced directors within the population was interviewed about the delisting of a company that was part of a pyramid structure and which is contrary to the rules of the JSE Limited. The transaction was concluded by issuing shares in the holding company equivalent to the asset value of the subsidiary i.e. no premium. Interestingly, given the nature of eliminating the pyramid holding the company did not need to disclose an independent fair and reasonable opinion, although the director interviewed alluded to the fact that independent opinions were nonetheless obtained.
The director stated that the reason for delisting was to ‘unlock value and eliminate the unhappy minority shareholders’. The reason was very important as the CEO was ‘smart, influential and had a forceful personality’ and the business rationale had to be sufficiently convincing to be able to deliver value, expand into Africa and grow internationally. The role of the board and the different contributions by the directors was commented on. The executive directors developed the strategy, recognizing that the previous bankassurance strategy had not been particularly successful and that the company was lagging its competitors. The job of the non-executive directors was to ‘stress-test’ the strategy and sustainability thereof. The technical issues required ‘extensive energy’ and a subcommittee was set up to look at the prospective delisting. They considered capital, regulations, capacity and perception of delisting by minority shareholders and policyholders. The contributions from the various directors differed and depended on the issue at hand e.g. finance, marketing, HR and transformation. The background and expertise of directors was relevant e.g. one director was of great value because of his JSE experience. Independent fair and reasonable opinions were also valued because comfort had to be given to minority shareholders. The interviewee stated that ‘protection of the shareholder and policyholder is the main reason for there to be independent non-executive directors’.

The key observations from Acq5 were that the executive directors are powerful and invariably conflicted. Director experience of and expertise in specific functions and regulations was valuable to the process.
Delisting – Acquisition of shares by an existing shareholder (Acq6)

The director interviewed said that the board played little or no role in the delisting. This was because the major shareholder had decided to buy the other shares. The interviewee had never been involved in a delisting where the board had played a significant role. In any event ‘he would be hard-pressed’ to recommend listing to a company because of South Africa’s ‘irresponsible press – who charge, trial, execute and sentence without any limitations’. To his mind, companies should remain unlisted but still follow the governance principles and practices recommended by the King Codes. The director said that the process of delisting was very regulated. The investment committee follows a process because ‘the minority shareholders can cause problems so it is important to do it by the book’. The main shareholder who was the offeror and a non-executive director, did consult the independent directors for their views and was respectful of the other shareholders rights. The interviewee stated that the board acted ‘marvelously’ as a team as they were comprised of strong and independent people. There was extensive information and it was interrogated and discussed. The attitude was that ‘if the deal was put under a microscope later, could a court find a problem with the process.’ The other shareholders were acquired at a premium of 8% to market value and the interviewee was reappointed by the sole shareholder as an independent non-executive director to the new board of the now unlisted company.

The key observation of this transaction is how differently the role and functioning of the board can be perceived by different outside directors during a take-over. Given the manner in which the transaction progressed, the desire to be compliant with the valuation process and the subsequent appointment of the director post the transaction, some people may argue that the necessary independence and/or experience by outside directors as well as the
board could have been lacking. The importance of the valuation process by independent external experts as the minimum protection of minority or other shareholders in the absence of either independence or experience is therefore necessary.

Delisting – Acquisition of shares by an existing shareholder (Acq7)

Another director interviewed, relayed the delisting experience by describing the decision as one that was driven by management and the existing major shareholding. ‘By the time it got to the board it was a done-deal’. ‘The role of the independent directors was to oversee the governance process – to oversee what has already been decided. If there is management with shareholding and non-executives representing shareholders who are acquiring – they have their ducks in a row. What can you do?’ The independent directors are on the investment committee that gets the fair and reasonable process done. The director mused whether it would be different if management were not shareholders or where the non-executive directors were not shareholders and concluded with the view that it all depends on the shareholding of the directors. ‘When the board is dominated by shareholders and when management have shares it’s a done deal. An independent director can look at the scope for influence and then do your best, but it depends on whether you have the power. With a ‘done-deal it’s the reputation of the executives, shareholders and chairman that affects the results.’

In this delisting, the director said that the board operated as a team, there was no hostility, because by the time it was presented to the board it was finished and merely presented as information. The role of the advisors was to provide information to the board and to act as a governance check. ‘The consultants do all the work’. This director had not seen any distinction between executive, non-executive and independent directors during a delisting
because for a change in shareholding it is seen as a business imperative. Unless there is a
change in CEO, then all the non-executive directors are on the same side. The director
noted that where you do see different camps is in the parastatals where the executive and
government are involved, and there is not role clarity between oversight and execution by
the board and the executive directors. Notwithstanding the independent directors views and
experience the acquisition was concluded at a 42% premium to the market price.

*Delisting – Acquisition of shares by an existing shareholder (Acq8)*

Another director who was an independent director of a company with operations in another
country relayed his experiences of the delisting. The major shareholder of 70% saw value
in the company but the share price was not moving. They wanted to clean up the company,
change the management and get a new shareholding structure on another exchange. The
board made the decision collectively as the delisting proposal made sense. The
interviewee said he could not remember there being a sub-committee as it was done by the
board. Contributions by directors differed depending on whether they were non-executives
and representing the major shareholder, or executive directors. These two director
categories had vested interests. The independent directors had to look at the bigger picture
and find a premium for the other shareholders. Despite these differences, the board
operated as a team and there was no discord. In the process, the former CEO was removed
and all those who were conflicted had no say in the decision.

*Comments on delisting through acquisition of shares by an existing major shareholder*

The most noteworthy features of all the acquisitions by an existing shareholder is how
different the perspectives and experiences of each of the directors was. The transactions
varied from ‘friendly’ to ‘problematic’, and from ‘hostile’ to ‘easy’ and a ‘done-deal’. The
predominant feature was the strength of the offeror shareholder on the board and the extent to which the other independent directors had the power to influence the process and the board decision to put the offer to all the shareholders. There were examples of effective as well as limited or somewhat helpless governance, by the independent directors and the board. Conflicts of interest are most extreme when the acquirer is an existing shareholder, and this is then when the regulated process of getting independent valuation opinions is most important. There appears to be evidence both for and against the relevance and effectiveness of the independence characteristic in director roles. Whilst the qualities of experience were mentioned as important by some interviewees, the primary consideration was on conflicts and the mitigation thereof through following the correct governance process. i.e. obtaining independent opinions on fairness and reasonableness of valuations.

6.6.5 Delisting due to forced buy-out of minorities holding less than 10% of shares: Section 440
The interviewed director, spoke briefly about the buy-out of minority shareholders under section 440 of the Companies Act. This provision allows a shareholder that obtains more than 90% of the shares, to ‘force’ the remaining minority shareholders to sell their shares at the offer price it acquired its 90% shareholding. In the interviewee’s situation, this is what occurred and there was a negligible premium for minority shareholders i.e. 1% to market value. The director said that the main shareholder led the decision. The board’s role was merely to guide management on how to get the deal signed. Whilst the director said that ‘there were no real issues’, it was mentioned that they ‘did struggle with unwilling sellers’, and also had a court action. To take over the minority shareholders, they got advice and disclosed any related party interests. The interviewee stated that the difficulties were resolved and that it was actually an easy transaction. ‘All the information was acceptable and it proceeded because it made sense and was expected.’
The most noteworthy feature of this interview was that neither the characteristic of independence of experience of the directors was mentioned or considered relevant. This is due to the nature of the shareholding and the laws that apply when there is a shareholding of over 90%.

6.6.6 Failed listings
Several of the directors interviewed had had experiences of being outside directors at ‘failed listings’. The companies and directors involved are provided to the University of Manchester in a blind table. To protect confidentiality of director identity it is not reported here. However, a summary of the directors recall of events and experience is disclosed below.

Delisting – Failed company (Susp1) – Unfriendly buy-out attempts and delisting due to contravention of JSE rules
The company arose out of an unbundling or shedding of divergent and non-core investments by a holding company. Thereafter the company disposed of a major portion of its assets and made a distribution in specie to shareholders (unbundling). The JSE gave the company twelve months to fix non-compliance with a JSE rule relating to pyramid holdings. The company had several large shareholdings, but not one with outright majority control. There were many difficulties and conflicts between the shareholders, and the director interviewed was appointed by a major shareholder to ‘get fair value because the other shareholder/management wanted to buy the company at bargain basement prices’. The shareholder who was trying to buy out the other shareholders claimed pre-emptive rights, which were questionable but arose prior to the Access to Information Act and this was believed but difficult to confirm. Various options were looked at by the board over an extended period (eighteen months, which included an extension by the JSE) and
discussions held. There were a lot of debates. Management's primary concern was the negative impact on net asset value and the consequences of being a small-cap company.

‘Management were concerned and tried to look after themselves.’ Some directors wondered whether in the long-term whether they should not just ‘sit it out’.

The role of the independent directors was to be on the independent committee, ensure a proper process and that the minority shareholders were not prejudiced. Shareholders concerns were listened to. They used outside advisors for the ‘fair and reasonable’ valuation, but clearly after two discussions could not get a willing buyer given the circumstances. The experienced director stated that when a transaction is floundering and there are arguments on everything from who is going to be a director, price etc usually those transactions are not successful. The longer a transaction takes the more likely it is to be compromised. Ultimately this company was delisted because it was in breach of the JSE rules prohibiting pyramid companies, although this was not the intention of the board.

The scenario depicted in Susp1 illustrates a situation of a divided board, where the conflicts were not managed. Certain major assets had been sold. It appears that with each faction of the board being management, non-executive directors and independently defined directors were not able to resolve the competing interests. Ultimately the company was delisted due to non-compliance and it is likely that many shareholders had diminished or non-tradable investments.

Key observations include the following:

• Even with experienced independent non-executive directors, a board may not be able to agree on a way forward.
• Executive directors with shareholding and possible ‘preemptive rights’ can be destructive if there is no other majority shareholder. i.e. the executives can in effect have control in the same manner as a majority shareholder.

• The independent director role and valuation process can be weakened to become redundant or ineffectual under circumstances of hostile management with threat of de facto control. All shareholders were likely losers.

Delisting – Failed Company - Fraud and liquidation of a company (L&II)

Delisting L&II was a South African corporate scandal. The information was provided by an outside director who was involved and who had both substantial experience and a good reputation. He was appointed to the board many years previously by a now diluted major shareholding family. It was an ‘interesting group of companies and the business was expanding all over the world’. There were several roleplayers and much conflict; - the executive directors who owned a minority portion of shares ‘thought they owned the company’. The executives treated the company as their own and withheld information from the board, did things separate from the company in their own personal capacities and not for the companies benefit. ‘It became a ‘we’ and ‘they’ situation’ on the board. It was ‘embarrassing because even some of the non-executive directors who were representing certain shareholders may have done ‘naughty things’ like trading in shares when the board was discussing matters’. The financiers were concerned about the funding and put one of their own people on the board and relied heavily on the independent non-executive directors. Upon enquiry as to why the executives had not been dismissed, the interviewee explained that they were, ‘but that it was too late and the horse had already bolted’. There was legal action taken against the executive directors and key management and the outside director had to give evidence. But he explained that when there is collusion involved on
everything right down to falsification of salaries and having ‘people in your pocket’ there is not much that can be done. The company had an audit committee and reputable auditors and internal auditors. He questioned to what extent a director ‘must be a bloodhound’ and stated that it was a ‘shame because there were so many people and directors with great reputations who were let down.’ Ultimately the company was liquidated, despite the experience, reputations and the involvement of well-known independent directors.

Some key observations from L&I1 were the following:

- In the event of fraud and collusion by the executive directors and management, even with all the best governance structures, controls and assurance mechanisms, there are few protections for shareholders.
- The most experienced and independent directors can be ineffectual in situations of dishonesty.

*Delisting - Failed Company (Susp2)*

The company operated in the IT sector and had made losses in the three previous financial years prior to delisting. The director who was interviewed explained that he/she was a community leader who had made an investment in the company for the purpose of black economic empowerment and was placed on the board. S/he was expected to attract government contracts and mobilize the community to invest in the company. Many of the directors at the company were from ‘activist backgrounds and not equipped for the business world’. The director stated that ‘people with proper business experience are necessary’ and that they ‘should have been sent on business programs’. It was a scenario where the main shareholder benefited at the expense of other shareholders. You could ask questions in the board meeting and ‘the answers are designed for you and the truth is not
given’. ‘All the directors were required to do was sign the resolutions after the ‘beautiful stories’ had been told to the non-executives’. The director expressed regret at the money that was lost by shareholders and made apologies to shareholders. The director resigned from the board disillusioned, and summarized events as a ‘sad and bad experience’.

Susp2 was an important interview because the director interviewed was by his/her own admission not qualified or sufficiently experienced to play the role of an independent non-executive director. Interestingly, this director considered accountability to shareholders as the most important job of the outside director and despite honest intentions but with lack of knowledge and experience could not play an effective role. This delisting differed from L&I1 above in that it elicited little information on the integrity of executive directors and major shareholders, but did demonstrate that inexperience and lack of competency could lead to reduced value for both company and shareholders.

In summary, directors interviewed from failed companies provided insight into the reasons for delisting being several namely; conflicts of interest that could not be resolved, fraud by the executives and suspension of listing with little protection of minority shareholders. In the first two scenarios Susp1 and L&I1, the directors were highly experienced and knowledgeable but with collusion and dishonesty by executive directors, or unmanageable conflicts were not effective in their stewardship or resource provision role. Susp2 provided an example where there may or may not have been untoward behavior by executives, but where a weak and inexperienced non-executive director could provide neither stewardship protection against agency abuse or advice. In conclusion, these delistings point to the importance of experience, but also demonstrate the limitations to experience adding company value when there is dishonesty or unmanageable conflicts of interest.
6.6.7 Mergers
During the course of interviewing the directors, it was noted that there were several delisting transactions that occurred in the property industry. The distinguishing features of these delistings were the commonality of purpose i.e. clear business rationale for merging two companies, the limited role played by the executive directors, the ease by which valuations took place (discounted cashflows of rentals and existing third property valuations in annual financial statements each year) and the fact that these transactions were more akin to restructuring debenture instruments as opposed to shares with voting rights. The companies and directors involved are presented in a blind table to the University of Manchester and their experiences relayed as follows:

Delisting - Merger (M1)
Delisting M1 occurred because the company was in the property industry and it ‘made commercial sense ‘to merge with another property company. This would increase economies of scale and reduce the potential for conflict between major shareholders who had investments in their own property companies. The director interviewed said that it was a smooth transaction as it made commercial sense for the two major shareholders to merge their property businesses. It was a good ‘deal made in heaven’. There was a small board balanced between independent directors and non-executive directors who represented the shareholders. Little input was required from management. The independent experts they used for the valuation were the property valuers in both of the shareholders businesses, and property valuations from the independent valuers of the company. It ‘was an easy valuation as it was just the underlying valuation of the properties’. The argument for merging was so convincing that there were no minority shareholder issues. They had experienced people doing the valuations, and for the board and the shareholder it was just a ‘rubber-stamping exercise.’
Delisting M1 had much in common with several other mergers that occurred in the property industry. Three other outside directors from three other listed property companies were interviewed and relayed their experiences.

*Delisting M2*

Delisting M2 was described as a situation where ‘there could be no appreciation or depreciation of the share.’ The opportunity arose to put two property funds together and it ‘made sense’ as there was a common Financial Director, which was a situation that was not liked by the investment community. Furthermore, through a merger they could reduce any competition between the two companies. The transaction was ‘inevitable and there was unanimous support from the board’. There was no distinction between executive director, non-executive director and independent non-executive directors as there were no vested interests. The board ‘acted as a team as there were just the next logical steps’ to follow. It took time to tidy up the balance sheet prior to the transaction. They acted in the best interest of the unit holders and their objective was to be as fair as possible to everyone. There was a share swop ratio and ‘everyone was square’. The premium to market price was 1%.

*Delisting M3*

Delisting M3 was not fully described by the outside director. He stated that he had been around at the start of BEE and whilst having run his own businesses did not fully understand corporate structures but was motivated to learn. He relied heavily on professional advisors such as lawyers and accountants. He stated that as a board member you are responsible to all shareholders exclusive of your own personal interests. During the
transaction, there were many discussions between executive, non-executive and independent directors and they ensured that the executive directors did not bring their personal agendas to the table. ‘The independent directors have a role to protect minority shareholders.’ The processes are important and independent directors are needed for them. The role of the chairman is important to allow the board to probe the information. At the end of the day you have to feel comfortable even though it is not ultimately the board decision, but the shareholders.’

**Delisting M4**

Delisting M4 happened many years ago (before the timeframe in which the quantitative analysis took place) and given the nature of the transaction ‘the role of the board was little’, and there were ‘no creditors who were in trouble’. They had to ensure the process was followed and that the shareholders ‘got a fair deal’. The director also stated that ‘you have one chance with your reputation and so it is best not to tarnish it’.

**Interpretation of the Merger delistings**

In Delisting M1, the delisting had clear commercial benefits and no valuation problems due to the underlying nature of the assets. The two major shareholders interests were aligned and there was no conflict of interests and limited potential for abuse of minorities. It is likely that the presence of experienced independent directors was not as necessary as in the other delisting scenarios. This was also evident in the manner in which the valuations were conducted.

The other property mergers also appear relatively simple, with reduced potential for conflicts of interest, other than from executive directors who may be concerned about
future jobs. The process of using independent directors for sub-committees, independent valuers and then obtaining board consent before putting it to the shareholder for approval is consistent with other mechanisms for delisting.

Key observations from the merger delistings are that:

• The nature of the industry (property) and the characteristics of companies can affect the complexity of a transaction.

• Where there is less potential for conflicts of interests (i.e. clear commercial benefits to all parties, major shareholder consensus and transparent, simple valuations), then the need for independent, non-executive directors to play a role in the investment and valuation process is diminished, but still considered necessary.

• Independent non-executive directors are still needed for the process and protection of minorities.

• The likely contribution from experienced outside directors in these circumstances may not be at its greatest at the time of delisting but rather prior to the event i.e. when running and overseeing the company in its day-to-day operations.

6.6.8 Other reasons for delisting

Delisting – Company unbundling (Unbdl)

A highly experienced director who had sat on numerous local and international boards gave the background to delisting Unbdl. The company came to market and shortly thereafter traded at a substantial discount to net asset value. The company had a balanced board of 8 directors of which there were 2 executive directors and 6 non-executive directors, including 2 independent directors. The executive directors approached the board with a proposal that as the company was going through turmoil, that it would be better to
return shareholders money. The board applied its mind and came to the unanimous
decision that it was in everyone’s interest to delist. The interviewed director was pleased
with the outcome of the delisting as the gap between net asset value and market closed to
10 to 12%. The director stated that all the directors understood their duties and obligations
i.e. care, skill, not to be conflicted and to act in the interest of the company and that
generally whether a director is management, non-executive or an independent director they
can all act in the best interests of the company. However, during the interview, the director
also mentioned that independent directors are also very concerned about their personal
reputations and potential actions against them. But he added that the value of a truly
independent director is that they can bring value to bear and stop any bad behavior.

As regards Delisting Unbdl, another director who was party to the same delisting event
was interviewed. He said that he was appointed after being approached by the chairman
who ‘needed support’. The company was in a mess and the share price was trading below
its net asset value. There were unhappy shareholders who thought the company had failed
to deliver. One of the lenders ‘had been too greedy’. The executive directors were
conflicted too because they had an interest in the structure and their fees. The situation was
not easy as there was management and an empowerment deal involved, and the way out
was protracted with many iterations. It was when the lenders came to the party that the
board could ‘play a supportive role’. The two independent directors ran the process and
could see things more clearly than the other parties who were involved. ‘The outside
shareholders were the winners.’
**Interpretation of Delisting Unbdl**

When a company does not perform there are other options available to unbundling such as getting new management. It is questionable that the board could make the decision to unbundle and that possibly it was the lenders who decided they wanted a return of their money and that maybe the company was not a worthwhile proposition in the medium term. It is interesting that there were no competitive bids or offers. Of interest was the comment that independent directors can become too detached from a company because they are first and foremost interested in protecting their reputations, as opposed to always looking after the company. As with other delistings, the executive directors have vested interests – which was mentioned by the second director interviewed.

Further key observations include the following:

- Even in an unbundling situation, there can be conflicts and a need for the independent director to play a role in the process of delisting.
- The nature of the company and circumstances i.e. size, profitability, gearing, complexity of balance sheet and funding (BEE) can impact a delisting decision.
- Whilst the stewardship theory of governance was mentioned by one director, agency theory (where the executives had to be managed by the outside directors) was also observed.
- The question of true independence also arises by virtue of the manner in which the outside directors were appointed and their primary concern for their reputations as opposed to the welfare of the organization.
- Experience of the independent outside director was not specifically referred to as being important or relevant. This was perhaps because the company was unbundling and
trading below net asset value, or perhaps because the experience of directors was not
significant enough of a positive influence to be of value.

Delisting - Delisting due to exercise of preemptive rights (PreRgt)

An experienced director explained the delisting of the company (PreRgt). An offer was
made to the company by two of the directors on behalf of another company. The existing
shareholders agreements had not been read or understood and the offerors were not aware
of the rights of another company that had an existing shareholding and preemptive rights in
the event of an offer. This was pointed out, the offer matched and the preemptive rights of
the shareholder could then be exercised at the offer price made by the original offeror.
‘The source of power comes from the shareholders’.

Little mention was made of the valuation process and the role of the board and directors. It
was explained that under the existing circumstances, it was an existing shareholder rights
that was the most important factor in the delisting.

6.6.9 Summary of the director interviews relating to the different delisting
scenarios

Each delisting event had it own unique ‘story’ and features. And yet despite the various
reasons for, means and manner of delisting, certain common themes were identified. The
structure of the shareholding, shareholder power, reason for delisting and nature of the
company are relevant drivers for the ease by which companies are taken over or delist.

Delistings always involve conflicts of interests that need to be managed. The conflict
almost always involves management (agency theory) and can vary in severity as it pertains
to non-executive directors who are affiliated to or represent the interests of a particular
shareholder. The second observation is that independence (and the want for objectivity and
fairness) is desired, regulated for, but not always regarded as truly possible or even
obtained. It is this need that has resulted in a particular role for the independent non-executive director in terms of agency theory. The role has been enforced through the JSE rules requiring a specific delisting process to be followed which requires the outside director to discharge a key governance oversight responsibility i.e. ensuring that independent outside advisors provide a ‘fair and reasonable’ opinion on the valuations. Thus, a party external to the board fulfills the potential deficiencies in independence, skills and experience of independent directors. This may be considered the primary protection for minority shareholders. Notwithstanding, the important role of the advisor, all participants be it the board, executive directors, non-executive directors and outside directors play a part in the delisting event. The primary function of the independent non-executive director is to oversee the proper functioning of the sub committee, appointment of advisor and communication and interface with the board as a whole. The independent non-executive director is therefore a key player in the process. The exceptions to this arise when shareholder supremacy e.g. s440 and 90% shareholder control law or preemptive shareholder rights take precedent.

Notwithstanding the stewardship and protection role that independent non-executive directors are supposed to play, the characteristic of ‘experience’ of outside directors (whether during the delisting or prior to the event) was consistently considered a valuable attribute by interviewees (except in cases where there was gross fraud and collusion and where it could not be brought to bear). However, there were also various comments made that in South Africa, the somewhat unique requirement to maintain social peace and redress the past through the appointment of BEE directors onto boards was making boards larger and weakening the experience resource base.
6.7 What advice would you give boards and directors who may go through a delisting?

The question asked of outside directors on the advice they would give to a board and other directors who may go through a listing was motivated to assess the primary characteristics or factors that are considered important during a common critical event. Answers could possibly provide insight on independence, necessary experience on how to handle the critical event as well as the roleplayers, and whether the regulations are appropriate to South Africa’s economic circumstances.

The replies varied depending on whether interviewees directed their answers towards the circumstances, the roleplayers, the delisting process, or the qualities and behaviors of roleplayers, or whatever they considered important.

Several of the outside directors spoke about the South African environment being highly and increasingly regulated, including the additional expectations recommended by the ‘governance’ codes or regime. One director specifically mentioned the responsibilities of directors under the new Companies Act, 2008 and the increased risk of personal liability. Another more experienced director provided his insight by explaining the increased regulations and governance in the context of a ‘distrust of the stewardship’ role of the board. All of the directors were aware of their fiduciary responsibilities and regarded their role as an independent non-executive director in fulfilling the regulatory requirements as both necessary and important. i.e. worthy and valid laws and protections.

Various roleplayers such as the shareholders, board, executive directors, non-executive director, independent non-executive directors and advisors were distinguished and advice provided on the delisting process. Quite a few of the directors said any advice given was
dependent on the structure of the shareholding of the company, with comments ranging from ‘the power comes from the shareholder’ to ‘when there is a majority shareholder you have little choice’. One piece of advice that addressed shareholding structure and acquirers was “Look at who is buying and understand why”.

Almost all the interviewees specifically mentioned the conflicts that arise during a delisting process. Comments such as ‘there are always conflicts’ or ‘the huge conflicts’ that have to be managed were frequently raised. These conflicts were identified as being always with management, sometimes with the non-executive director/s representing majority shareholder/s, as well as between the minority shareholder and major shareholder/s. This was always followed with identification of the need for independent non-executives to play the lead or dominant role in managing the conflicts and particularly in defending minority rights and value. Comments similar to ‘the independent non-executive director is needed for protecting the minority shareholders’ were frequent.

The importance of the independent advisor responsible for providing an opinion on the fairness and reasonableness of the valuation was emphasized. As one director lamented ‘Few boards are independent or objective’. Advice from most of the directors included: ‘Know and understand the conflicts’, ‘Use advisors’, ‘Get the best advice’, ‘ensure you use capable and experienced advisors who have integrity’ and ‘advice is needed and depends on the circumstances’. In summary, one of the key recommendations was to get high quality advice from independent experts in order to manage the conflicts that inevitably arise during a delisting. This advice confirms and justifies the regulations requiring a third party, independent from the board and management, to provide an independent opinion on delisting price or consequences. It also points to the board needing to appoint a truly independent, experienced and skilled advisor to perform the valuation, because boards
and/or directors are not sufficiently objective or independent to be trusted with this stewardship responsibility.

Practical advice on how to conduct the process all related to ensuring that the process was properly and comprehensively followed e.g.

‘Establish the sub-committee of the board quickly’, ensure that it is filled with ‘the right people’ and that it has the ‘mandate and authority’ to ‘operate freely without interference from the board, non-executive and executive directors’.

Directors were advised to ‘take the time’ to ‘do it properly’, yet act with ‘speed and urgency’. They were advised to ‘weigh up the options’, ‘get the best possible price’, ‘communicate frequently with the board’ and ‘manage perceptions’. Other interesting pieces of advice included ‘try to bring the executives along with you’ and ‘don’t forget about the human or personnel element – nominate a director to be able to communicate with management and staff’.

As regards behavior the advice provided was to ‘ensure that the process followed was transparent’, to ‘keep cool’, ‘be careful and ask questions’, ‘keep your eyes and ears open’, ‘do the right thing’. Several directors spoke about conducting an ‘unimpeachable’ process so that in ‘hindsight there could be no accusations’, due to ‘impeccable behaviour’ and that ‘maintaining their reputations’ was extremely important.

When providing advice, several interviewees also referred to director characteristics. Some said that it was necessary to ‘have expertise on the board’, that ‘boards need a balance of experience and representivity’, and that they should ‘have the right skills on the sub-
committee’. Some directors stated that the ‘honesty of the executive directors was important and that ‘experience of the board comes into play’.

In summary, the advice that was provided by interviewees demonstrated that the delisting process was not one that required a passive role from the independent non-executive directors. Despite the regulations that are constructed to compensate for any potential lack of independence and objectivity by the board or the outside directors, it appears that the independent non-executive director is required to be both competent and involved in the process, despite their being a large role for and reliance on the independent advisor in the valuation process. All these factors and comments lend support for the relevance and value placed on the independent non-executive director.

6.8 What experience are directors most lacking in, in South Africa?

All the directors interviewed had much to say on the experience that directors are lacking in in South Africa. However, their insights were not limited to the experience they considered lacking but also other deficient characteristics and qualities as well as the reasons for this.

The broad categories of missing or required characteristics pertained to:

- Lack of knowledge and experience of business
- Insufficient skills on boards
- Lack of exposure to other boards
- Insufficient time, and too many other board appointments
- True independence and lack of objectivity

More comments in relation to the above were provided, but should be viewed in the context or background below.
Over two thirds of interviewees spoke about boards requiring, in the words of one director, a ‘peculiarly South African composition’. By this they were referring to the legal requirements to address black economic empowerment (BEE) and that South Africa is in ‘transition’, or a ‘developmental state’ needing to ‘fast-track’ and ‘play catch-up’. The directors generally appeared resigned that this was necessary and as a result of the past political and economic dispensation, but there were several comments relating to ‘tokenism’, ‘BEE directors can’t contribute’ or ‘don’t say a word at meetings’ and that there is a ‘huge learning curve’ and at ‘least another 20 years’ of experience required. A couple of directors indicated that progress is being made referring to a ‘new class of black professional directors’, ‘some of whom are very good’ but on average they are ‘unskilled and inexperienced’.

Several directors expressed frustration at the ‘corporate governance pendulum swinging too far’, saying that the governance codes and excessive, onerous regulations were making boards too big and cumbersome and distracting boards from attending to the real business issues. Comments ranged from the huge responsibility placed on independent non-executive directors, their reluctance to assume the associated risks, the low remuneration and the consequential impact on a diminishing pool of older, retired but highly experienced directors becoming unwilling/unable to serve on boards.

By far the most frequent type of experience identified as absent or deficient, related to lack of business experience. This was most commonly referred to as ‘not having business experience’, lacking ‘commercial exposure’, ‘not having run a business’, ‘inability to identify and understand the real issues’, absence of ‘knowledge about the industry’ and
that ‘particular company’s business’. Consequences were described as ‘having to follow
management because they have no decision-making exposure’, or are ‘light on strategy’
and cannot ‘deal with and debate the real issues’ and ‘opportunities’.

Many of the directors interviewed, stressed that the board should be composed of a
‘variety’ of skills and competencies, be ‘rounded’ and ‘balanced’. Specific technical skills
identified as necessary and still lacking were financial skills, experience and
understanding. One director said that ‘social and political skills were not in short supply’
and another stated that ‘we are moving to an era where skills are important’.

Other types of experience that was considered lacking related to experience on other
boards. This was described as ‘not seeing, serving and doing on other successful boards’.
One of the consequence of this as explained by one director was the ‘free-rider effect’ –
where all the other non-executive directors behave passively and place over-reliance on
the most experienced and knowledgeable, independent non-executive director. A problem
with both lack of exposure to other good boards and business or commercial experience
was that many of the interviewees complained about a shortage of experienced outside
directors. Frequent comments, almost as much as the absence of real business operating
experience, were complaints about busy directors. There are ‘few experienced independent
directors’ and they do not have enough ‘time for all the director appointments’ they have
accepted. There were at least twenty complaints relating to lack of time, overloading, too
many other board appointments, non-preparedness for meetings and being generally too
busy. Two interesting comments were made that directors who have an excessive number
of board directorships e.g. 10 or more, can be independent because they are not reliant on
any one company’s remuneration. However, too few outside directorship appointments can
also inhibit an outside director from ‘speaking his/her mind’ and exercising independence and objectivity for fear of losing remuneration.’

A problem in South Africa appears therefore to be that either there are too few experienced, independent directors who are over-committed and thereby less effectual; or too many inexperienced, independent directors being placed on boards who are having to learn and develop but are as yet unable to make valued contributions. The latter problem was corroborated by directors who said that it takes time and years to get experience and that the average age of outside directors was lower than in the past.

The characteristic of independence did arise when directors were asked what experience was lacking. There were many responses that included reference to the need for independent directors and the shortage of truly independent directors. The comments related to independent directors being necessary for objectivity in matters such as remuneration or serving on board sub-committees, for the ‘checks and balances’ as they are the ones who can ‘challenge’ and ‘stand up to the executives’. Necessary qualities mentioned for directors were ‘courage’, ‘guts’, ‘care’ and demanding of ‘accountability’ – in short justification for the trend in laws, regulations and codes requiring the presence of independent directors on boards in South Africa.

In conclusion, it appears that the interviewed directors recognize the need for a balanced board and the value of independent and experienced directors. There appears generally to be two broad ‘groups’ of outside directors – those that are experienced and independent, many of whom are too busy or over-committed and who as a consequence may not contribute optimal value; and the other group of outside directors who are inexperienced in
business, board operations and who are not sufficiently independent or experienced to add great value to the board and the company.

6.9 Do you have any other views or comments about outside director experience and the impact on company value?

The vast majority of directors interviewed thought that there was a positive relationship between outside director experience and company value. However, several comments were qualified as to the extent of value or the circumstances under which experience could translate into value. The majority of interviewees used adjectives such as experience is ‘important’, ‘relevant’, ‘absolutely’, ‘positively’ and ‘directly correlated’ to value. Explanations were provided that experience ‘helps management’, ‘broadens the skill-base’, brings the ‘right perspectives’, assists with ‘avoiding pitfalls’ and helps the board ‘decide what information is relevant’.

However, there were a handful of directors who were more circumspect in their opinions and who qualified the value that outside directors experience can bring with statements such as ‘the link is tenuous, they are not the main value engine as this is the executives. On occasions they can warn, watch for and protect value’. One director said that there was ‘no correlation as value is due to the executive directors and in particular the CEO.’ However, his further comment revealed the advisory role outside directors should play in that ‘inexperienced directors reduce the sounding board that management needs, and there are plenty of these directors around.’ Another director stated that experienced outside directors could add huge value to a weak board in the short term, and another director added that ‘in good times it is the executive directors who add the value, and that only in the bad times are experienced directors needed.’ Other interesting comments included statements that ‘value depends on many things’, ‘good companies attract good people’ and ‘the right
people do the right things – but it is all linked to the government of the day and its sense of urgency’.

In conclusion the outside directors interviewed, who were themselves mostly highly experienced individuals’, believed that experience, (whether wholly or partially contingent on the circumstances), is a valuable characteristic and positively related to company value.
7 Discussion

Little research has been performed on corporate governance in the South African context. These results contribute to an understanding of the specifics peculiar to this country, and in general to the vast amount of globally available corporate governance studies.

South Africa is a developing country that has undergone extreme change in the past 20 years. The political regime transferred in 1994 from an apartheid era to a full democracy. Political change has brought with it economic and social change as evidenced by a more open economy, new laws including Black Economic Empowerment to redress past economic exclusions, and a stakeholder inclusive approach to governance of business entities. The latter is evidenced in the release of successively progressive governance codes i.e. King 2 and King 3. Unfortunately the legacy of apartheid has resulted in a large percentage of the previously disenfranchised population being poor and badly educated. Politics and society continues to move towards greater social democracy intent on redressing the past with government playing a larger role in the economy and laws being enacted to encourage economic transition to the previously disadvantaged e.g. Broad-based Black Economic Empowerment Act of 2003, Preferential Procurement Policy Framework Act of 2000, Employment Equity Act of 1999 and the numerous non-regulatory industry charters. Against this context of ‘poor human capital’ as would be described by North, and increasing social democracy as would be identified by Roe, corporate South Africa has to continue to ‘perform’. These authors research would each respectively predict that South African economic prosperity would be inhibited by the lack of knowledge and skills (North’s research) and would move towards reduced or less dispersion of company
ownership i.e. increased block-holdings (Roe’s theory). These broad theories have implications for companies and the boards of directors who are responsible for directing and controlling them. In South African listed companies, some of the potential consequences in reaction to these forces could be an increase in delistings, an increase in block-shareholdings, and a decrease in the number of independent non-executive directors on the boards over a period of time. My research uses the large number of delisted companies since 2003 as a basis for study but does not investigate shareholding trends over this period. Indeed, the latter may be a limitation to findings and an area for future study.

As regards a reduction in independent non-executive directors, this has not happened because as I report above, the laws and governance codes have regulated for more outside directors. Independence is therefore recognized as an important attribute for the board and points to recognition of agency theory by regulators, if not the board and/or shareholders. These research results show that both the size of the board and the number of independent directors consequently increased.

My research is grounded in the resource theory of the board, specifically that director experience is an attribute that adds value to a company. Despite the limited ‘stock of knowledge’ i.e. quantity of outside directors and notwithstanding the increased size of the board and number of independent directors required, listed companies – even those that are weak enough to be taken over or delist- still recognize that the experience of directors is of value.

The quantitative analysis show positive results between director experience and company performance i.e. premiums in a delisting event, based on comparison of means for director experience between companies that achieve a premium and those that do not i.e. The better
companies (those that get a premium) have more experienced outside directors than those that do not get a premium. Probit regression results confirm that board experience has a positive and statistically significant impact on the likelihood of a positive premium. The size of the company, profitability and the reason for delisting are also statistically significant variables. The independence variable, the advent of governance codes/JSE rules, the size of the board and type of industry are not significant to likelihood of an associated positive premium. However, the importance of independence may be masked in probit as the premium outcome arises from a regulated process that requires the involvement of independent directors. Interestingly, during collation of the interview data, the results organised most naturally into the reasons or types of delistings that occur. This is because it is the natural conflicts that arise on the board that make the independent director more aware of individual and group director motives. South Africa recognizes agency theory by requiring a standard governance/valuation process to be conducted by non-interested directors during a delisting. Agency theory is recognized to such an extent that the primary safeguard for the company and/or minority shareholders is the reliance by the board on an independent third-party advisor/valuer and which has been mandated by law/JSE rules. Outside directors confirm this during the interviews.

The qualitative interview information generally supports and explains the quantitative results. The answers to questions pertaining to definition of experience, type of experience valued, how and why the experienced director was appointed and generally the directors opinions on the correlation of experience to company value all affirm that experience is a positive attribute for company’s and its performance. However, the degree and extent of perceived value did vary amongst interviewees. Interestingly, the merits of independence and relevance of experience during the delisting event were commented on by directors.
Frequently, the nature or mere existence of independence was queried. One director profoundly distinguished between ‘objectivity’ that is needed, versus ‘independence’ that may or may not exist irrespective of the mandated independence definition. All directors confirmed that independent directors are needed to ensure that the proper governance process of delisting is conducted, and that experience with the process is advantageous for all.

Whilst from both a quantitative and qualitative results perspective, there is good evidence of a positive association between experience and premium, there remain several factors which could diminish the effect of director’s experience on the premium that is achieved. Directors indicate several reasons namely; - the outside director merely runs the investment/governance process during a takeover transaction. Value is determined independently of the outside director by third party, independent advisors and the price is agreed by the board collectively, and not by the outside director who is unlikely to be part of the negotiating team. Directors confirm this when they advise of the importance of choosing the right advisors/valuers. Finally it is the shareholder who ultimately decides whether a premium is sufficient, and many interviewees acknowledged the shareholder as the true source of power. This however, does not detract from the value of the outside director at delisting as many directors recounted the value of experience and/or independence for such matters as dealing with management conflicts, preventing abuse of minorities, advising on takeover proceedings and providing shareholders with confidence that the process had been fairly conducted.

Quantitative analysis above, supported with interview information, shows that experience is positively associated with company value. However, endogeneity persists. Comparison
The quantitative research defines but limits the nature of director experience to general business experience, specific deeper skills and experience with other listed boards as proxied by age, number of degrees and number of seats on other listed companies. Yet interviewees identify other types of experience that are valuable but which are not incorporated into the experience variable coded for quantitative analysis e.g. industry experience, business experience and merger and acquisition experience. Specific skills e.g. finance and resources such as sufficient time are also considered important. In general, whilst interviewees report the importance of a balanced board in terms of independence, necessary skillsets and variety of experience the pool of experienced outside directors is small. Many interviewees expressed concern about the impact of black economic empowerment on the composition of boards, and that the increase in board size and addition of inexperienced/under-skilled directors is having a detrimental effect on board functioning. This may be an area for further research.

Outside directors interviewed think that experience is a valuable characteristic for boards and positively impacts company value by way of advice and protection i.e. both resource and agency theory apply. They support this by advocating for outside directors with more
business experience and greater exposure to other boards. They also call for outside directors to have sufficient time, independence and technical skills for performing the director role in a manner consistent with director fiduciary duties. Many directors recognize that boards are on a ‘developmental journey’ and that it will take years for governance to mature in the South African context. The demands and expectations on experienced directors are likely to increase.
8 Implications

Increased recognition of the value of outside directors experience could impact on the supply and demand for experienced outside directors, board composition and changes to future governance codes or guidelines.

The recent socio-political, legal and governance changes has led to South African boards increasing in size and independence. Whilst this research does not comment substantially on the impact of these variables on the performance of the company, except to the extent that outside directors are needed and valued for a delisting, the research confirms the value of outside directors experience. To date, this has not been explicitly recognized in South African legislation except to the extent that company law requires the audit committee to be comprised of members with appropriate skills, and King 3 recommends for considering the collective knowledge, skills, size, diversity and demographics for board composition. The third King Report in section 71 states that ‘Diversity applies to academic qualifications, technical expertise, relevant industry knowledge, experience, nationality, age, race and gender’. Explanation or guidance on the type/nature of experience is not provided except that it should assist when conducting the business of the board.

This research provides insight into the types of experience that are valued i.e. business experience (running a business), exposure to other boards, industry experience, as well as specific experience such as mergers and acquisitions and dealing with regulations. It differentiates experience from skills e.g. accounting, legal, engineering and technical skills.
that many directors believe can be ‘bought in’ or procured. Nominations Committees are provided with better insight into the collective resource requirements of the board.

The new Companies Act, 2008 makes provision for application of the ‘business judgement rule’ by directors for not only actual knowledge but also deemed knowledge of what would be expected of a director given his/her position and experience. This in conjunction with section 218, which opens the door for director personal, civil liability clarifies the personal obligations and extent of fiduciary duty required of experienced independent non-executive directors. In a country that lacks human capital, skills and experience, the experienced outside director is likely faced with a more onerous workload and increased responsibility. This could further diminish the pool of available, experienced outside directors and/or increase their remuneration leading to increased costs for the company and decreased value for shareholders.

For corporate South Africa, a move towards social democracy and inclusive stakeholder governance, could mean that shareholder returns will be adversely impacted if sustained growth is not achieved. If continued implementation of black economic empowerment occurs in a manner that affects the appointment of directors for reasons other than skills and experience, this means that those directors who are experienced will be subject to further demands. Several experienced directors expressed concern about non-experienced directors being appointed to boards who are either unable or too busy to make a contribution. Consistent with the Institute of Directors recommendation in King 3 that recommends in section 72 that “In situations where directors may lack experience, detailed induction and formal mentoring and support programmes should be implemented’. As a
consequence and as anticipated, ongoing director training and education should increase in South Africa.

Finally, the potential implications for future governance codes and guidelines is recognition that ‘experience’ is scarce, distinguishable from skills, requires time to accumulate, and needs to be specifically addressed when shareholders consider the composition of the board.
9 Conclusion

South Africa is a country undergoing social and economic change. Notwithstanding the problems of endogeneity, outside director experience is positively associated with company value. Possible future consequences will be greater demand for director experience in an environment where there is increasing complexity and scarce resources. However, other drivers of good governance are also likely to adjust and impact on the governance of local companies. These include how shareholders organize themselves, management incentives, laws and regulations (and enforcement thereof) e.g. takeover, competition, labour and tax laws, as well as the socio-political imperatives of black economic empowerment. The impact of these could each in turn, or in combination, affect company value in the South African context. Further research could extend this study by investigating how shareholding impacts on companies that delist. Other studies on each of the drivers could be undertaken to assess their impact on company value.

This research is grounded in the resource theory of the board. Other aspects of resource theory i.e. director relationships and reputations could also be investigated to assess their value on company performance. Resources could also be more broadly defined beyond ‘experience’ to include skills or other attributes i.e. industry, specific company, or transactional knowledge that may be associated with added board and company value. Finally, given the paucity of research in general into corporate governance in South Africa, the impact of new laws and governance codes, in particular King 3, should be evaluated further to assess the impact on corporate South Africa as well as the country’s other socio-economic goals.
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