

**THE RELATIVE IMPORTANCE OF CORPORATE
GOVERNANCE ATTRIBUTES: EVIDENCE FROM
CORPORATE STAKEHOLDERS**

by

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CERTIFICATION

I hereby certify that this thesis is the result of my own research and that it has not, nor has any part of it, been submitted for a higher degree to any other university or institution. The extent to which I have availed myself of the work of others is acknowledged in the text.

.....

Christofer Adrian

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ABSTRACT

This study investigates shareholders' and directors' perceptions of the relative importance of corporate governance attributes in their assessments of effective corporate governance in Australia. These attributes are chosen from existing corporate governance literature and current corporate governance requirements in Australia, namely (i) Australian Securities Exchange Principles of Good Corporate Governance (ASX POGCG) and (ii) the Corporate Law Economic Reform Program Act 2004 (CLERP 9).

Overall, 230 shareholders and 46 directors participated in this study. The respondents are the members of Australian Shareholders Association (ASA) and Australian Institute of Company Directors (AICD). This study finds that both shareholders and directors perceive CEO duality to be almost twice as important as other attributes, followed by Board composition, Audit committee composition and Provision of non-audit services by the auditor. Shareholders' and directors' overall views of factors that constitute effective corporate governance are relatively similar. These findings indicate that directors' views are broadly aligned to those of shareholders, which might suggest that their interests are also aligned.

The study provides several contributions to the literature and practice. Firstly, this study adds another dimension to the existing corporate governance literature by being the first study to compare shareholders' and directors' relative preferences for key corporate governance attributes. Secondly, this study provides suggestions to regulatory bodies, such as ASIC and ASX, regarding future amendments to corporate governance requirements. Specifically, it identifies corporate governance attributes that are perceived by both shareholders and directors to be relatively important. Thirdly, this study also makes a contribution in terms of the research method used in this study, in using Adaptive Conjoint Analysis (ACA). The use of this method in the accounting and corporate governance literature will encourage its further use in this discipline, to provide insights into respondents' relative preferences in situations involving choice.

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CHAPTER 1

INTRODUCTION

1.1 Overview of the study

Corporate governance, defined by the Australian Securities Exchange (ASX) as “the framework of rules that run and control the corporation”, is a core concept in capital markets. The importance of effective corporate governance is highlighted in research that shows its strong correlation with the market valuation of firms (e.g. Klapper and Love, 2004), and by the regulatory focus on it to maintain investor’s confidence in the capital market. Since the early 2000s, corporate governance has received much attention following the occurrence of some large and high-profile corporate collapses in many countries, such as Enron and WorldCom in the U.S. and HIH Insurance in Australia. Poor corporate governance practices are argued to have contributed to these collapses, which in turn undermined confidence in capital markets. In the long-run, this lack of confidence in capital markets could have a detrimental impact on many countries’ economies.

As a response to these collapses and the adversity of their consequences, a movement towards stronger corporate governance requirements arose in different jurisdictions. The consistent focus of these changes across jurisdictions was on improving the effectiveness of corporate governance practices, which aim to protect the interests of all corporate stakeholders. In U.S., the Sarbanes-Oxley Act was enacted in 2002 after the collapse of Enron. In Australia, two important regulatory changes to governance were introduced following the collapse of HIH, namely (i) Australian Securities Exchange Principles of Good Corporate Governance 2003 and its subsequent amendment in 2007 and 2010 (hereafter ASX POGCG) and (ii) The Corporate Law Economic Reform Program Act

2004 (hereafter CLERP 9). ASX POGCG states that the recommendations are designed to “optimise corporate performance and accountability in the interests of shareholders and the broader economy.” (ASX POGCG, 2010). That is, they are intended to improve corporate governance practices in protecting the interests of stakeholders and restoring confidence in the capital market. In achieving these purposes, the recommendations include several attributes, many of them are concerned with the independence of various parties involved in corporate governance, namely the board of directors, audit committee, remuneration committee, and auditors. In order to understand better the interests of stakeholders and how those interests link with confidence in the capital market, regulators and policy makers would benefit from knowing what stakeholders consider important in terms of corporate governance.

This study investigates stakeholders’ perceptions of effective corporate governance to contribute to debate on this issue in the academic literature. Specifically, it examines the views of two groups of key stakeholders, namely shareholders and directors, on effective corporate governance by identifying their relative preferences among a set of corporate governance attributes. This study finds that both shareholders and directors perceive CEO duality to be almost twice as important as other attributes and that both groups perceive audit committee composition and provision of non-audit services by the auditor to be important. Furthermore, board composition is also found to be strongly influential for most shareholders and directors in their assessments of effective corporate governance.

Although differences in the views of these external and internal stakeholders (shareholders and directors) are expected by various theories, this study finds that shareholders’ and directors’ overall views of factors that constitute effective corporate governance are in fact relatively similar. This indicates that directors’ views are broadly aligned to those of shareholders, which might suggest that their interests are also aligned.

This chapter is organised as follows. Section 1.2 details the motivations for the study. The contributions of this study are discussed in Section 1.3. Section 1.4 outlines the structure of the thesis.

1.2 Motivation

This section explains the three motivations for the study. Firstly, this study is motivated by the importance of examining stakeholders' views in the context of increased regulation. The second is to provide empirical evidence on factors affecting perceptions of corporate governance. Thirdly, this study is also motivated by the importance of knowing how different stakeholders might have different perceptions of effective corporate governance. Specifically, it is important to know whether directors' views are broadly aligned to those of shareholders and whether their interests are also aligned. These motivations are discussed in more detail in the following sections.

1.2.1 The importance of examining stakeholders' views in response to increase in regulation

This study is firstly motivated by the importance of recognising stakeholders' views in response to increase in regulation. In order to understand the interests of stakeholders and how those interests link with confidence in the capital market, it is necessary to examine what stakeholders consider important in terms of corporate governance. This motivation is grounded in the fact that stakeholders are important to the effective operation of capital markets. For example, shareholders are important for firms as they are the owners and capital providers. Consequently, it is necessary to protect their interest to encourage them

to invest in the capital market. In addition, creditors also provide capital to firms in the form of debt financing. Therefore, it is also important to protect creditors' interests since creditor protection provides incentives to them to enter into financial contracts, namely providing capital for firms.

Concerns about potential over-regulation on corporate governance have been well-documented in previous studies. For example, Burkart, Gromb and Panunzi (1997) argue that excessive monitoring can be costly and limit managerial initiatives to undertake risky investment projects, hence affecting a firm's value. In relation to the U.S. adoption of the Sarbanes-Oxley Act (SOX) in the aftermath of the Enron case, Chhaochharia and Grinstein (2007) find some evidence that adoption of SOX is associated with reduced values of small firms.

While the introduction of ASX POGCG and CLERP 9 brought major changes to corporate governance practices in Australia, stronger corporate governance does not necessarily lead to more effective corporate governance as the costs incurred might outweigh the benefits (Gillan, Hartzell, and Starks, 2003), resulting in over-regulation. This potential for over-regulation motivates the examination of factors that are considered by stakeholders to be important for effective corporate governance, in order to achieve an appropriate level of regulation.

1.2.2 The absence of empirical factors affecting effective corporate governance

Previous corporate governance studies have attempted to investigate effective corporate governance by examining the association between the attributes included in the corporate governance requirements already mentioned, for example board composition, and various corporate governance outcomes, such as firm performance and financial reporting quality. However, over time and across jurisdictions, there has been an absence of consistent empirical evidence to provide an understanding of the components or attributes of effective corporate governance. This research addresses the gap in the existing corporate governance literature, by analysing the appropriateness and importance of these attributes in stakeholders' perceptions of effective corporate governance.

The literature also exhibits the problem of endogeneity (Brown, Beekes and Verhoeven, 2011), in which an association between two variables that could be simultaneously causal, or in which both variables could be affected by a third factor, is interpreted as causation. "More significantly, it could lead to erroneous calls for the establishment of more prescriptive legislation, mandating specific governance practices or fuel support for the so-called 'one-size fits all' viewpoint..." (Brown, Beekes and Verhoeven, 2011). This problem is minimised in the current study, which extends the literature by using a qualitative approach in examining stakeholders' perceptions of corporate governance attributes. Nevertheless, the endogeneity problem is not fully eliminated since the corporate governance requirements (ASX POGCG and CLERP9) guided the selection of attributes used in this study and shaped the respondents' perceptions of the attributes, independent of actual impact on effective corporate governance.

In formulating corporate governance requirements, regulators have relied on discussions with stakeholders' representatives, such as the Australian Institute of Company Directors

(AICD) and the Australian Shareholders Association (ASA). This study contributes empirical evidence on what attributes are perceived to be important by individual members of these organisations as to which corporate governance requirements improve corporate governance practices after a period under new regulations.

1.2.3 The importance of recognising different perceptions of effective corporate governance that different stakeholders have

This study is also motivated by the importance of recognising how different stakeholders might have different perceptions of effective corporate governance. Firstly, shareholders are important for firms as they are the owners and have their money at stake through their investments. They are one of the major capital providers (another being the creditors) through equity financing and it is important to protect their interests in order to maintain their confidence, therefore encouraging them to enter and invest in the capital market. The importance of shareholders in the capital market has been acknowledged by regulators through the introduction of corporate governance mechanisms such as CLERP 9 and ASX POGCG, which principally aim to protect investors.

Secondly, while corporate governance requirements have focused on shareholders as an important group of stakeholders, directors are also important as they have positional power in the corporation. They are the link between shareholders and management and are able to make decisions that can affect other stakeholders. In terms of corporate governance, they implement the requirements from the corporate governance codes in their firms. As well as being shareholders' representatives, directors are also important in their own right due to their financial interests in the firm, including their remuneration and the risk of financial penalties as a result of fraud. An industry representative of

directors who was interviewed as part of this study expressed the view that corporate governance codes (ASX POGCG and CLERP 9) have placed too much focus on protecting the shareholders from the directors' supposed misbehaviour without considering directors themselves as important stakeholders in the firms.

Tensions between shareholders and directors have received much attention and are well documented in both academic research (McConvill and Bagaric, 2004; Hill, 2010; Vanderpol and Waitzer, 2012; Millstein, Gregory, and Grapsas, 2013) and the media (AICD, 2005; AICD, 2013; ASA, 2013). From both stakeholder groups' perspectives, the key underlying issue is whether the interests of shareholders and directors are aligned. Two key representatives of these groups, the Australian Shareholders Association (ASA) and the Australian Institute of Company Directors (AICD), have been continuously involved in longstanding debates on corporate governance practices. For instance, in August and September 2013, both organisations were engaged in debates on board structures, shareholders engagement, and executive remuneration, through the release of policy discussion papers.

As these two stakeholder groups are integral components of a firm, it is important to examine their views on corporate governance. This paper is the first to seek the views of key stakeholders, shareholders and directors, on their relative preferences among a set of corporate governance attributes. Specifically, this study examines whether directors' views are broadly aligned to those of shareholders and whether their interests are also aligned, or whether potential conflicts in shareholders' and directors' views exist. These findings could provide suggestions to regulators, such as ASX and ASIC, in their refinement of corporate governance requirements in Australia.

1.3 Contribution

This study makes several important contributions to both practice and literature. Firstly, this study provides suggestions and recommendations to regulatory bodies such as ASX and ASIC. The findings of this research indicate the attributes for which shareholders' and directors' higher relative preferences correspond, which provides support for current practices and regulations. It also shows the attributes for which their lower relative preferences correspond, which provides potential areas in which regulations could be reduced in the future. Parsimonious set of attributes perceived by corporate stakeholders to be important for effective corporate governance can guide the design of future corporate governance regulations, to avoid costly over-regulation. Therefore, this study compares the views of the two stakeholder groups most affected by potential over-regulation, namely shareholders and directors. While there are other stakeholder groups affected by corporate governance, such as debtholders, employees, customers, and suppliers, this study focuses on shareholders and directors. The ASX Guidelines place most emphasis on shareholders who are the owners of the firm and have their money at stake through their investments. Directors are also important stakeholders as they have positional power in the firm providing the link between shareholders and management, and making decisions that can affect other stakeholders.

Subject to verification by future research using different stakeholders and some different corporate governance attributes, this study recommends that the four attributes considered by stakeholders to comprise effective corporate governance should remain key elements in any regulation: CEO duality, the independence of the board of directors, the independence of the audit committee and restrictions on the provision of non-audit services. The results show that other attributes included in this research are less important,

and policy-makers should re-consider their effectiveness as part of any future revisions to governance guidelines, recommendations or legislation. This study finds no evidence to suggest that restrictions on multiple directorships should be added to current requirements, and considering its prominence in international debates about good governance, there is surprisingly low perception of audit partner tenure as important. Furthermore, this study notes that while stakeholders perceive audit committee and board independence as part of good corporate governance, they prefer substantially less than complete independence on these bodies.

Secondly, the study also makes several contributions to the corporate governance literature. The first, mentioned in Section 1.2.2, is that most studies in this area have attempted to investigate effective corporate governance by examining the association between the attributes and outcomes of corporate governance, such as firm performance and financial reporting quality. Larcker, Richardson and Tuna (2007) acknowledge that this empirical research has not produced a consistent set of results, which they partially attribute ‘to the difficulty in generating reliable and valid measures for the complex construct that is termed “corporate governance”’ (Larcker, Richardson and Tuna, 2007). The current study adds another dimension to the existing corporate governance literature by utilising a qualitative approach in investigating factors that affect the perceived effectiveness of corporate governance. For future researchers seeking to capture governance in a limited number of measures, this study has identified four attributes considered by stakeholders to comprise effective corporate governance: CEO duality, the independence of the board of directors, the independence of the audit committee, and the provision of non-audit services. Identifying CEO duality as the most important attribute of corporate governance compared to other attributes is a contribution to the literature. Next, as the first study to compare shareholders’ and directors’ relative preferences for

key corporate governance attributes, this research provides insights into whether and how their views differ or are aligned. Specifically, it provides suggestions on whether directors on the whole have their interests aligned to those of shareholders and therefore are likely also to be good monitors of managers.

Lastly, the study also provides a contribution in terms of the research method used in this study, in using Adaptive Conjoint Analysis (ACA). ACA has been used extensively in marketing research, but the application of this method has been rare in accounting and corporate governance research. The study presents the first application to corporate governance research of a research method that enables researchers to examine the relative importance of attributes associated with a construct in a situation of constrained choice, rather than the absolute importance of attributes. This study de-composes the construct of corporate governance within a set of attributes chosen from the literature and regulations, based on the views of key stakeholders.

There are only a few instances of ACA being applied in accounting research. Some notable studies that utilize this approach are Kilgore, Radich and Harrison (2011) and Kilgore, Harrison and Radich (2014) who examine the relative importance of audit-team and audit-firm factors in perceptions of audit quality, and Clark-Murphy and Soutar (2004), who examine attributes that influence individual investors in their decisions to purchase shares.

Moreover, no previous qualitative studies in corporate governance have used ACA. Most qualitative studies in this area have been conducted by examining the absolute importance of the attributes without analysing the extent to which one attribute is relatively more important than the others. For instance, Holder-Webb, Cohen, Nath, and Wood (2008) and McDonald, Khanna, and Westphal (2008), used likert-type scales that indicate the

absolute importance of attributes, but do not allow for relative comparisons between attributes because likert-type scales only provide ordinal data. The advantage that relative importance upholds over absolute importance is that not only does it provide the ranks of attributes, but it also shows the extent to which one attribute is more important than the others. Specifically, it provides insights into how respondents perceive the attributes if they are provided with trade-offs over several attributes. The use of this method in the accounting and corporate governance literature will encourage its further use in this discipline, to provide insights into respondents' relative preferences in situations involving choice.

1.4 Structure of thesis

The remainder of this thesis is structured as follows. Chapter 2 provides a review of the theoretical framework and literature that underpin this study. Specifically, this literature review explains the corporate governance attributes examined in this research. This chapter also discusses the development of three testable hypotheses.

Chapter 3 outlines the choice of research method used in this study to test the research questions developed in Chapter 2. In particular, this chapter justifies the choice of Adaptive Conjoint Analysis as the key data analysis technique for this study. It also outlines the operational definition and attribute levels of corporate governance attributes.

Chapter 4 outlines the data collection method used in this study. This also includes details on the design and construction of the survey instrument and the way the survey questionnaire is previewed and tested. Chapter 5 presents the data descriptives for this

study, including data sources and information regarding respondents who participated in this study.

Chapter 6 presents and discusses the results of the study for both shareholders and directors, including comparisons between these two stakeholder groups. Lastly, the overall implications of this study are discussed in Chapter 7 along with its limitations and suggestions for future research.

CHAPTER 2

LITERATURE REVIEW

2.1 Introduction

This study investigates shareholders' and directors' perceptions of effective corporate governance in Australia. The importance of effective corporate governance is highlighted in research that shows its strong correlation with the market valuation of firms (Klapper and Love, 2004), and by the ASX's focus on it to maintain investor's confidence in the capital market. In examining these perceptions, this study focuses on the relative importance of individual corporate governance attributes. The corporate governance attributes examined in this study are selected from the international literature and the corporate governance codes in Australia, namely ASX POGCG and CLERP 9. Prior studies in the corporate governance literature have examined the association between a number of attributes and various corporate governance outcomes, such as firm performance and value, financial reporting quality and monitoring quality. While previous studies report some mixed findings, they indicate the importance of the chosen attributes to the achievement of effective corporate governance.

This chapter reviews the prior literature relevant to this study. Section 2.2 provides the theoretical framework that underpins this study. Section 2.3 outlines the corporate governance attributes examined in this research and outlines their importance, as evident from previous studies that have examined the association between these attributes and the corporate governance outcomes mentioned about. Section 2.4 discusses stakeholders'

perceptions of corporate governance attributes and develops specific hypotheses to be examined in this study. The conclusion of this chapter is presented in Section 2.5.

2.2 Theoretical Framework

Corporate governance, defined by the Australian Securities Exchange (ASX) as “the framework of rules that run and control the corporation”, is a complex construct. While there is no single accepted definition and measure of effective corporate governance, several theories, including agency theory, stewardship theory, resource dependence theory, and signalling theory, have been used in the literature to explain what encompasses effective corporate governance. As this study focuses on two main stakeholder groups, shareholders and directors, it uses (i) Agency theory and (ii) Signalling theory to predict stakeholders’ perceptions of effective corporate governance. Resource dependence theory, while it is related to directors, is not used as this study is concerned with directors as individuals rather than as a group at the board level. Stewardship theory is also not used to develop hypotheses in this study as this theory focuses on alignment between managers’ and shareholders’ interests, whereas the underlying notion of this study is the tension between managers and shareholders with regards to shareholders’ value maximisation. Section 2.2.1 and 2.2.2 discuss these theories in detail, and in particular how they relate to shareholders and directors’ perceptions of effective corporate governance.

2.2.1 Shareholders

Shareholders are important to the governance of the firm as they are the owners of the firm and have their money at stake through their investments. Because they are one of the two major capital providers (the other being creditors) through equity financing, it is important to the existence of an effective capital market for regulators to protect shareholders' interests and maintain their confidence in the capital market. According to Martinov-Bennie and Kilgore (2013), there are both public and private benefits of an effective capital market. The public benefits of an effective capital market include having a more equitable distribution of the gains from trade and investment and encouraging more investment in the capital market. The private benefits include higher investment returns and lower cost of capital as the risks associated with investing are reduced. The importance of shareholders in the capital market has been acknowledged by regulators through the introduction of corporate governance mechanisms such as CLERP 9 and ASX POGCG which principally aim to protect this particular stakeholder group. In the literature, prior research has mainly used agency theory to explain the need for and importance of effective corporate governance from the perspective of shareholders.

Agency theory

Agency theory of the firm originates from Jensen and Meckling's (1976) description of the principal-agent relationship as a contract in which principals engage an agent to perform some services for them in the form of authority delegation. A central premise of the principal-agent relationship in this setting is the separation of ownership and control in a firm. This separation results from the fact that the owners of a firm might not have the capability, namely expertise and/or availability, to run the firm, hence they need to

appoint managers to do this on their behalf. This separation of ownership and control restricts the owners' access to full information regarding the decisions made by managers, that is, information asymmetry exists between the principals and the agents (Broadbent, Dietrich and Laughlin, 1996).

According to Jensen and Meckling (1976), if both principal and agent are utility maximisers, the agent might not always act in the best interests of the principal. As a consequence, there is potential for agency problems to arise because the agents may misuse the control delegated by the principals. Agency problems occur when there is opportunistic behaviour by managers (agents) which may cause their actions to be contrary to the best interests of the owners (principals) (Adams, 1994). Eisenhardt (1989) outlines two possible agency problems that might arise in this context. The first type can result from the diversion in interests between the principal and the agent, that is, conflicts of interest. The second type can result from the different perceptions of risk that cause agents to act differently from principals.

As these problems might adversely affect shareholder wealth, shareholders can undertake several actions to limit such detrimental effects. Firstly, shareholders can undertake activities to monitor managers, to prevent the managers acting contrary to the shareholders' interests. Costs associated with such activities are termed *monitoring costs*. For example, in order to mitigate agency problems that potentially arise from the opportunism of management, the establishment of an independent board of directors who monitor managers on behalf of shareholders could serve as a monitoring mechanism (Donaldson and Davis, 1991). Costs associated with establishing the board of directors are examples of monitoring costs.

Secondly, principals can also incur *bonding costs* to ensure that the agents do not undertake actions that might harm the principals' wealth (Jensen and Meckling, 1976). An example of a bonding cost is the expense associated with providing managers with ownership in the firm to align their interests with those of shareholders. Bonding activity also includes the establishment of a remuneration committee, whose aim is to ensure the directors are fairly remunerated, hence linking the wealth of directors to the wealth of shareholders.

Thirdly, the principals may also bear *residual losses*. While the principals have attempted to minimise wealth loss through monitoring and bonding activities, residual losses may arise as there could be some diversions between agents' actions and principals' interests (Hill and Jones, 1992). For example, agents and principals might make different decisions under the same circumstances. In summary, agency costs consist of monitoring costs, bonding costs, and residual losses (Jensen and Meckling, 1976).

As previously explained, one way to align shareholders' and managers' interests is by establishing a monitoring mechanism. Monitoring by shareholders is an example. However, it might be difficult for shareholders to exercise control in monitoring managers if there is a wide dispersion of share ownership (John and Senbet, 1998), because of the costs associated with monitoring. This argument is consistent with Hart (1995) who argues that shareholders have little incentive to monitor management as it is costly. In particular, smaller shareholders, since they have only a small stake in the firm, will not exercise any monitoring mechanisms when the costs they have to incur outweigh the benefits. Therefore, there is a need for external monitoring mechanisms.

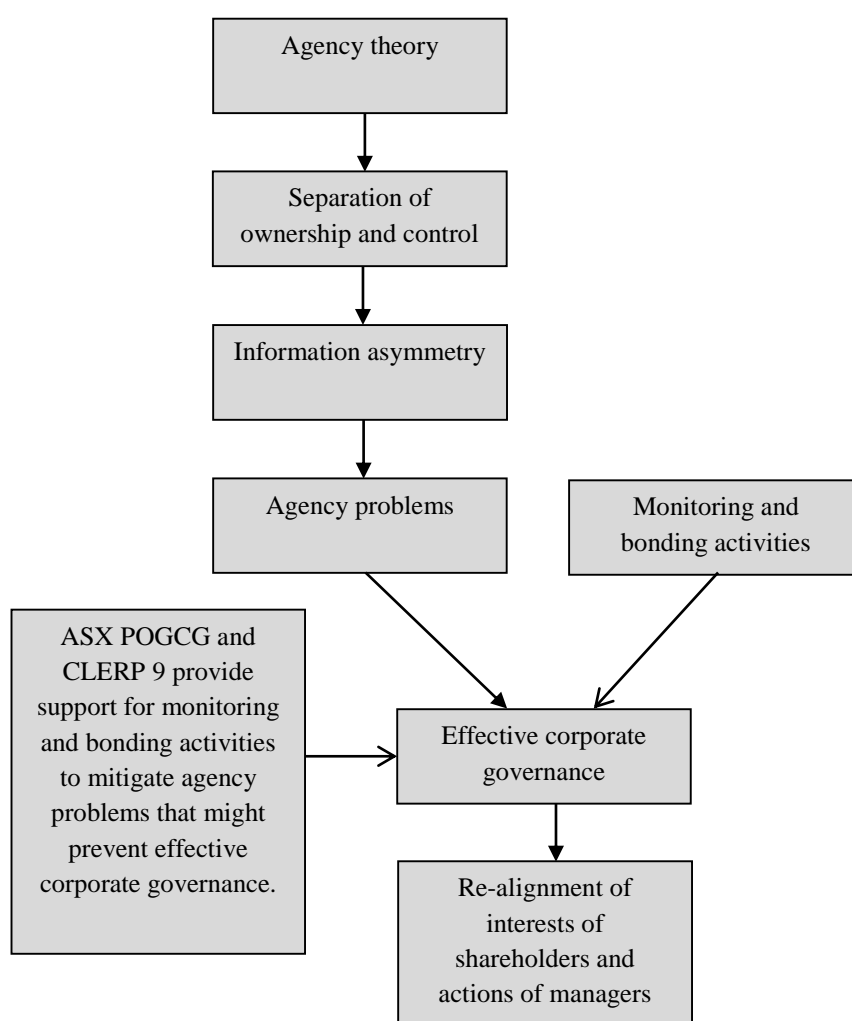
Australian corporate governance requirements, namely the ASX POGCG and CLERP 9, were introduced to protect shareholders. These requirements include several corporate governance attributes that serve as external monitoring mechanisms to minimise potential agency problems. For instance, Recommendations 2.1 and 2.3 of ASX POGCG provide suggestions regarding the composition of the board of directors and the importance of division of roles between CEO and Chairman.

Donaldson and Davis (1991) describe the board of directors as one possible mechanism available to monitor managers on behalf of shareholders. John and Senbet (1998) also emphasize the importance of the board of directors as a core component of corporate governance. As a monitoring mechanism, the board of directors is expected to be independent and objective in order to protect the interests of shareholders from managers' potentially value-decreasing actions. As suggested by the ASX POGCG, the independence and objectivity of the board of directors can be enhanced by establishing certain board attributes, such as having a majority of independent directors on the board and ensuring the roles of Chief Executive Officer and Chairman are kept separated. As outlined by Hart (1995), executive directors would not be able to monitor themselves, therefore outside directors are expected to provide a more effective monitoring function. Moreover, it is argued that CEO duality (the role of CEO and Chairman held by the same person) increases the CEO's influence over the board of directors which might impair the board's effectiveness. Therefore, separation of these roles is essential. These board attributes are expected to minimise a manager's opportunity to pursue their self-interest.

In summary, this section has explained the agency theory framework that underpins this study. It explains separation of ownership and control, as a result of the principal-agent relationship, and the resultant issues of information asymmetry and agency problems. In mitigating these problems, it is necessary to undertake external monitoring (and bonding)

mechanisms, as recommended by ASX POGCG and CLERP 9. These corporate governance requirements specify several attributes, including board and audit committee composition, limitation of audit partner tenure and non-audit services fees, and recommendations against CEO duality. These attributes are intended to achieve effective corporate governance, that is, they serve as external mechanisms to resolve the agency problems. Figure 2.1 summarises the theoretical framework which explains how the current corporate governance requirements fit in with agency theory.

Figure 2.1 Theoretical Framework (Agency Theory)



2.2.2 Directors

While prior corporate governance studies have concentrated on shareholders as an important group of stakeholders, directors have not been a focus of previous studies. However, directors are also important as they have positional power in the firm providing the link between shareholders and management, and making decisions that can affect other stakeholders. In terms of directors' roles in corporate governance, they implement the requirements of the corporate governance codes in their firms. As well as being shareholders' representatives, directors are also important in their own right due to their own financial interests in the firm, including their remuneration and the risk of financial penalties as a result of fraud. An industry representative of directors who was interviewed as part of this study expressed the view that corporate governance requirements (ASX POGCG and CLERP 9) have placed too much focus on protecting the shareholders from directors' supposed misbehaviour without considering directors themselves as important stakeholders of firm. In explaining the importance of effective corporate governance from the perspective of directors, this study draws on signalling theory.

Signalling theory is grounded on information asymmetry that exists between two parties. One of the first studies that utilised signalling theory, Spence (1973), examines the information asymmetry that exists between potential employers and candidates in the labour market. As potential employers do not have sufficient information to assess candidates' quality, candidates send signals in the form of educational qualifications to enable potential employers to assess their capability, hence reducing this information asymmetry. In the corporate governance literature, signalling theory has been used by some studies to examine how the capital market views firms using the signals provided by the boards. For example, Musteen, Datta and Kemmerer (2010) find that firms with a higher proportion of outside directors are associated with better reputation. This finding

suggests that the signal sent to market participants in the form of certain board attributes, namely proportion of independent directors, could affect participants' perceptions of the firm's reputation.

The current study uses signalling theory in examining directors' perceptions of effective corporate governance, to see which corporate governance attributes can act as a signal to market participants to demonstrate effective corporate governance in the firm. Specifically, the arguments about directors' incentives to send signals to the market are grounded in their attempt to protect their reputation and avoid litigation risks. These are explained in the directors' reputation hypothesis and legal liability argument respectively.

Directors' reputation hypothesis

The directors' reputation hypothesis proposes that directors are concerned to maintain their reputation. This provides incentives for directors to enhance the effectiveness of corporate governance, as it may impact their reputation. For example, Fama and Jensen (1983) suggest that directors have incentives to exercise optimally roles like monitoring in order to signal to the labour market that they pursue shareholders' interests, which can enhance their reputation.

According to Fama and Jensen (1983), a director's reputation can be proxied by the number of directorships s/he holds, that is, more directorships indicate a better quality of director. One possible way to enhance their reputation is by ensuring that firm is effectively run and controlled, that is, effective corporate governance is achieved.

Prior literature provides some evidence for the directors' reputation hypothesis. Specifically, several previous studies have established the association between directors'

reputation, generally proxied by the number of additional directorships that directors hold (Fama and Jensen, 1983; Yermack, 2004), and various outcomes of corporate governance, such as firm performance and financial reporting quality. Firstly, it was found that the appointment of directors is positively associated with firm performance. Yermack (2004) uses opportunities to serve on boards of other companies as a proxy for a director's reputation and finds a positive association with firm performance. In interpreting the finding, however, he acknowledges that external directorships might not be the best measure of reputation. His findings suggest that directors in underperforming firms might face the threat of poor reputation, as evidenced by fewer opportunities to serve on other boards. Furthermore, Brickley, Coles and Linck (1999) also find that firm performance is positively associated with the likelihood of the CEO serving as an outside director of another company, that is, good firm performance leads to sound CEO reputation. These findings indicate that firm performance, as an outcome of corporate governance, is associated with directors' reputation.

Despite previous studies showing a positive association between multiple directorships and firm performance, it can be argued that directors serving on multiple boards might have a negative impact on firm performance as they become busier (busyness hypothesis). Fich and Shivdasani (2006) find that firms with a majority of outside directors holding three or more directorships are associated with lower market-to-book ratios and weaker profitability. Nevertheless, this study develops hypotheses based on the finding in the literature that directors aim at securing existing and future directorships, which provides incentives for them to enhance the corporate governance effectiveness in maintaining their reputation.

Secondly, prior research also finds that the financial reporting quality of the firm may affect directors' reputations, that is, directors in firms with poor financial reporting quality

might be punished by a decline in the number of additional directorships they are able to hold. A study conducted by Fich and Shivdasani (2007) examined the reputational impact of financial fraud on outside directors and, consistent with the reputation hypothesis, they found a decline in the number of external directorships held by outside directors following lawsuits in the firm associated with financial fraud. This finding indicates that outside directors suffer reputational damage as a result of the occurrence of fraud.

The findings of the studies mentioned here indicate associations between a firm's performance and financial reporting quality and its directors' reputations. As firm performance and financial reporting quality are the outcomes of corporate governance (Brown, Beeks and Verhoeven, 2011), there is an incentive for directors to send signals to the public to protect their reputation. In achieving this, directors are expected to perceive particular corporate governance attributes to be more important, which is the point that is explored in this study in more detail.

Directors' legal liability argument

In addition to damage to their reputation, directors might also be concerned to avoid legal liability that is associated with their failure to exercise appropriate control in minimising the occurrence of financial fraud in the firm. Eichenseher and Shields (1985) provide evidence on how directors of US companies are exposed to legal actions which might be caused by their negligence and misconduct. These incidents involving directors reached their pinnacle with the introduction of the Foreign Corrupt Practices Act of 1977 which emphasised the importance of the establishment of internal control in corporations.

As a form of “insurance” to protect them against such exposure to litigation, directors have an incentive to exercise their monitoring function optimally in order to provide evidence (that is, signal the public) that they have exercised due care in fulfilling their duties, as argued by Eichenseher and Shields (1985). Specifically, those authors argue that, as a result of legal actions, directors favoured two aspects of corporate governance. Firstly, directors have an incentive to support the establishment of an audit committee. There are several benefits associated with audit committee formation. Not only can it be argued that an audit committee increases the efficiency and effectiveness of the audit process, it is also useful to signal that the board has exercised its duty of care, hence reducing directors’ legal exposure (Eichenseher and Shields, 1985). Moreover, Menon and Williams (1994) also argue that while an audit committee might not be viewed as useful by a board, its existence can be utilised to signal to stakeholders that monitoring activity has been implemented effectively. Secondly, there was a tendency to favour the use of Big-eight audit firms as an aid against litigation. There are several advantages of engaging a Big-eight audit firm. The most notable benefit is that the Big-eight audit firms have a sound reputation for delivering good audit quality, and therefore serve as a signal to the public in an attempt to protect directors from the adverse consequences of legal action.

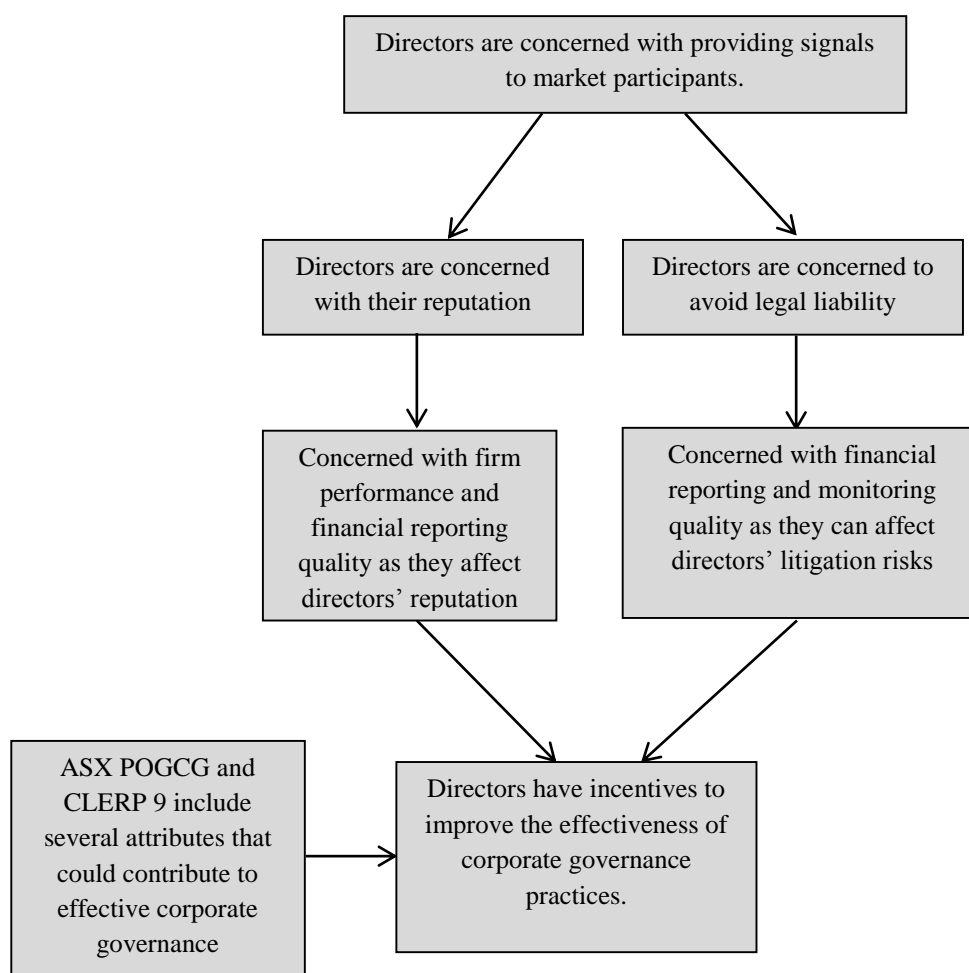
While the above arguments explain why directors might take certain actions to insure them against potential legal actions, these propositions might be negated by the fact that corporations are able to indemnify their directors from legal liability by purchasing directors and officers (D&O) insurance. There are several contrasting views regarding D&O insurance. On the one hand, D&O insurance arguably encourages managers to take more risks which might be more aligned with shareholders’ interests (O’Sullivan, 1997) and attract potential high quality directors to the firm (Daniels and Hutton, 1993;

O'Sullivan, 2002). On the other hand, D&O insurance is also scrutinised for having an adverse impact on corporate governance as its existence potentially negates shareholder litigation as one monitoring mechanism (O'Sullivan, 1997). Nevertheless, Bhagat, Brickley and Coles (1987) posit that although D&O insurers are responsible for bearing the costs and damages awarded as a result of litigation, reputational costs might still need to be borne by directors. These associated costs are one possible incentive for directors to perform their roles optimally despite the existence of D&O insurance.

Legal liability arguments explain why directors are likely to be concerned about the corporate governance of the firm. Although recent trends show that D&O insurance has been used increasingly to protect directors, directors still have incentives to take some precautionary measures to improve the effectiveness of corporate governance. These actions serve as a form of insurance in order to avoid the risk of litigation against them regarding fraud.

Overall, this section has discussed how directors are concerned with sending signals to the public to protect their reputation and avoid legal liability against them. In order to protect their reputation and avoid litigation risks, directors need to maintain firm performance, financial reporting and monitoring quality. As these are associated with corporate governance, directors have incentives to enhance the effectiveness of corporate governance. Figure 2.2 summarises the theoretical framework which explains how the current corporate governance requirements and the attributes included in these requirements fit in with signalling theory and, specifically, with directors' reputation hypothesis and legal liability argument.

Figure 2.2 Theoretical Framework (Signalling Theory)



2.3 Prior literature on corporate governance attributes

In defining the concept of effective corporate governance, this study uses eleven corporate governance attributes. As mentioned earlier in this chapter, these attributes are sourced from the two corporate governance codes in Australia, ASX POGCG and CLERP 9. These attributes have also been extensively examined by previous studies in the international corporate governance literature. Studies conducted by Aggarwal and

Williamson (2006) and Aggarwal, Erel, Stulz and Williamson (2010) examine whether the regulations introduced by the Securities and Exchange Commission (SEC) in the U.S. are effective in including the relevant corporate governance attributes. Those studies were based on the changes introduced by the Sarbanes-Oxley Act. In exploring how the legislation changed corporate governance practice in the U.S., they used 64 corporate governance attributes developed by the Institutional Shareholder Services (ISS), which are further classified into seven major groups. However, not all of these groups and attributes are relevant to the current study since it examines perceptions of corporate governance in Australia, which has different requirements to the U.S.

This section discusses prior literature that has examined the eleven corporate governance attributes included in this study and their association with various corporate governance outcomes (firm performance and value, financial reporting quality, and monitoring quality). The method of selecting the attributes is explained in Chapter 4. These outcomes of corporate governance are identified by Brown, Beekes and Verhoeven (2011) as important outcomes of corporate governance practices. While this study focuses on the Australian literature, it also considers evidence from studies conducted in other countries which have similar regulatory and economic settings, such as the U.S. and U.K.

The selection of these attributes is influenced by four important aspects of corporate governance, namely: (i) Board of directors, (ii) Audit committee, (iii) Audit independence, and (iv) Executives. These attributes are summarised in Table 2.1. The following sections demonstrate how these attributes are important, by providing discussion of the findings from previous studies related to them.

Table 2.1
Corporate Governance Attributes

| Categories | Corporate Governance Attributes |
|--------------------|--|
| Board of Directors | Board Composition |
| | Board Size |
| | Board Meeting Frequency |
| | Multiple Directorships |
| Audit Committee | Audit Committee Composition |
| | Audit Committee Size |
| | Audit Committee Meeting Frequency |
| Audit Independence | Provision of Non-audit Services by the Auditor |
| | Audit Partner Tenure |
| Executives | Remuneration Committee Composition |
| | Chief Executive Officer Duality |

2.3.1 Board of directors

The board of directors has several important roles within firm. According to the ASX POGCG (2007), the roles of boards of directors include but are not limited to overseeing the company, appointing the Chief Executive Officer, and monitoring senior executives' performance. As a core part of the firm's internal governance, they have a role as one possible monitoring mechanism to ensure that managers' actions are aligned to shareholders' interests (Baysinger and Butler, 1985). Previous research shows that the effectiveness of the roles of the board of directors is influenced by the attributes of the

boards, including composition, size, meeting frequency, and the number of directorships a director holds (multiple directorships).

Board composition

According to agency theory, the role of the board of directors in corporate governance is to monitor management in order to protect the interests of stakeholders. As stated by Fama (1980) and Fama and Jensen (1983), one possible factor that may affect the board monitoring function is its independence, which is itself measured by the proportion of independent directors on the board or board composition. In particular, they posit that a board of directors dominated by inside directors might suffer from collusion with managers in expropriating shareholders' wealth; therefore outside directors are needed to mitigate such problems. Regulators, taking an agency theory perspective, are concerned with the independence of the board of directors in ensuring that they perform their monitoring role optimally. ASX POGCG includes a recommendation that a majority of the board should consist of independent directors (Recommendation 2.1). ASX POGCG itself defines an independent director as "a non-executive director who is not a member of management and who is free of any business relationship that could materially interfere with the independent exercise of judgment" (ASX POGCG, 2007).

Previous studies have examined the association between board composition and various outcomes of corporate governance, and report mixed findings. Some studies (Rosenstein and Wyatt, 1990; Brickley, Coles and Terry, 1994; Rhoades, Rechner and Sundaramurthy, 2000; Singhchawla, Evans and Evans, 2011) report a positive association between board composition and firm performance (value), whereas others (Agrawal and Knoeber, 1996; Yermack, 1996; Klein, 1998; Muth and Donaldson, 1998; Christensen,

Kent and Stewart, 2010) find a negative association. A study conducted by Dalton, Daily, Ellstrand and Johnson (1998) finds little evidence of systematic board composition and firm performance relationship.

Prior corporate governance studies have investigated the association between board composition and financial reporting quality. Dechow, Sloan and Sweeney (1995), Beasley (1996), Klein (2002) and Davidson, Goodwin-Stewart and Kent (2005), for example, report a positive association between board independence and financial reporting quality. Furthermore, He, Wright, Evans and Crowe (2009) find a weak positive association between the proportion of non-executive directors and earnings management. With regard to the impact of board independence on monitoring quality, Hermalin and Weisbach (1998) report that firms with a majority of independent directors (at least 60%) are more likely to replace the CEO. Furthermore, Carcello, Hermanson, Neal and Riley (2002) report that higher board independence is associated with higher audit fees, indicating that firms with a majority of independent directors are concerned with audit quality. Regardless of the mixed findings of the studies related to association between board composition and firm performance, board composition is established as one of the important corporate governance attributes that has been extensively examined by prior research and found to be associated with several outcomes of corporate governance.

Board size

Board size reflects the number of members of the board of directors. From a theoretical perspective, Eisenberg, Sundgren and Wells (1998) argue that board size is important for two reasons: (i) communication and coordination issues and (ii) the ability of the board to control and monitor management. From the regulatory perspective, ASX POGCG has

not specifically recommended an ideal size for a board of directors. Nevertheless, recommendation 2.4 states: “The board should be of a size and composition that is conducive to making appropriate decisions. The board should be large enough to incorporate a variety of perspectives and skills, and to represent the best interests of the company as a whole rather than of individual shareholders or interest groups. It should not, however, be so large that effective decision-making is hindered” (ASX POGCG, 2007).

The association between board size and various outcomes of corporate governance has been investigated by prior research with conflicting findings. For example, Yermack (1996) and Mak and Kusnadi (2005) find a negative association between board size and Tobin’s Q, as a proxy for firm value. On the other hand, Dalton, Daily, Johnson and Ellstrand (1999) and Kiel and Nicholson (2003) report a positive association between board size and firm performance.

With regard to the association between board size and financial reporting quality and monitoring quality, prior research also reports inconsistent findings. On the one hand, several studies, such as Yermack (1996), Beasley (1996), and Vafeas (2000), indicate that there is a negative association between them. Specifically, they find that smaller boards are more effective in enhancing financial reporting and monitoring quality. However, using discretionary accruals as a proxy for financial reporting quality, Xie, Davidson and DaDalt (2003) find a negative association between board size and discretionary accruals, indicating that larger boards may be more effective in mitigating earnings management. In interpreting their findings, they argue that larger boards might have more experience and therefore be a better mechanism for improving financial reporting quality.

Previous studies have extensively examined the association between board size and various corporate governance outcomes, such as firm performance and value, monitoring quality and financial reporting quality. Despite conflicting findings from this previous research, board size is shown to be an important corporate governance attribute.

Board meeting frequency

Board meeting frequency has been utilised to measure the level of board activity. The importance of board meeting frequency is raised by Lipton and Lorsch (1992), who argue that one common problem that restricts the effectiveness of the board is the lack of time to fulfil its responsibilities. From a regulatory point of view, CLERP 9 and ASX POGCG do not have specific regulations regarding the number of board meetings required to enhance corporate governance of the firm. ASX POGG (recommendation 2.4) suggests only that the members of board of directors should be able to devote time in fulfilling their duties, without specifying the number of meetings required.

Prior research has rarely examined the impact of board meeting frequency on outcomes of corporate governance. The most notable finding is reported by Vafeas (1999) who examines the association between board meeting frequency and firm performance. In particular, Vafeas (1999) finds that more frequent board meetings are associated with higher future operating performance. On the other hand, a negative association between the number of board meetings and firm performance (proxied by Tobin's Q) is found for Australian companies, as reported by Christensen, Kent and Stewart (2010).

Prior studies have also examined the relationship between board meeting frequency and the monitoring quality of the board. Conger, Finegold and Lawler (1998) argue that more

frequent meetings may enhance the effectiveness of the board as it might have more time to discuss important issues. This argument is consistent with Xie, Davidson and DaDalt (2003), who find that board meetings are negatively associated with discretionary accruals, indicating that more active boards are able to limit earnings management practices in the firm and hence improve financial reporting quality. Conversely, Vafeas (1999) fails to provide evidence that board meeting frequency has a significant impact on monitoring quality (proxied by CEO turnover).

In summary, prior research has rarely investigated the association between board meeting frequency and the outcomes of effective corporate governance. Furthermore, conflicting findings are found. Nevertheless, board meeting frequency is an important corporate governance attribute which is included in this study as a proxy for board activity since it is found in the prior literature to be associated with firm performance, monitoring quality, and financial reporting quality.

Multiple directorships

Multiple directorships or interlocks occur when two or more corporations share one or more directors, that is, a director holds more than one directorship (Allen, 1974). In the U.S., interlocks between competitors are prohibited under Section 8 of the Clayton Act 1914, as it is argued that interlocks restrict competition and bring detrimental effects to consumers. In particular, Mizruchi (1996) argues that interlocks may facilitate collusion with other firms in the same industry, in order to gain competitive advantage in terms of price-fixing. In Australia, no similar regulation has been imposed. Regulation (prohibition or restriction) of multiple directorships might be considered as a future corporate governance principle to be recommended in Australia. From an agency theory

perspective, holding multiple directorships might adversely affect the effectiveness of boards. In particular, overcommitted directors might not have their interests aligned with those of shareholders. That is, as explained in Section 2.2.2, multiple directorships may result in a ‘busyness’ effect on directors as they become too busy to focus on maximising shareholders’ wealth. Consequently, limiting the number of directorships is one possible mechanism in ensuring the alignment of directors’ and shareholders’ interests.

Previous studies have extensively examined the association between multiple directorships and various corporate governance outcomes, and reveal inconsistent findings. Carrington (1981) and Pombo and Gutierrez (2011) find that multiple directorships (interlocks) are positively associated with firm performance, whereas Fich and Shivdasani (2006) find that boards which have “busy” directors (holding three or more outside directorship) have weaker performance, as shown by lower market-to-book ratios and weaker profitability.

Previous studies also examine the association between multiple directorships and other outcomes of corporate governance, such as a boards’ monitoring function and financial reporting quality. Hallock (1997) and Barnea and Guedj (2007) report that interlocks are associated with greater CEO compensation. On the other hand, Hashim and Rahman (2011) and Mindzak (2013) report a positive association between interlocks and earning quality, although the latter finds that interlocked boards of directors are negatively associated with voluntary disclosures.

Based on this discussion, it appears that multiple directorships are significantly associated (although the directions of associations vary between studies) with corporate governance outcomes such as firm performance and value, monitoring quality, and financial reporting quality. Therefore, the category of multiple directorships is an important corporate

governance attribute and is included in this study as a possible new attribute that is worthy of examination in an Australian setting.

2.3.2 Audit committee

ASX POGCG suggests that company boards of directors should establish an audit committee to ensure the integrity of financial reporting (ASX POGCG, 2007). Prior literature suggests that the audit committee serves an important role in improving corporate governance practices, for instance, selecting auditors and monitoring the audit process (Menon and Williams, 1994). Klein (2002) also states that the audit committee has a role in reviewing financial statements and internal controls within corporations. Furthermore, she argues that the audit committee might serve the role of a mediator in conflicts between management and external auditors. From another perspective, Spira (1999) also argues that the establishment of the audit committee might increase auditor independence.

The discussion above should indicate the importance of the audit committee in enhancing corporate governance. In order to exercise these roles effectively, the audit committee is expected to be independent, competent, and adequately resourced (Rezaee, Olibe, and Minmier, 2003). Prior research shows that the effectiveness of the audit committee is determined by several attributes, namely (i) audit committee composition, (ii) audit committee size, and (iii) audit committee meeting frequency.

Audit committee composition

As explained in the previous section, the audit committee plays an important role in effective corporate governance in the firm (Menon and Williams, 1994; Klein, 2002). To ensure that the audit committee is independent and can perform its tasks effectively, ASX POGCG (recommendation 4.2) recommends that the audit committee consists of only non-executive directors and a majority of independent directors. The ASX POGCG argues that the audit committee's ability to exercise independent judgment is essential (ASX POGCG, 2007). An independent audit committee is also proposed to improve the integrity of its monitoring (Menon and Williams, 1994) and to limit the influence of management on the auditors, which, as for the board itself, is consistent with agency theory.

Previous studies have examined the association between audit committee composition and various corporate governance outcomes, with conflicting results. For instance, Abbott, Park and Parker (2000), Klein (2002), Bradbury, Mak and Tan (2006), and Lary and Taylor (2012) find a positive association between audit committee composition and financial reporting quality. Conversely, Lin, Li and Yang (2006) and Xie, Davidson and DaDalt (2003) find no significant association between audit committee independence and financial reporting quality, proxied by earnings restatements and discretionary accruals respectively.

With regard to the impact of audit committee independence on monitoring quality, Carcello and Neal (2000) and Bronson, Carcello, Hollingsworth and Neal (2009) find that audit committee independence is positively associated with the likelihood of the firm receiving a going concern opinion, although the latter suggest that this only happens if the audit committee is totally independent. In the Australian setting, Chen, Moroney and

Houghton (2005) find that a higher proportion of non-executive directors on the audit committee is associated with the appointment of an industry specialist audit firm. These findings indicate that the presence of an independent audit committee is positively associated with audit quality, hence improving monitoring quality.

Prior studies have rarely examined the association between audit committee composition and firm performance and value. One possible reason might be that the audit committee is established for monitoring purposes rather than profit-generating purposes. Some notable studies that do examine this association, such as Klein (1998) and Cotter and Silvester (2003), do not find any significant relation.

As one of the corporate governance attributes, audit committee composition is deemed to be important by corporate governance researchers considering the extensive research that has been undertaken in examining this attribute. In particular, it is found to be associated with various corporate governance outcomes, such as financial reporting quality and monitoring quality.

Audit committee size

ASX POGCG (recommendation 4.2) recommends that the audit committee should be of sufficient size to be able it to exercise its functions effectively (ASX POGCG, 2007). The same source specifies that the audit committee should consist of at least three members (recommendation 4.2), which is consistent with the recommendation from the Blue Ribbon Committee (BRC) in the U.S. The BRC also argues that audit committee size is important as adequate resources need to be available to assist the committee when it encounters complexity in financial issues.

Prior research has not examined the relationship between audit committee size and firm performance. Previous studies have focused mainly on how audit committee size is associated with financial reporting quality and monitoring quality. Lin, Li and Yang (2006) find that larger audit committee size may provide better financial reporting quality, as shown by a negative association between audit committee size and earnings restatements. This is consistent with Felo, Krishnamurthy and Solieri (2003), Yang and Krishnan (2005) and Kent, Routledge and Stewart (2010) who find a positive association between audit committee size and financial reporting quality. On the other hand, Xie, Davidson and DaDalt (2003) report no association between them.

Furthermore, using the likelihood of choosing a big-N audit firm as a proxy for monitoring quality, Chen and Zhou (2007) find that firms with larger audit committees are more likely to choose a big-N audit firm, indicating that a larger audit committee may be able to exercise its function better in choosing the auditors and hence improving audit quality (monitoring quality).

The above discussion demonstrates that audit committee size is an important corporate governance attribute examined by prior research. Furthermore, regardless of minor inconsistency between the results, audit committee size is found to be associated with financial reporting quality and monitoring quality.

Audit committee meeting frequency

Another audit committee attribute that might influence the effectiveness of an audit committee is audit committee activity, which is proxied by its meeting frequency. ASX POGCG (recommendation 4.2) recommends that the audit committee should meet

frequently in order to be able to perform its functions effectively. Whilst it does not specify the number of meetings required to enable the audit committee to exercise its monitoring function optimally, Morrissey (2000) and the BRC (1999) suggest that audit committee members should meet at least four times a year to assure the quality of financial reporting.

Prior research has not examined the association between audit committee meeting frequency and firm performance. Previous studies have focused on how audit committee meeting frequency is associated with financial reporting quality, as one outcome of corporate governance. Most of the studies have reported that more active audit committees (holding more frequent meetings) result in a lower incidence of earnings management. For instance, Xie, Davidson and DaDalt (2003) find a negative association between the frequency of audit committee meetings and discretionary accruals. This result is consistent with Abbott and Parker (2000) and Beasley, Carcello, Hermanson and Lapides (2000) who find that audit committee meeting frequency is negatively associated with fraudulent financial reporting. Kent, Routledge and Stewart (2010) also report that audit committee meeting frequency is positively associated with innate accruals quality.

In the Australian setting, Goodwin-Stewart and Kent (2006) find a positive association between the frequency of audit committee meetings and audit fees. Furthermore, Stewart and Munro (2007) report that the frequency of audit committee meetings is negatively associated with perceived audit risk. The findings from these studies indicate that a higher frequency of audit committee meetings is associated with higher monitoring quality.

Previous studies have extensively examined audit committee meeting frequency as one attribute of corporate governance and found it to be associated with financial reporting

quality, and monitoring quality. Therefore, it is an important attribute to be included in this study.

2.3.3 Audit independence

Audit process serves as an external monitoring mechanism in ensuring that the financial report reflects a true and fair view of the company's financial situation, and therefore audit quality holds an important role in maintaining investors' confidence. Following several corporate collapses, such as Enron in the U.S. and HIH Insurance in Australia, the notion of auditor independence as an important aspect of audit quality has been prominent. Several legislative reforms, such as the Sarbanes-Oxley Act in the U.S. and CLERP 9 in Australia, have been introduced to enhance auditor independence. The concept of auditor independence itself is defined as the auditor being intellectually honest and free from any conflict of interest with the firm's clients (AICPA, 1990).

Spira (1999) emphasizes the importance of auditor independence by arguing that it is essential in improving financial reporting and corporate governance practice. While actual auditor independence is important, perceived auditor independence is also important in its own right as perceptions of audit independence and objectivity can affect financial report users' decisions and reliance on audited financial statements (SEC, 2000).

CLERP 9 has introduced two mechanisms that are expected to enhance auditor independence: (i) limitation of the provision of non-audit services by the auditor and (ii) limitation of audit partner tenure via mandatory audit partner rotation.

Provision of non-audit services by the auditor

Prior literature has brought to light two perspectives on how non-audit fees may impact monitoring quality (audit quality), and consequentially affect financial reporting quality. On the one hand, excessive non-audit services fees may impair auditor independence as they cause the auditor to be financially dependent on the client and hence to have fewer incentives to report material misstatements in financial reports. This argument is supported by findings from several studies, including Frankel, Johnson and Nelson (2002), Larcker and Richardson (2004), and Ferguson, Seow and Young (2004), who find a positive association between non-audit service fees and discretionary accruals, indicating that large non-audit fees impair financial reporting quality. Wines (1994) also finds that a higher level of non-audit fees is associated with a lower likelihood of audit qualification, indicating an impairment in audit quality. Habib (2012) provides evidence using meta-analysis that non-audit fees are perceived by investors as a threat to auditor independence, as shown by negative association between non-audit fees and earnings response coefficients.

Supporting this perspective, in the aftermath of Enron's collapse in the U.S., the Sarbanes-Oxley Act was introduced in 2002 to require non-audit services to be approved by the audit committee and disclosed in the financial report. Similarly, Australia's CLERP 9 also requires that non-audit service fees should be disclosed and should be limited. From an agency perspective, these regulations limit non-audit services, and strengthen the role of audit as a monitoring mechanism.

On the other hand, it can be argued that non-audit fees might improve auditors' knowledge of the company and may help them to discover material misstatements in financial reports. The results of Antle, Gordon, Narayanamoorthy, and Zhou (2006) are

contrary to the previous studies, in finding that non-audit service fees decrease abnormal accruals, that is, improve financial reporting quality.

While these studies find conflicting results regarding the impact of non-audit fees on financial reporting quality and audit quality, several studies (Craswell, 1999; Lennox, 1999; DeFond, Raghunandan, and Subramanyam, 2002) find no significant association between the level of non-audit fees and audit quality, as proxied by the propensity to issue going-concern and qualified audit opinions.

Despite inconsistent results from these studies, prior research has extensively examined the impact of non-audit fees on various outcomes of corporate governance, such as financial reporting quality and monitoring quality (audit quality). This indicates that non-audit fees are an important attribute of corporate governance and need to be included in this study.

Audit partner tenure

CLERP 9 specifies that the audit partner (both the lead engagement and review partners) of the company must be rotated after five years. The introduction of this requirement is attributed to the concern regarding long auditor tenure which, it is argued, tends to impair auditor independence. Similar to the limitation on the provision of non-audit services, the limitation on audit partner tenure is considered to be a monitoring mechanism to prevent potential conflict of interests and hence increase auditor independence.

Prior research has examined both short and long auditor tenure, and their association with various outcomes of corporate governance, such as financial reporting quality and monitoring quality. On the one hand, short auditor tenure (with auditor rotation) results

in the new auditor not being able to benefit from the client-specific experience of the previous auditor (Lu and Sivaramakrishnan, 2009) and causes a significant learning curve for the new auditors (Knapp, 1991). It is argued that this problem can be mitigated by have longer auditor tenure, as longer tenure can reduce the information asymmetry problem associated with auditor rotation (Knapp, 1991).

On the other hand, it is argued that long auditor tenure may create a problem regarding the auditors' ability to detect material misstatements, as found by Copley and Doucet (1993), Vanstraelen (2000), Myers, Myers, Palmrose and Scholz (2005), and Carey and Simnett (2006). Specifically, long auditor tenure provides incentives for auditors to employ less effort as they have gained client-specific knowledge over the period of the tenure. Auditor rotation is also found to be advantageous by Monroe and Hossain (2013) who suggest that the implementation of mandatory audit partner rotation is associated with higher audit quality, that is, a higher likelihood for auditors to issue qualified going-concern opinions.

Audit Partner Rotation versus Audit Firm Rotation

Fargher, Lee and Mande (2008) compare how partner rotation and firm rotation may differ in terms of the quality of audit services. They suggest that audit partner rotation might mitigate the impairment of audit quality that occurs in the early years of the engagement compared to audit firm rotation. That is, the new partner from the incumbent audit firm faces a less steep learning curve, compared to the new audit partner from a (new) audit firm.

Furthermore, they argue that the audit partner faces a more severe threat of dismissal compared to the audit firm. The reason is that the audit partners also face the threat of being dismissed by the audit firm if they lose valued clients. Based on this argument, Fargher, Lee and Mande (2008) suggest that for long audit partner tenure, the audit partner might have more financial incentives to favour the client, that is, resulting in a decrease in audit quality. Since the current corporate governance requirements mandate the audit partner, rather than the audit firm, to be rotated every five years, this study places the emphasis on audit partner tenure.

The prior research indicates that audit partner tenure is an important corporate governance attribute that is associated with financial reporting quality and monitoring quality, and is therefore included in this study.

2.3.4 Executives

Executives hold the ultimate role with regard to control within the firm and have decision-making power that determines the direction of the company. While executives are important for the company, their effectiveness in fulfilling their roles is affected by several attributes. It is emerging in both literature and practice that the attributes of remuneration (compensation) committee independence and CEO duality are important to achieve effective corporate governance.

Remuneration committee composition

The remuneration committee's role is to determine the remuneration of executives (Klein, 1998). ASX POGCG (recommendation 8.1) recommends that the board establish a

remuneration committee as an efficient mechanism for appropriate remuneration policies (ASX, 2007). Specifically, ASX POGCG suggests that the remuneration committee is essential to ensure fair remuneration for executives and a clear relationship between remuneration and firm performance (ASX, 2007).

As the remuneration committee serves an important role in the company, it is argued that its members should be independent from the management to effectively fulfil their roles. ASX POGCG in 2007 (recommendation 8.2) suggests that the remuneration committee should consist of a majority of independent directors in order to perform its function effectively. In 2010, the ASX made a major amendment to its recommendations, and now requires the top-300 ASX listed companies to have a remuneration committee consisting entirely of independent directors.

From the literature, the remuneration committee is shown to be important by prior studies that have thoroughly investigated its association with various corporate governance outcomes. In relation to the association between remuneration committee composition and firm value, Klein (1998), Vafeas and Theodorou (1998) and Cotter and Silvester (2003) all fail to find evidence of a significant association.

With regard to financial reporting quality and monitoring quality, previous studies report conflicting findings. On the one hand, Williamson (1985) and Newman and Mozes (1999) find that an independent remuneration committee is important in preventing the executives determining their own remuneration. Conversely, Conyon and Peck (1998) find that the proportion of outside directors on the remuneration committee is positively associated with the top level of management remuneration. However, they also find that top level of management remuneration and firm performance are more aligned if the remuneration committee is dominated by outside directors.

While the foregoing studies report conflicting findings, Daily, Johnson, Ellstrand and Dalton (1998), Conyon and He (2004), and Lawrence and Stapledon (1999) do not find a significant association between remuneration committee composition and CEO remuneration.

In summary, prior research demonstrates an association between remuneration committee composition and various governance outcomes, such as financial reporting quality and monitoring quality. Although there are inconsistent findings, the investigation on remuneration committee composition indicates that it is an important attribute of corporate governance.

CEO duality

CEO duality occurs when the same person holds the positions of CEO and Chair of the Board. CEO duality, it is argued, increases CEO influence over the board of directors that might impair its effectiveness. Furthermore, Rechner and Dalton (1991) argue that when the CEO and Chair of the Board are the same person, the shareholders may suffer from agency costs arising from management's opportunistic behaviour. ASX POGCG (recommendation 2.3) recommends that the Chair position and CEO should not be the same person. From an agency perspective, this recommendation is important since CEO duality is said to affect adversely the monitoring functions in the firm.

Prior research has investigated how CEO duality is associated with firm value although the results have been conflicting. On the one hand, Donaldson and Davis (1991) find a positive association between them. On the other hand, Carter, Simkins and Simpson (2003) report an inverse association between CEO duality and firm value. Furthermore,

several studies do not find any significant association between CEO duality and firm performance (Abdullah (2004) and Baliga, Moyer and Rao (1996)). In the Australian setting, Christensen, Kent, Routledge and Stewart (2013) find that the results on CEO duality are mixed. They suggest that these mixed findings imply that the effects of recommendations against CEO duality are not as strong as the regulators' expectations.

Prior research has also examined the relationship between CEO duality and financial reporting quality. Anderson, Deli and Gillan (2003) and Gul and Leung (2004) provide support for the recommendations against CEO duality, while Bradbury, Mak and Tan (2006) fail to provide evidence of an association between CEO duality and earnings quality. With regard to monitoring quality, prior studies such as Jensen (1993) and Boyd (1994) suggest that CEO duality makes it difficult for the board to operate optimally, as there is a conflict of interest for the CEO in performing both roles.

This discussion summarises the findings of prior studies on the relation between CEO duality and several outcomes of corporate governance, such as firm performance and value, financial reporting quality and monitoring quality. Although these studies have reported inconsistent results, given the extensive research that has been conducted, recommendations against CEO duality can be considered to be an important corporate governance attribute.

2.4 Hypothesis development

In Section 2.2 the theoretical framework that underpins this study was presented, while in section 2.3 the literature on corporate governance was reviewed, particularly in regard to the association between corporate governance attributes and their outcomes. This

section develops three specific hypotheses from the theoretical framework and literature relating to both shareholders' and directors' perceptions of effective corporate governance.

2.4.1 Shareholders

One of the aims of this study is to investigate shareholders' perceptions of effective corporate governance. Specifically, it examines which attributes are relatively more important to shareholders in their perceptions of effective corporate governance. As explained in Section 2.2.1, separation between ownership and control in the firm results in information asymmetry and the occurrence of agency problems, both of which can adversely affect shareholder wealth. To mitigate these problems, shareholders engage in both monitoring and bonding activities. Prior studies have found attributes related to the function of the boards to be associated with performance and value, which are of concern to shareholders. Consequentially, based on theory and the prior literature, it is expected that they will perceive attributes closely related to the function of board of directors to be relatively more important. These attributes are: (i) **Board size**, (ii) **Board composition**, (iii) **Multiple directorships**, (iv) **Remuneration committee composition**, and (v) **CEO duality**. Formally, H1a is stated as follows:

H1a: Shareholders perceive corporate governance attributes related to the board of directors to be relatively more important in their assessments of effective corporate governance.

In addition to their primary concern with firm value and performance, shareholders also focus on financial reporting quality of the firm. That is, shareholders are also concerned with avoiding financial irregularities especially in the context of recent corporate collapses. However, shareholders are expected to perceive maximising firm value and performance to be relatively more important than avoiding financial fraud. While attributes related to the audit committee and audit independence, such as audit committee composition and audit partner tenure, are related to maintaining financial reporting quality in the firm, they are not directly related to firm performance/value. Consequently, these attributes are expected to be relatively less important for shareholders. H1b is stated as follows:

H1b: Shareholders perceive corporate governance attributes related to the audit committee and audit independence to be relatively less important in their assessments of effective corporate governance.

2.4.2 Directors

It might be argued that executive and independent directors have slightly different roles in firms (as the management and monitor respectively). Nevertheless, the ASX POGCG does not separate their roles and it could also be argued that they have similar incentives to maintain firms' corporate governance. Specifically, as discussed in Section 2.2.2, directors as a whole are expected to be concerned with their firms' corporate governance in order to send signals to the public to protect their reputation and avoid litigation risks that might arise from the occurrence of fraud. These concerns are related to the fact that

directors have financial interests in the firms that are affected by their reputations. Therefore, this study treats the roles of executive and independent directors as a whole homogenous board.

The board of directors is the main monitoring mechanism in the firm and the importance of its independence in achieving effective corporate governance is widely known. Board independence is publicly disclosed, and affects both the reputations of the company and the directors. Previous studies have measured board independence by the proportion of non-executive directors on the board and also by whether the positions of CEO and Chairman are held by the same person. As board independence is closely linked to the reputation of the directors, this study predicts that directors will rate **board composition** and **CEO duality** ahead of other attributes.

According to Fama and Jensen (1983), a director's reputation is measured by the number of directorships held, that is, more directorships indicate a better reputation. Therefore, holding **multiple directorships** is expected to be perceived as important corporate governance attribute as it is related to director reputation. Moreover, having directors who hold multiple board positions is valuable to their companies as these directors could bring their extensive experience to the boardroom. According to AICD (2005), limiting the number of directorships a director holds might force firms to incur more costs in selecting new directors from the directors' labour market. Formally, H2a is stated as follows:

H2a: Directors perceive corporate governance attributes related to their reputation to be relatively more important in their assessments of effective corporate governance.

Attributes related to the audit committee and audit independence, such as the size, meeting frequency, and composition of the audit committee, the provision of non-audit services and audit partner tenure, might have an impact on directors' reputation. Nevertheless, the magnitude of this impact is not expected to be as strong as the impact of the aforementioned attributes (board composition, CEO duality, and multiple directorships) on directors' reputation. Specifically, these attributes are more related to the sub-committee of the board (audit committee) and the auditor, rather than the board itself. Consequently, directors are expected to be relatively less concerned with attributes related to the audit committee and audit independence. There are no expectations regarding the relative importance of the remaining corporate governance attributes (board size, board meeting frequency, and remuneration committee composition). H2b is stated as follows:

H2b: Directors perceive corporate governance attributes related to audit committee and audit independence to be relatively less important in their assessments of effective corporate governance.

2.4.3 Comparisons between shareholders and directors

After examining both shareholders' and directors' perceptions of effective corporate governance separately, this study will also compare the results between these groups. This comparison is conducted to address the issues of resolution of the agency problem, namely information asymmetry, and the appropriate content and level of regulation. Specifically, this comparison provides insights into whether and how their views differ or

are aligned, and whether directors on the whole have their interests aligned to those of shareholders and therefore are likely also to be good monitors of managers.

Based on preceding discussions on both H1 and H2, shareholders and directors are expected to have similar perceptions of the importance of corporate governance attributes. As explained in previous sections, shareholders are concerned with firm performance and value as they are the owners of the firms. Moreover, directors' concerns with corporate governance are driven by their incentives to protect their reputation. Therefore, H1a and H2a predict that both stakeholder groups are likely to perceive attributes related to board of directors to be relatively more important in their assessments of effective corporate governance. This is because these attributes are found to be associated with firm performance and value, and also have impacts on directors' reputation. The common attributes expected to be perceived by both shareholders and directors to be important are: (i) Board composition, (ii) CEO duality, and (iii) Multiple directorships.

With regards to attributes perceived to be relatively less important by shareholders and directors, H1b and H2b predict that these stakeholder groups perceive attributes related to the audit committee and audit independence, such as the size, meeting frequency, and composition of the audit committee, the provision of non-audit services and audit partner tenure to be relatively less important. This is because these attributes have no direct impacts on firm performance and value, and on directors' reputation. It can be argued that these consistent expectations between both groups are attributed to the alignment in their goals and interests in the firm as the maximisation of firm value and return are beneficial for both shareholders' wealth and directors' reputation. Therefore, the hypotheses are stated as follows:

H3a: Shareholders and directors have similar perceptions of attributes that are relatively more important in their assessments of effective corporate governance.

H3b: Shareholders and directors have similar perceptions of attributes that are relatively less important in their assessments of effective corporate governance.

The answers to H3a indicate the extent to which shareholders' and directors' higher relative preferences correspond, which provides assurance that current practices and regulations are achieving their purposes. H3b shows the extent to which their lower relative preferences correspond, and provides potential areas in which regulations could be reduced in future.

2.5 Conclusion

This chapter summarises the theories that underlie this study. This chapter also discusses the corporate governance attributes examined in this study which are selected from the existing corporate governance requirements and also based on prior studies in corporate governance literature. Furthermore, based on the theories and prior literature, this chapter presents the argument that leads to the development of the hypotheses. Specifically, it outlines three testable hypotheses concerning the relative importance of corporate governance attributes from the perspective of two groups of stakeholders, namely (i) Shareholders and (ii) Directors, and the comparisons between these results. Details about the research method utilised to test these research questions are outlined in chapter 3.

CHAPTER 3

RESEARCH METHOD

3.1 Introduction

This chapter discusses the choice of research method used in this study to test the hypotheses developed in Chapter 2. Section 3.2 explains the choice of Adaptive Conjoint Analysis as the data analysis technique. Section 3.3 discusses the operational definitions of corporate governance attributes that are used in this study. Next, Section 3.4 identifies the attribute levels that have been chosen for each of the corporate governance attributes. The chapter is concluded in Section 3.5.

3.2 Justification of research method

As discussed in Chapters 1 and 2, this study investigates stakeholders' perceptions of effective corporate governance. Specifically, it examines the relative importance of several corporate governance attributes from the perspective of two groups of stakeholders, namely shareholders and directors. The hypotheses are concerned with associations between several independent variables (shareholders' and directors' perceptions of corporate governance attributes) and one dependent variable (shareholders' and directors' assessments of effective corporate governance). As there is more than one independent variable, multivariate analysis is the most appropriate method for use in this study.

3.2.1 Multivariate techniques

Hair (2006) presents an overview of several multivariate analysis techniques, including multiple regressions, multiple discriminant analysis, canonical correlation analysis, multivariate analysis of variance, and conjoint analysis. Hair (2006) explains a three-step approach that is necessary to select the most appropriate multivariate technique, the choice of which depends on the nature of the study. Accordingly, this study also follows these three steps in determining the data analysis technique used.

The first step is to determine whether the variables can be classified as independent and dependent. According to Hair (2006), a dependence technique is the most suitable method if the variables can be defined as independent and dependent variables. On the other hand, in the case that no single variable can be classified as a dependent or an independent variable, an interdependence technique should be used. Given the nature of this study, a **dependence technique** is more suitable since both independent (perceptions of corporate governance attributes) and dependent variables (assessments of effective corporate governance) can be identified.

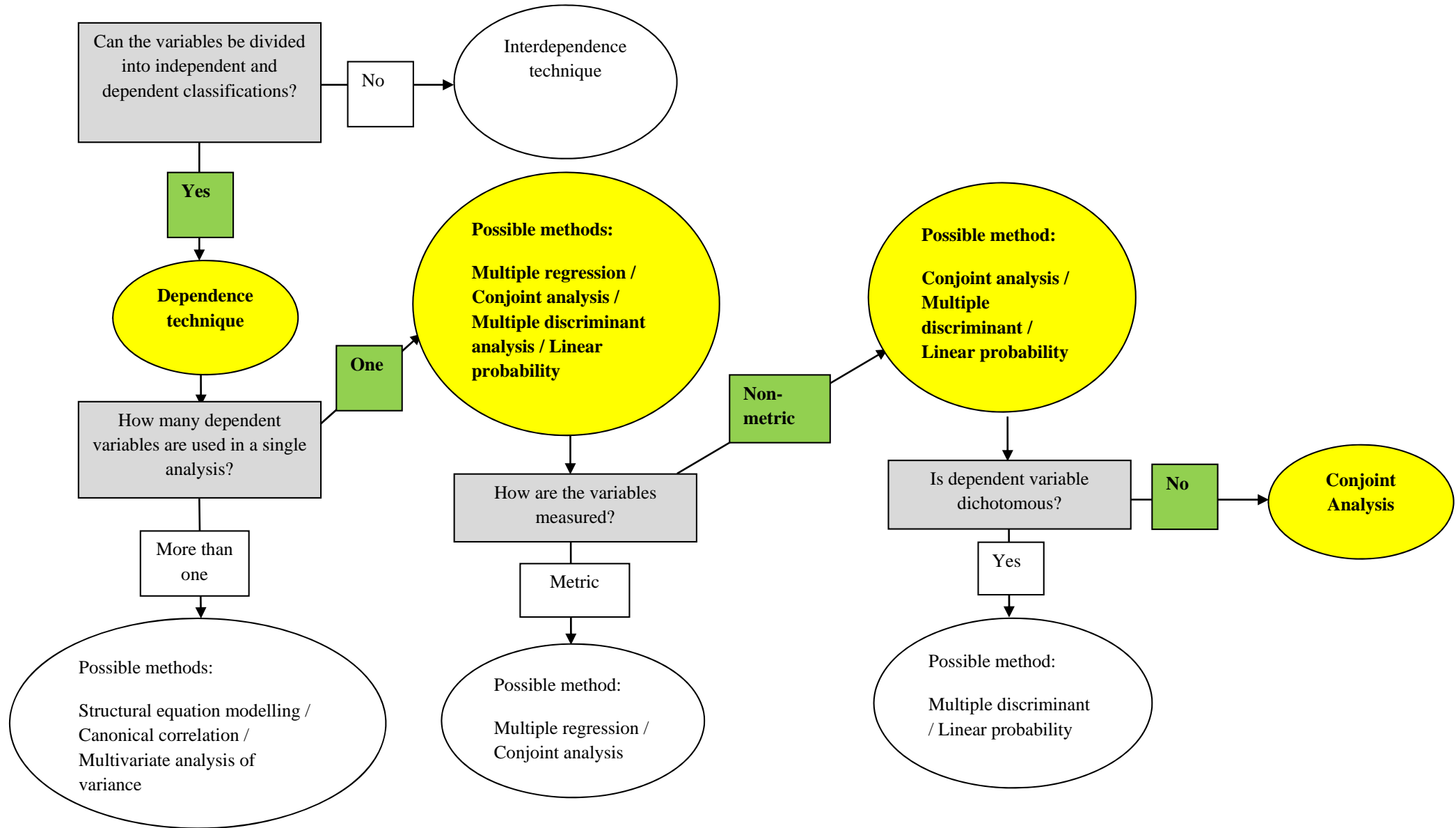
Secondly, it is necessary to determine how many dependent variables are used in a single analysis, that is, whether the study utilises one or more dependent variables. In the case that there is only one dependent variable, there are four suggested methods (Hair, 2006). They are (i) Multiple regression analysis, (ii) Conjoint analysis, (iii) Multiple discriminant analysis, and (iv) Linear probability models. Conversely, if there is more than one dependent variable, Hair (2006) suggests the following methods: (i) Structural equation modelling, (ii) Canonical correlation analysis, and (iii) Multivariate analysis of variance. Since this study involves only one dependent variable, namely

assessments of effective corporate governance, the latter methods are therefore eliminated from consideration.

Lastly, Hair (2006) suggests that the choice of method depends on the way both dependent and independent variables are measured, that is, whether the variables are quantitative (metric) or qualitative (nonmetric). Multiple regression and conjoint analysis are more appropriate in the case where the variables are quantitative in nature, although the latter can also be used if the variables are qualitative. If the variables are qualitative, multiple discriminant analysis, linear probability models and conjoint analysis are suitable. As this study aims to collect data that are qualitative in nature, the latter methods are considered to be more appropriate.

Across these three methods of analysis, namely (i) multiple discriminant analysis, (ii) linear probability models, and (iii) conjoint analysis, the first two are suitable if the dependent variable is dichotomous (Hair, 2006). Since this study aims to collect qualitative and non-dichotomous data, the appropriate method is **conjoint analysis**. The justification of the choice of the data analysis technique, including the elimination of several other techniques, is summarised in Figure 3.1.

Figure 3.1 The Choice of Data Analysis Technique (Hair, 2006)



3.2.2 Conjoint analysis

Hair (2006) defines conjoint analysis as “a multivariate technique developed specifically to understand how respondents develop preferences for any type of object”. Conjoint analysis is built around the concept of utility, namely people’s judgment in measuring the value of products. Conjoint analysis can be used to assess and analyse consumers’ trade-offs for particular products and services with many attributes and characteristics (Green and Srinivasan, 1990), that is, it allows the respondents to indicate their preference for the products and to what extent they choose one product over the others.

According to Hair (2006), conjoint analysis differs from other multivariate analysis methods as it takes a decompositional, as opposed to a compositional, approach. The compositional approach measures the choice of attributes and the associated value ratings separately (Green and Srinivasan, 1978). On the other hand, a decompositional approach provides respondents with a complete description of the choice of attributes and assesses the value of the attributes using an overall preference measure (Hair, 2006). Hair (2006) emphasizes the importance of this distinction: a decompositional approach enables researchers to analyse the value of attributes using only the overall preference measure, that is, without conducting separate analyses which can be undertaken in a compositional approach.

Compared to other multivariate techniques, conjoint analysis offers several advantages. Hair (2006) states that conjoint analysis enables researchers to estimate models at the individual level. Conversely, estimations of other multivariate methods are conducted at the aggregate level. Conjoint analysis can also work under circumstances where the relationships between dependent and independent variables are not linear, such as the

association between human judgment and preference. In addition, conjoint analysis also provides higher predictive validity (Kilgore, Radich and Harrison, 2011) and avoids double-counting between attributes (Sattler and Hensel-Borner, 2000).

According to Green and Srinivasan (1990), conjoint analysis consists of several different types of models. The first model is traditional conjoint analysis. Green and Srinivasan (1978) explain that the traditional conjoint model consists of two different approaches, namely trade-off and the full-profile approaches. Under the trade-off approach, respondents are given a set of pairwise combinations in a matrix and are asked to rank them from the most to the least preferred combination. According to Green and Srinivasan (1978), the disadvantage of the trade-off approach is that respondents are asked to compare two attributes in isolation at a time, which is not a realistic situation. Conversely, the full-profile approach provides respondents with a complete description of the attributes examined. The respondents are then asked to indicate their preference on the combination of attributes. While this approach arguably increases predictive validity, it is subject to a limitation that the relative importance of the attributes could be influenced by the order in which the attributes appear (Johnson, 1989).

Irrespective of the approach used, the traditional method has a weakness of causing information overload for the respondents if the number of attributes is large. In particular, Green and Srinivasan (1990) suggest that the traditional method can work well only if there are six or fewer attributes.

To overcome these problems associated with having a large number of attributes, researchers have developed a self-explicated model. Firstly, respondents are given a set of attributes and are asked to rank them in order of preference. Next, they are asked to

allocate points that reflect the relative importance of these attributes using the constant sum scale. Finally, estimates of the overall preference (part-worths) associated with the attributes are calculated. While the self-explicated model can mitigate the problem of having a large number of attributes and is easy to design, Green and Srinivasan (1990) identify several limitations associated with this approach. Firstly, it is subject to intercorrelation problems between attributes, which results in respondents experiencing difficulty in rating attributes. Secondly, it can cause a problem of double-counting between attributes as all attributes are questioned separately. Another disadvantage associated with the self-explicated method is that since respondents are asked to rate the attributes individually, they do not make trade-offs and might not be aware of what attributes appear in the next questions which might alter their responses.

The third type of model is hybrid (adaptive) models. These are a combination of traditional conjoint and self-explicated models and were developed in response to the limitations of the earlier models. Green and Srinivasan (1990) provide an insight into how the hybrid model might overcome the limitations of the traditional conjoint and self-explicated models. Firstly, hybrid models can be used with a large number of attributes without resulting in information overload for respondents. Secondly, they can also mitigate the problems of intercorrelation and double-counting which are associated with the use of a full-profile approach in the self-explicated models.

According to Hair (2006), the most widely-known hybrid conjoint model is Adaptive Conjoint Analysis (ACA).¹ This method is administered in a computer-interactive mode (Green and Srinivasan, 1990). ACA is an approach that enables examination of the relative importance of attributes associated with a product or a concept. ACA derives the relative importance of attributes from trade-offs chosen by the respondents, which it

¹ Adaptive Conjoint Analysis (ACA) was developed by Richard Johnson of Sawtooth Software.

uses to indicate the respondents' strength of preference, or their lack of preference, between attributes.

This method was introduced by Johnson (1987). It starts by providing respondents with a list of attributes which they are asked to rank in accordance with their preference. Then, paired comparisons, which are developed based on the responses provided by the respondents to the previous questions, are used in assessing respondents' overall preferences for the attributes (explained in more detail in Chapter 4). In this way, this method enables researchers to observe the respondents' preference for attributes and to what extent one attribute is more important than others (relative importance of the attributes).

According to Huber and Hansen (1986), ACA can work with up to 30 attributes and a maximum of nine levels within each attribute, which provides a significant advantage compared to the other conjoint analysis models. Furthermore, this method enables the respondents to see all attributes before making trade-offs, which overcomes the limitation of self-explicated models in which the respondents are not aware of what attributes appear in the next questions which might alter their responses. However, ACA is also subject to a common limitation of conjoint analysis, in that it can cause respondent fatigue, particularly when there are large numbers of attributes to be examined.

After considering the advantages and disadvantages of other conjoint analysis methods, ACA is chosen to be used in this study as it is the most appropriate method to examine shareholders' and directors' perceptions of the relative importance of corporate governance attributes in their assessments of effective corporate governance.

3.2.3 Adaptive Conjoint Analysis (ACA) and its application to this study

No previous studies in corporate governance have used ACA to examine the relative importance of attributes. Previous studies (Ho and Wong, 2001; Solomon, Lin, Norton, and Solomon, 2003; McDonald, Khanna, and Westphal, 2008) used likert-type scales to examine various issues in corporate governance, such as voluntary disclosure, CEO's advice network, and role of board of directors. Likert-type scales could also be used in this study to examine the importance of corporate governance attributes. However, this method can only provide the absolute importance, rather than relative importance of attributes. The advantage that relative importance has over absolute importance is that in addition to providing attribute ranking, it also indicates the extent to which one attribute is considered to be relatively more important than the others. Specifically, it provides insights into how respondents perceive the attributes if when are provided with trade-offs across several attributes.

Moreover, in only a few instances has ACA been applied in accounting and finance research. Two notable studies that utilises this approach are Kilgore, Radich and Harrison (2011) and Kilgore, Harrison and Radich (2014) which examined the relative importance of audit-team and audit-firm factors in perceptions of audit quality. Another study that has applied this method, Clark-Murphy and Soutar (2004), examined attributes that influence individual investors in their decision making to purchase shares.

3.3 Operational definition of corporate governance attributes

This section discusses the operational definition of the corporate governance attributes described in Chapter 2. The method of selecting the attributes is explained in Chapter 4. The corporate governance attributes and their operational definition are summarised in Table 3.1.

3.3.1 Board composition

With regard to board composition, previous studies such as Brickley, Coles and Terry (1994), Agrawal and Knoeber (1996), Beasley (1996), Klein (2002), Matolcsy, Stokes and Wright (2004), Lim, Matolcsy and Chow (2007), and Christensen, Kent, Routledge, and Stewart (2013) utilise the proportion of independent directors on the board of directors as a measure of board independence. This measure is also consistent with the requirement in ASX POGCG (Recommendation 2.1) which suggests that the board is independent if the majority of the board comprises independent directors (the proportion of independent directors is equal to or greater than 50%). Based on prior literature and ASX POGCG, this study operationalises board composition (independence) as the **proportion of independent directors on the board.**

3.3.2 Board size

Most studies examining board size, such as Yermack (1996), Kiel and Nicholson (2003), Matolcsy, Stokes and Wright (2004), Mak and Kusnadi (2005), Ahmed, Hossain and Adams (2006), Lim, Matolcsy and Chow (2007), Coles, Daniel and Naveen (2008) and Nakano and Nguyen (2012), have quantified it as the number of

directors on the board. On the other hand, Eisenberg, Sundgren and Wells (1998) measure board size using its log transformation in order to make a more symmetrical distribution as is required for ordinary least-squares regression analysis. This measurement is not appropriate to this study, since the respondents are only able to provide their responses to real numbers, namely the actual number of directors, rather than the numbers that have been transformed into logarithm. Consistent with the majority of studies, this study operationalises board size using **the number of directors on the board** to measure board size.

3.3.3 Board meeting frequency

Board meeting frequency is measured as **the number of board meetings in a year**. This measure is consistent with prior studies such as Vafeas (1999), Xie, Davidson and DaDalt (2003), Kent and Stewart (2008), and Christensen, Kent and Stewart (2010).

3.3.4 Multiple directorships

Previous studies have used several measures of multiple directorships. Firstly, Kiel and Nicholson (2003) and Pombo and Gutierrez (2011) measured multiple directorships as the number of additional board positions held by directors. Secondly, multiple directorships can also be proxied by the reciprocal CEO interlock (Hallock, 1997; Fich and White, 2005; Pombo and Gutierrez, 2011). Reciprocal interlock is defined as the situation in which the CEO of a company sits on the board of another company and the CEO of the second company has a position on the board of the first company (Fich and White, 2005). A third proxy for multiple directorships is the ratio of the number of

directors who hold multiple directorships (interlocks) to the total number of directors (Non and Franses, 2007; Chen, Dyball and Wright, 2009). This study utilises the third measure of multiple directorships, namely **the ratio of the number of directors who hold multiple directorships to the total number of directors** as it enables the measurement of the extent to which the level of multiple directorships is acceptable to respondents. The first measure is not appropriate as it only calculates the number of additional directorships outside the companies, which does not control for board size. The second measure is also not appropriate since it only considers CEO interlocks and not all board members.

3.3.5 Audit committee composition

Most corporate governance studies that examine audit committee independence, such as Cotter and Silvester (2003), Klein (1998), Klein (2002), Chen, Moroney and Houghton (2005), and Lary and Taylor (2012), measure it as the proportion of independent directors on the audit committee. However, Cotter and Silvester (2003) also use an alternative measure of audit committee independence. They argue that independence can also be measured by the absence of the company's chief executive officer (CEO) from the committee. However, this measure is not appropriate in this study as it does not capture the existence of non-CEO executive directors on the audit committee.

Consequently, this study uses **the proportion of independent directors on the audit committee** as a proxy for audit committee independence, which is consistent with Recommendation 4.2 of the ASX POGCG that regulates the minimum proportion of independent directors to the total number of directors on audit committees.

3.3.6 Audit committee size

Although a log transformation for board size has been used in the literature, it is not applied to audit committee size. Prior research, such as Felo, Krishnamurthy and Solieri (2003), Xie, Davidson and DaDalt (2003), Anderson, Mansi and Reeb (2004), Kent and Stewart (2008), and Lary and Taylor (2012), has operationalised audit committee size as **the number of members of the audit committee**. Consistent with these studies, this study also uses the same measure for audit committee size.

3.3.7 Audit committee meeting frequency

Audit committee meeting frequency is used as a proxy for audit committee activity. Previous studies have measured audit committee activity as **the number of audit committee meetings during a financial year** (Beasley, Carcello, Hermanson and Lapides, 2000; Goodwin-Stewart and Kent, 2006; Stewart and Munro, 2007; Kent and Stewart, 2008; Lary and Taylor, 2012). Accordingly, this study operationalises audit committee meeting frequency using the same measure.

3.3.8 Provision of non-audit services by the auditor

The extent of non-audit services provision is often proxied as the amount of non-audit fees paid to the auditors. Previous studies have shown that non-audit fees can be operationalised using several measures. Firstly, several studies such as Palmrose (1986), Antle, Gordon, Narayanamoorthy, and Zhou (2006) and Whisenant, Sankaraguruswamy and Raghunandan (2003) operationalise non-audit fees as the natural logarithm of the fees paid to the auditors that are unrelated to audit services. This measure is not

appropriate in this study as it is not feasible for the respondents to provide their response based on non-audit fees that have been transformed to their natural logarithm. Secondly, Abbott, Parker, Peters and Raghunandan (2003) divide their sample based on whether non-audit fees are greater than audit fees. However, this method might also not be appropriate since it does not enable this study to capture the extent to which the level of non-audit fees is acceptable to respondents. Thirdly, non-audit fees have also been measured as the ratio of non-audit fees to total fees paid to auditors. This measure has been extensively used by previous studies such as Wines (1994), Craswell (1999), Lennox (1999), Frankel, Johnson and Nelson (2002), Larcker and Richardson (2004), and Dhaliwal, Gleason, Heitzman, and Melendrez (2008). As an alternative and equivalent measure to this proxy, this attribute can also be operationalised as the ratio of non-audit fees to total audit fees. This measure is used by Kilgore, Radich and Harrison (2011) and Kilgore, Harrison and Radich (2014) in examining the provision for non-audit services fees as one factor that might affect perceptions of audit quality. In an Australian setting, the use of this measurement is practicable as the amounts paid for both audit and non-audit services are disclosed in the annual report. This alternative measure (ratio between non-audit fees and total audit fees) has an advantage in that it is easier to calibrate, that is, it enables direct comparison between non-audit and audit fees. Accordingly, this study uses the **ratio between non-audit fees and the audit fees** as a measure of provision for non-audit services.

3.3.9 Audit partner tenure

In examining the association between auditor tenure and various corporate governance outcomes, such as financial reporting quality and monitoring quality, previous studies

have commonly used the length (in years) of an audit engagement between auditors and clients to operationalise auditor tenure. Studies examining auditor tenure in the literature have been conducted on two levels, namely (i) Audit-firm level and (ii) Audit-partner level. Firstly, studies in audit-firm tenure including Vanstraelen (2000), Geiger and Raghunandan (2002) and Johnson, Khurana and Reynolds (2002) have proxied tenure by the period of the relationship between audit firm and clients (in years).

Secondly, Chi and Huang (2005), Gates, Lowe and Reckers (2007), Fargher, Lee and Mande (2008), Monroe and Hossain (2013), Kilgore, Radich and Harrison (2011) and Kilgore, Harrison and Radich (2014) have investigated audit partner tenure and operationalised it as **the length of the auditor engagement between audit partner and clients (in years)**. This study focuses on audit partner tenure, as CLERP 9 requires the audit partner (not audit firm) to be rotated every five years. Therefore, this study also utilises the same measure used by these studies.

3.3.10 Remuneration committee composition

With regard to remuneration committee independence, previous studies such as Conyon and Peck (1998), Daily, Johnson, Ellstrand and Dalton (1998), Vafeas and Theodorou (1998), Cotter and Silvester (2003), and Cybinski and Windsor (2013) have operationalised remuneration committee independence as **the proportion of independent directors on the remuneration committee**. This measure is consistent with the requirement of ASX POGCG that specifies the proportion of independent directors on the committee as a measure of independence. Consistent with these studies and ASX POGCG, this study uses the same proxy to measure remuneration committee independence.

3.3.11 CEO duality

Previous studies, such as Donaldson and Davis (1991), Rechner and Dalton (1991), Boyd (1995), Carter, Simkins and Simpson (2003), Kent and Stewart (2008), and Christensen, Kent, Routledge, and Stewart (2013), have operationalised CEO duality as dichotomous, that is, **whether the CEO and chair position are held by the same person**. Accordingly, this study also utilises the same approach as these studies.

Table 3.1 Corporate Governance Attributes and Operational Definition

| CG Attributes | Operational Definition |
|---|---|
| 1. Board Composition | Proportion of independent directors on the board |
| 2. Board Size | Number of directors on the board |
| 3. Board Meeting Frequency | Number of board meetings in a year |
| 4. Multiple Directorships | Ratio of the number of directors who hold multiple directorships to total number of directors |
| 5. Audit Committee Composition | Proportion of independent directors on the Audit Committee |
| 6. Audit Committee Size | Number of directors on the Audit Committee |
| 7. Audit Committee Meeting Frequency | Number of Audit Committee meetings in a year |
| 8. Provision of Non-audit Services by the Auditor | Ratio of non-audit fees to total audit fees |
| 9. Audit Partner Tenure | Length of the tenure of audit partner (in years) |
| 10. Remuneration Committee Composition | Proportion of independent directors on the Remuneration Committee |
| 11. Chief Executive Officer Duality | Whether Chief Executive Officer and Chair of the Board are the same person |

3.4 Corporate governance attributes levels

Section 3.3 has discussed corporate governance attributes and their operational definitions. This section explains the appropriate levels associated with these attributes, particularly with regard to the number, spacing and range of attribute levels required in this study. Analysis on preference for attribute levels produces average utility values (AUV), which indicate respondents' preferences for levels within each attribute. The details of these metrics are explained in more detail in Chapters 4 and 5. The levels within all corporate governance attributes are summarised in Table 3.2.

3.4.1 Board composition

Previous studies, such as Dechow, Sloan and Sweeney (1996), Klein (2002), and Christensen, Kent, Routledge, and Stewart (2013), have determined a benchmark of 50% independent directors on the board for assessing board independence. However, given that Australian boards for listed companies are recommended to have at least 50% independent directors, it is appropriate for this study to use a higher benchmark. A study conducted in an Australian setting (Cotter and Silvester, 2003) reports the median proportion of independent directors at 0.67, indicating that half of their samples had at least 67% independent directors on the board. Nevertheless, a caveat to the use of this benchmark is that the study was conducted prior to the introduction of ASX POGCG in 2003, and the level of board independence after 2003 is expected to be greater than prior to the introduction of this recommendation.

A study conducted by He, Wright, Evans and Crowe (2009) appears to be the most appropriate study in Australia to refer to, as it was conducted in 2005 after the

introduction of ASX POGCG. Their study reports a median proportion of independent directors at 0.75, an indication that the introduction of ASX POGCG encouraged companies to have more independent directors on their boards, that is, an increase from the median of 0.67.

Based on He, Wright, Evans and Crowe (2009), this study will use three attribute levels for board composition, namely **(i) less than 50% of the board are independent directors, (ii) between 50% and 75% of the board are independent directors, and (iii) more than 75% of the board are independent directors.** The rationale for not following the approach taken by Dechow, Sloan and Sweeney (1996) and Klein (2002) in using 50% as the only benchmark is that this measure might not capture the difference in respondents' preferences between having a moderate proportion of independent directors (50-75%) and a high proportion of independent directors (> 75%).

3.4.2 Board size

ASX POGCG does not specify the appropriate number of board members. A study conducted by Yermack (1996) analysed the association between board size and firm value by partitioning the sample into four groups based on board size, namely: (i) fewer than 6 members, (ii) 6-12 members, (iii) 13-24 members and (iv) more than 24 members. This classification might not be appropriate to this study since the number of board members in Australia is generally smaller than that in the U.S. (Kiel and Nicholson, 2003; Lau, Sinnadurai and Wright, 2009). Australian studies conducted by Arthur (2001) and Christensen, Kent and Stewart (2010) show that the median board size in Australia is 5 members. Another Australian study, conducted by Cotter and Silvester (2003), finds a median of 8 board members, indicating that half of their sample

had at least 8 members on the board of directors. This difference can be attributed to the fact that Cotter and Silvester (2003) only included the top-200 ASX listed companies in their study, as opposed to all publicly listed companies which were included in the previous two studies. Consistent with these Australian studies, this study utilises three levels of board size, they are: **(i) less than 5 board members, (ii) between 5 and 8 board members, and (iii) more than 8 board members.**

3.4.3 Board meeting frequency

ASX POGCG does not indicate the appropriate number of board meetings in a financial year. A study conducted by Vafeas (1999) has reported a median of 7 board meetings in a year. In Australian settings, Goodwin-Stewart and Kent (2006) and Christensen, Kent and Stewart (2010) find the median of board meetings per year is 11 times. This study utilises the same approach as the latter studies as it is conducted in Australia. Therefore, this study utilises two levels of board meeting frequency, namely **(i) less than 11 board meetings in a year and (ii) 11 or more board meetings in a year.**

3.4.4 Multiple directorships

As indicated in Section 3.3.4, this study operationalises multiple directorships as the ratio of the number of directors who hold multiple directorships to the number of directors. As prior research has not indicated the level of interlocking directorates that might alter participant perceptions of multiple directorships, the attribute levels for multiple directorships will be equally-spaced. This is consistent with Duncan (1994) who suggests that if no evidence is available for researchers to have prior knowledge in

determining the spacing of the attribute levels, equal spacing of the attributes is appropriate. Accordingly, multiple directorships (the ratio of the number of directors who hold multiple directorships to the total number of directors) is partitioned into three levels with an approximately equal spacing: **(i) less than 30% of the board hold multiple directorships, (ii) between 30 and 60% of the board hold multiple directorships, and (iii) more than 60% of the board hold multiple directorships.**

3.4.5 Audit committee composition

Previous studies such as Dechow, Sloan and Sweeney (1996) and Klein (2002) have defined an independent audit committee as one that is dominated by independent directors (at least 50% of the committee members being independent directors). Similar to board composition, this classification might restrict respondents in distinguishing a moderate level of independence (50-75% independent directors) and high level of independence (> 75% independent directors). As the audit committee is a subset of the board of directors, it is justifiable to use the same attribute levels spacing as the board composition. Accordingly, this study also utilises three levels of audit committee composition, namely **(i) less than 50% of the audit committee are independent directors, (ii) between 50% and 75% of the audit committee are independent directors, and (iii) more than 75% of the audit committee are independent directors.**

3.4.6 Audit committee size

In a study conducted by Lin, Li and Yang (2006) in the U.S., audit committee size is reported to have a median of four members, indicating that 50% of the sample has at least four audit committee members. However, this attribute level might not be appropriate in Australia since audit committee size in Australia is generally smaller than in the U.S. This difference in size may be attributed to the fact that the size of Australian boards is generally smaller compared to those of the U.S.

Studies in Australia such as Cotter and Silvester (2003) and Kent, Routledge and Stewart (2010) report the median number of directors on the audit committee as three. This is consistent with guidelines from the ASX POGCG that requires the audit committee to have at least three members. Following these Australian studies and the ASX POGCG, this study uses two attribute levels for audit committee size, namely **(i) 3 or less audit committee members** and **(ii) more than 3 audit committee members**.

3.4.7 Audit committee meeting frequency

ASX POGCG does not specify the appropriate number of audit committee meetings in a year. Nevertheless, several studies have examined audit committee meeting frequency. Morrissey (2000) reports that median audit committee meeting frequency is 4 meetings each year. This finding is consistent with the recommendations of the Blue Ribbon Committee (BRC) in the U.S., which suggests that an audit committee needs to meet at least four times annually. An Australian study conducted by Kang, Kilgore and Wright (2011) also reports a median of 4 audit committee meetings annually. Consistent with these studies and the recommendation of the BRC, this study employs two attribute

levels for audit committee meeting frequency, namely **(i) less than 4 audit committee meetings in a year** and **(ii) 4 or more audit committee meetings in a year**.

3.4.8 Provision of non-audit services by the auditor

As discussed in Section 3.3.8, provision of non-audit services by the auditor is proxied by the amount of non-audit fees, which is operationalised as the ratio of non-audit fees to audit fees. Prior research provides evidence on how this attribute level can be partitioned. Pany and Reckers (1988), in examining the association between non-audit service fees and perceptions of auditor independence, partitioned the ratio between non-audit fees and audit fees into four levels: (i) 0%, (ii) 25%, (iii) 60% and (iv) 90%. In an Australian setting, Kilgore, Radich and Harrison (2011) and Kilgore, Harrison and Radich (2014) used three attribute levels to separate the proportion of non-audit fees to the total of audit fees (30%, 30-60% and > 60%). This partition is consistent with McKinley, Pany and Reckers (1985) who indicate that the 30% ratio of non-audit fees to audit fees affects neither loan decisions nor the perceptions of auditor independence, that is, 30% ratio is an appropriate cut-off point.

Consistent with the study conducted by Kilgore, Radich and Harrison (2011) and Kilgore, Harrison and Radich (2014) in an Australian setting, this study will also utilise three attribute levels for the ratio between non-audit fees and audit fees, that is **(i) less than 30% ratio of non-audit fees to total audit fees**, **(ii) between 30% and 60% ratio of non-audit fees to total audit fees** and **(iii) more than 60% ratio of non-audit fees to total audit fees**.

3.4.9 Audit partner tenure

As indicated previously, audit partner tenure is defined as the length (in years) of audit engagement between the audit partner and clients. Previous studies, in examining audit partner tenure, have used different partitioning of partner tenure based on the length of the engagement. Firstly, Chi and Huang (2005) have classified audit partner tenure into three different levels: (i) Short tenure (2-3 years), (ii) Medium tenure (4-8 years) and (iii) Long tenure (9 or more years). Secondly, Fargher, Lee and Mande (2008) have defined long partner tenure as greater than six years' audit engagement; otherwise it is classified as short tenure. Thirdly, Chen, Lin and Lin (2008) and Monroe and Hossain (2013) have chosen five years as the cut-off point between long and short partner tenure.

In Australia, CLERP 9 introduced a mandatory requirement for listed companies to rotate their audit partner every five years, which is also the case for U.S. companies under the Sarbanes-Oxley Act (SOX). As the purpose of the study is to gather respondent perceptions on audit partner tenure and provide feedback to the regulatory bodies, this study follows the requirement from CLERP 9 in partitioning the length of audit partner tenure into two levels: **(i) audit partner tenure of 5 years or less** and **(ii) audit partner tenure of more than 5 years**. This measure is also consistent with Kilgore, Radich and Harrison (2011) and Kilgore, Harrison and Radich (2014) who examined perceptions of audit quality in the Australian setting.

3.4.10 Remuneration committee composition

Remuneration committee independence is measured by the proportion of independent directors on the remuneration committee. Similar to the audit committee, the remuneration committee is a sub-committee of the board of directors. In terms of determining the attribute levels for remuneration committee composition, the mechanism applied to board and audit committee composition is not applicable here as there is a different requirement under ASX POGCG. While its recommendation suggests that the board should have a majority of independent directors, it mandates that the remuneration committee wholly comprise independent directors. Accordingly, one possible partitioning of attribute levels for remuneration committee composition is: (i) the remuneration committee consist of all independent directors (100% independent directors) and (ii) the remuneration committee consist of less than 100% independent directors. This partitioning is consistent with Cybinski and Windsor (2013).

However, this partitioning only allows respondents to indicate whether they prefer a wholly independent remuneration committee or not, that is, it does not capture specific respondent preferences for the level of independence. In order to overcome this problem, this study uses the following partitioning: **(i) less than 75% independent directors on the remuneration committee, (ii) between 75% and 100% independent directors on the remuneration committee and (iii) 100% independent directors on the remuneration committee.** This attribute is partitioned with unequal spacing, since there is an *a priori* argument discussed above.

3.4.11 CEO duality

As discussed in Section 3.3.4, CEO duality is operationalised as a dichotomous variable, namely whether the CEO and Chair of the board are the same person.

Accordingly, there are two levels for this attribute: **(i) CEO and Chair of the board are the same person** and **(ii) CEO and Chair of the board are not the same person.**

Table 3.2 Corporate Governance Attributes, Operational Definition, and Attribute Levels

| CG Attributes | Operational Definition | Attribute Levels |
|----------------------------|---|--|
| 1. Board Composition | Proportion of independent directors on the board | <ul style="list-style-type: none"> • Less than 50% of the board are independent directors • Between 50% and 75% of the board are independent directors • More than 75% of the board are independent directors |
| 2. Board Size | Number of directors on the board | <ul style="list-style-type: none"> • Less than 5 board members • Between 5 and 8 board members • More than 8 board members |
| 3. Board Meeting Frequency | Number of board meetings in a year | <ul style="list-style-type: none"> • Less than 11 board meetings in a year • 11 or more board meetings in a year |
| 4. Multiple Directorships | Ratio of the number of directors who hold multiple directorships to total number of directors | <ul style="list-style-type: none"> • Less than 30% of the board hold multiple directorships • Between 30 and 60% of the board hold multiple directorships |

| | | |
|---|--|--|
| | | <ul style="list-style-type: none"> • More than 60% of the board hold multiple directorships |
| 5. Audit Committee Composition | Proportion of independent directors on the Audit Committee | <ul style="list-style-type: none"> • Less than 50% of the Audit Committee are independent directors • Between 50% and 75% of the Audit Committee are independent directors • More than 75% of the Audit Committee are independent directors |
| 6. Audit Committee Size | Number of directors on the Audit Committee | <ul style="list-style-type: none"> • 3 or less Audit Committee members • More than 3 Audit Committee members |
| 7. Audit Committee Meeting Frequency | Number of Audit Committee meetings in a year | <ul style="list-style-type: none"> • Less than 4 Audit Committee meetings in a year • 4 or more Audit Committee meetings in a year |
| 8. Provision of Non-audit Services by the Auditor | Ratio of non-audit services fees to total audit fees | <ul style="list-style-type: none"> • Less than 30% ratio of non-audit fees to total audit fees • Between 30% and 60% ratio of non-audit fees to total audit fees • More than 60% ratio of non-audit fees to total |

| | | |
|--|--|---|
| | | audit fees |
| 9. Audit Partner Tenure | Length of the tenure of audit partner (in years) | <ul style="list-style-type: none"> • Audit partner tenure of 5 years or less • Audit partner tenure of more than 5 years |
| 10. Remuneration Committee Composition | Proportion of independent directors on the Remuneration Committee | <ul style="list-style-type: none"> • Less than 75% independent directors on the remuneration committee • Between 75% and 100% independent directors on the remuneration committee • 100% independent directors on the remuneration committee |
| 11. Chief Executive Officer Duality | Whether Chief Executive Officer and Chair of the Board are the same person | <ul style="list-style-type: none"> • CEO and Chair of the Board are the same person • CEO and Chair of the Board are not the same person |

3.5 Conclusion

This chapter discusses the research method used in this study. In particular, it explains the choice of Adaptive Conjoint Analysis as its data analysis technique. It also outlines the operational definitions and the attribute levels for all corporate governance attributes examined. The data collection process is explained in Chapter 4.

CHAPTER 4

DATA COLLECTION

4.1 Introduction

This chapter outlines the data collection procedures used in this study. Section 4.2 presents the choice of data collection method. Section 4.3 discusses details of interviews conducted as part of this study. Section 4.4 provides details of the design and construction of the survey instrument. Section 4.5 explains the previewing and testing of the instrument. The chapter is concluded in Section 4.6.

4.2 Data collection method

The choice of data collection method depends on the nature of the study. As explained in Chapter 1, the purpose of the study is to examine the relative importance of corporate governance attributes from the perspective of two groups of stakeholders. Several data collection methods are available to accommodate the purpose of this research, including experiments and survey. Based on the nature of the study, the most appropriate data collection method is survey as it enables the researchers to collect first-hand data and increase the generalisability of the results. This method is explained in more detail in the next part.

Survey research

According to Singleton and Straits (2010), the survey method has several advantages. Firstly, it involves large-scale probability sampling, which increases the generalisability of the results. Generalisability of the results for this study is important because knowing the perceptions of stakeholders on corporate governance attributes may contribute to regulatory policy. Secondly, the survey method can also combine many research questions in a single survey (Singleton and Straits, 2010).

On the other hand, Singleton and Straits (2010) outline several limitations associated with the survey method. Firstly, there may be endogeneity issues as the cause and effect relationship is not easily identified. Secondly, a survey is highly standardised, so changes cannot be made once the survey is administered. Thirdly, in a self-administered survey, the fact that the researchers are not present with the respondents makes it difficult for them to clarify any confusion with regard to the questionnaire. Fourthly, Dillman (2000) argues that non-response error might distort the results of the survey, that is, when there are differences in the characteristics between those who complete the survey and those who do not.

Different types of survey

There are different types of surveys based on the way they are administered. The first type of survey method is a face-to-face survey (interview). This method has several advantages including the presence of the researcher that enables the respondent to clarify any confusion or ambiguities (Singleton and Strait, 2010). Furthermore, face-to-face interviews result in more complete responses as they allow flexibility in the questionnaire and have a greater response rate compared to the other means of survey.

However, this type of survey is generally expensive and time consuming which causes the researcher to limit the number of responses in order to save costs and time.

In this study, this method is utilised as a preliminary approach in order to confirm the appropriateness of the attributes likely to be included in the survey questionnaire. This phase is critical to avoid errors and ensure that the survey instrument can accurately address the research questions. Face-to-face interview is considered the most appropriate method in this first phase of the study's data collection as it allows the respondents to provide feedback on the survey questions in more interactive and flexible discussion without being limited by the scope of the questions asked. The use of interviews in this study is explained in more detail in section 4.3.

The second type of survey is a paper-based survey questionnaire. While it is less expensive than face-to-face interview and hence allows for a larger sample size, it is subject to non-response bias and there is no opportunity to resolve any confusion with regard to the questionnaire because the researcher is absent (Singleton and Straits, 2010).

The last type of survey is an internet-based survey. It offers several advantages, such as cost and time reduction and, more importantly, web questionnaires offer greater flexibility of design. Although internet-based survey has a problem with coverage error and low response rate (Singleton and Straits, 2010), it is used in the second phase of this study as it is the most appropriate method to collect data in an ACA-based survey.

4.3 Interviews

As discussed in the previous section, the first phase of this study involves face-to-face interviews with the respondents from a variety of backgrounds, including but not limited to academics, accounting professionals, directors and financial analysts. The main reason for conducting these preliminary interviews is to minimise the common limitation of ACA, that is, respondent fatigue caused by large numbers of attributes examined which can lead to inaccurate results. As ACA works best with a small number of attributes, it is impracticable to include a large number of attributes in the survey. Interviews are therefore used to eliminate the attributes that are perceived to be least important to practitioners in an absolute sense before proceeding to the next step. After short-listing those attributes that are perceived to be more important to all potential respondents, this study utilises a survey approach using ACA to collect and analyse the data for shareholders and directors, in order to assess the relative importance of these corporate governance attributes for these groups of respondents.

The interview is of a semi-structured format and has three purposes: (i) to gain insights into the interviewees' ideas of what constitutes effective corporate governance and their views on the effectiveness of current corporate governance practices, (ii) to explore important corporate governance attributes and, most importantly, (iii) to obtain feedback for the researcher to determine the suitability of corporate governance attributes to be included in this study. A copy of the interview questions is attached in Appendix A.

The first part of the interview asked the respondents about the concept of effective corporate governance. Specifically, they were asked to define effective corporate governance and identify factors that contribute to it. Furthermore, the respondents were

asked for their assessments of current corporate governance practices in Australia, such as ASX POGCG and CLERP 9 set out, and the effectiveness of these codes in enhancing corporate governance.

Secondly, the respondents were provided with eleven corporate governance attributes that may be used in this study and were asked to indicate the order of importance they would give to them. The third part of the interview asked the respondents to assess the suitability of the corporate governance attributes initially selected to be included in this study to ensure that they fully and accurately capture the concept of effective corporate governance.

While some interviewees had difficulty in defining effective corporate governance, the majority indicated that the board of directors has a very important role in enhancing effective corporate governance. In particular, they suggest that effective boards depend on the integrity, activity and skill of its members, and the structure of the board itself. With regard to the effectiveness of current corporate governance requirements, namely ASX POGCG and CLERP 9, the interviewees are divided in opinion. Some of them argue that these requirements have worked effectively in increasing company awareness of corporate governance. Others suggest that the requirements are politically compromised and, to some extent, they might over-regulate.

Regarding the respondents' assessments of the eleven attributes pre-selected for this study, most of them agreed about the importance of various parties being independent, such as the board, the audit committee, and the auditor who all hold important roles in enhancing the effectiveness of corporate governance. On the other hand, the respondents consistently rate the size and meeting frequency of various groups to be less important in their assessments of effective corporate governance.

Lastly, in relation to the main purpose of the interview, which is to ascertain the suitability of corporate governance attributes selected for inclusion in this study, the interviewees agree that all eleven attributes capture the scope of effective corporate governance. Accordingly, these corporate governance attributes were included in the second phase of the study and explained in the following section.

4.4 Design and construction of survey questionnaire using internet-based survey (Adaptive Conjoint Analysis)

This section outlines the design and construction of the ACA survey. Specifically, an overview and the issues associated with the design of the survey are discussed.

4.4.1 Overview of the survey questionnaire

The second phase of this study involves the development of an online survey questionnaire using the Sawtooth Software ACA module. This section discusses the design and construction of the survey questionnaire itself. An ACA survey consists of four sections, namely (i) ACA Rating Section, (ii) ACA Importance Section, (iii) ACA Pairs Section, and (iv) ACA Calibration Section, and they are discussed in detail as follows.

The first section of the ACA survey is the ACA Rating Section. In this section, the respondents are given a list of all attributes with different levels within each attribute and are asked to rate each of the levels based on their desirability of the attribute levels. For example, they are asked to indicate their preference on the attribute level ‘Less than 5 board members’ within the attribute of Board Size. In indicating their preference for

attribute levels, respondents are provided with a seven-point likert-scale with points ranging from “not desirable” to “extremely desirable”. In total, there are eleven ACA Rating questions (28 sub-questions), consistent with the number of attributes and attribute levels.

The second section of the ACA survey is the ACA Importance Section. A unique feature of ACA is that it utilises the responses provided in the previous section to develop questions in the next section, which in effect tailors the questionnaire to the individual respondent. In this second section, respondents are provided with two levels within the same attribute and are asked to indicate the importance of having one particular attribute level over the other. For example, the question might ask the respondents how important it is for them to have less than 5 instead of more than 8 board members. Similar to the previous section, this section uses a seven-point likert-scale with points ranging from “not important” to “extremely important”. As eleven attributes are examined, the total number of ACA Importance questions is also eleven.

The third section of the ACA survey contains ACA Pairs Questions. ACA asks respondents for their preference between two combinations of two or three attributes with different attribute levels. The ACA Pairs Section consists of two stages. The first stage consists of ten questions and asks the respondents to compare combinations containing two attributes. The second stage also consists of ten questions and asks the respondents to compare two combinations with three attributes each.

Although having a lot of questions might improve the accuracy of the results, it might also cause respondents confusion and fatigue. In order to avoid this issue, an ACA survey should not have too many attributes and levels. The ACA System Guidelines recommend a formula to enable the researcher to set an optimal number of ACA Pairs

Questions, in balancing between improving the accuracy of the results and avoiding respondents' confusion and fatigue. Specifically, the result of this formula should be between 15 and 30 as a guide. The formula is specified as follows:

$$P = 3 (N - n - 1) - N$$

Where:

P = number of ACA Pairs questions;

N = number of attribute levels;

n = number of attributes.

Using this formula, the number of ACA Pairs questions included in this study is 20, that is $3 (28 - 11 - 1) - 28$, which is within the guidelines.

The fourth section of the ACA survey is the ACA Calibration section. By analysing the answers provided by the participants in the previous sections, ACA provides the respondents a choice between sets of several attributes with various attribute levels. Respondents are then asked to rate these sets of attributes from 0-100, thus indicating their level of preference for them. Specifically, a score of 100 indicates that the respondents are completely satisfied with the set of attributes and 0 means they are completely unsatisfied with it. ACA System Guidelines indicates that there should be at least five ACA Calibration questions and no more than six attributes in the combination. This recommendation is made to prevent respondents' confusion in facing too many factors and questions to consider in indicating their preference. Consistent with the

recommendation, this study includes five ACA Calibration questions with five attributes in each question.

4.4.2 Issues associated with design of the survey

This section discusses other issues associated with the design of the survey. In particular, it explains independence between attributes and specifying prohibitions for attributes in the survey. The final structure of the survey is also presented in this section.

Independence between attributes

According to the Sawtooth Software (2007), attributes need to be independent in order to ensure the accuracy of the results. Specifically, having non-independent attributes might result in a double-counting problem which leads to inaccurate results. This problem is not evident in this study since it does not include attributes with similar meanings. This view is also supported by the interview respondents who did not identify that any attributes had similar meanings.

Specifying prohibitions for the attributes

According to the ACA System Guidelines, prohibitions should be included in the survey questionnaire if it is expected that two attributes or attribute levels should not appear together in an ACA question, particularly in the ACA Pairs and ACA Calibration Sections. Specifically, prohibitions are required when it is unrealistic in practice that two attributes do exist together. While prohibitions might be required in some studies, the ACA System Guidelines specifically outline that too many prohibitions might result in inaccurate estimation of the utility, which might distort the overall results of the study.

In this study, two specific prohibitions are included. Firstly, a prohibition is specified between the attributes Board Composition and Audit Committee Composition. Specifically, it is expected that an audit committee is more independent than the board. That is, it is very unlikely for a highly independent board to have a non-independent audit committee. Therefore, this prohibition is included between the attribute levels “more than 75% of the board are independent directors” and “less than 50% of the audit committee are independent directors” as these two scenarios are unlikely to occur together. Secondly, a prohibition is also included between the attributes Board Composition and Remuneration Committee Composition. Similar to the first case, it is also expected that remuneration committee is more independent than the board of directors as it is a subset of the board. This expectation is also supported by the fact that ASX POGCG requires the remuneration committee to be composed entirely of independent directors. Hence, the attribute levels “more than 75% of the board are independent directors” and “less than 75% independent directors on remuneration committee” are prohibited to appear in the same combination of questions.

Structure of the Survey Questionnaire

The section discusses the technical details in terms of the way the questionnaire is structured. Specifically, it involves the design of the following pages:

1. **“InfoStatement” page** – this page consists of general information regarding the survey for the respondents as required by the Macquarie University Human Research Ethics Committee, including a general description of the survey.
2. **“Intro” page** – this page outlines instructions for respondents in completing the survey, including a definition of each corporate governance attribute.

3. **“IntroRating” page** – this page outlines specific instructions for respondents in completing section one of the survey (ACA Rating Section).
4. **ACA Rating pages** – these pages contain the questions asked in the first section of the survey (ACA Rating Section). As indicated earlier, there are eleven questions in total.
5. **“IntroImportance” page** – this page outlines specific instructions for respondents in completing section two of the survey (ACA Importance Section).
6. **ACA Importance pages** – these pages contain the questions asked in the second section of the survey (ACA Importance Section). As indicated earlier, there are eleven questions in total.
7. **“IntroPairs” page (first part)** – this page outlines specific instructions for respondents in completing the first part of section three of the survey (ACA Pairs Section).
8. **ACA Pairs page (first part)** – these pages contain the questions asked in the first part of the third section of the survey (ACA Pairs), in which respondents are asked to compare two combinations of corporate governance attributes with two attributes in each combination. As indicated earlier, there are ten questions in total.
9. **“IntroPairs” page (second part)** – this page outlines specific instructions for respondents in completing the second part of section three of the survey (ACA Pairs Section).
10. **ACA Pairs page (second part)** – these pages contain the questions asked in the second part of the third section of the survey (ACA Pairs), in which the respondents are asked to compare two combinations of corporate governance

attributes with three attributes in each combination. As indicated earlier, there are ten questions in total.

11. **“IntroCalibration” page** – this page outlines specific instructions for respondents in completing section four of the survey (ACA Calibration Section).
12. **ACA Calibration pages** – these pages contain the questions asked in the fourth section of the survey (ACA Calibration Section). As indicated earlier, there are five questions in total.
13. **“IntroDemographic” page** – this page informs the respondents that they are required to answer some demographic questions.
14. **“Gender” page** – this page contains the question regarding the respondents’ gender.
15. **“Age” page** – this page contains the question regarding the respondents’ age.
16. **“Qualification” page** – this page contains the question regarding the respondents’ highest educational qualifications.
17. **“Finish” page** – this page informs the respondents that they have completed the survey and thanks them for their efforts.

4.5 Previewing and testing of survey questionnaire

4.5.1 Previewing of survey questionnaire

Before the survey was uploaded to the internet, it was previewed and tested to ensure there were no significant errors. ACA Software utilises an automatic error-detection system to discover any errors associated with the questionnaire. This survey was tested using this system and no errors were discovered.

Furthermore, this survey questionnaire was previewed and pilot-tested by 13 members of the Faculty of Business and Economics at Macquarie University in order to estimate its time consumption and to ensure its appropriateness and understandability. That is, the pilot study was used to ensure that the survey is easily understood and not too long for the respondents. The members of the pilot group were also shareholders, which provides an appropriate proximity to one of the actual target respondent groups of this study. Using directors as part of the pilot group was not feasible, due to the challenges of obtaining and getting their responses within a short period of time. Nevertheless, discussion with an AICD representative during the interview stage (explained in Section 4.3) ensured that both groups' view were covered in the development of the survey. This process revealed that respondents spent approximately 20 minutes on average to complete the survey, confirming the researchers' earlier prediction. With regard to the appropriateness and understandability of the questionnaire, two major amendments were made after the pilot tests were conducted.

Firstly, several faculty members suggested that the number of questions was excessive. As the length of the questions is heavily influenced by the number of attributes, they suggested removing several attributes deemed not to be particularly important in perceptions of effective corporate governance. Most of the reviewers advised the removal of attributes which measure quantity rather than quality of corporate governance, namely size and meeting frequency of various groups. Vafeas (1999) argues that it is unclear how board meeting frequency is a good proxy for board activity, as the board might only discuss some routine tasks rather than exchanging ideas that add value. As board meeting frequency is an indirect proxy of board activity, it is implied that more frequent board meetings do not necessarily indicate a more active board. Specifically, he also suggests that it is not clear whether the increase in the

frequency of board meeting increases monitoring activity or is merely to educate non-executive directors. On the other hand, board size directly measures the number of directors included in the board, that is, a higher number of directors indicates a larger board size. Therefore, it was considered appropriate to maintain board size in this study. Based on these arguments, the attributes of the meeting frequency of various groups (board and audit committee) were removed from the survey.

The change in the number of attributes results in several changes in the design of the questionnaire. Firstly, the number of ACA Rating and ACA Importance questions are nine for each section (instead of eleven), which correspond to the number of attributes. Secondly, this change also reduced the number of pair questions to 18, that is, $3(24 - 9 - 1) = 24$, since the survey will only have nine attributes and 24 attribute levels after the change compared to eleven attributes and 28 levels prior to the change.

The second amendment made after the pilot tests were conducted was related to the operational definition of multiple directorships. Before the pilot test was conducted, multiple directorships was measured as the percentage of directors who hold more than one directorship compared to the total number of directors. One of the reviewers suggested that this operational definition might not capture the extent to which a director is busy, that is, the number of directorships held. Consistent with prior literature (Ferris, Jaganathan and Pritchard, 2003), this study uses the number of directorships held by the directors as it is a better proxy for each director's busyness. Specifically, this attribute is partitioned into three levels, which are the individual board members hold only (i) one directorship, (ii) 2-3 directorships, and (iii) more than three directorships.

The changes made after the pilot tests are summarised in Table 4.1. The final set of corporate governance attributes, their operational definitions and the levels of these attributes, after incorporating the feedback from pilot tests and the changes made, are presented in Table 4.2. A copy of ACA survey questionnaire used is attached in Appendix B.

Table 4.1 Changes to Attribute and Attribute Levels

| Attribute | Prior Operational Definition | Prior Attribute Levels | New Operational Definition | New Attribute Levels | Note |
|-----------------------------------|---|---|--|---|--|
| Audit Committee Meeting Frequency | Number of audit committee meetings in a year | <ul style="list-style-type: none"> • Less than 4 Audit Committee meetings in a year • 4 or more Audit Committee meetings in a year | N/A | N/A | This attribute is removed from the survey. |
| Board Meeting Frequency | Number of board meetings in a year | <ul style="list-style-type: none"> • Less than 11 board meetings in a year • 11 or more board meetings in a year | N/A | N/A | This attribute is removed from the survey. |
| Multiple Directorships | Ratio of the number of directors who hold multiple directorships to total number of directors | <ul style="list-style-type: none"> • Less than 30% of the board hold multiple directorships • Between 30 and 60% of the board hold multiple directorships • More than 60% of the board hold multiple directorships | The number of directorships a director holds | <ul style="list-style-type: none"> • Individual board members hold only 1 directorship • Individual board members hold 2-3 directorships • Individual board members hold more than 3 directorships | There is a change in the operational definition of this attribute from “Ratio of the number of directors who hold multiple directorships to total number of directors” into “ The number of directorships a director holds ”. |

Table 4.2 Corporate Governance Attributes, Operational Definition, and Attribute Levels

| CG Attributes | Operational Definition | Attribute Levels |
|--------------------------------|--|--|
| 1. Board Composition | Proportion of independent directors on the board | <ul style="list-style-type: none"> • Less than 50% of the board are independent directors • Between 50% and 75% of the board are independent directors • More than 75% of the board are independent directors |
| 2. Board Size | Number of directors on the board | <ul style="list-style-type: none"> • Less than 5 board members • Between 5 and 8 board members • More than 8 board members |
| 3. Multiple Directorship | The number of directorships a director holds | <ul style="list-style-type: none"> • Individual board members hold only 1 directorship • Individual board members hold 2-3 directorships • Individual board members hold more than 3 directorships |
| 4. Audit Committee Composition | Proportion of independent directors on the Audit Committee | <ul style="list-style-type: none"> • Less than 50% of the Audit Committee are independent directors • Between 50% and 75% of the Audit Committee are independent directors • More than 75% of the Audit Committee are independent directors |
| 5. Audit Committee Size | Number of directors on the Audit Committee | <ul style="list-style-type: none"> • 3 or less Audit Committee members • More than 3 Audit Committee members |

| | | |
|---|--|---|
| | | |
| 6. Provision of Non-audit Services by the Auditor | Ratio of non-audit services fees to total audit fees | <ul style="list-style-type: none"> • Less than 30% ratio of non-audit fees to total audit fees • Between 30% and 60% ratio of non-audit fees to total audit fees • More than 60% ratio of non-audit fees to total audit fees |
| 7. Audit Partner Tenure | Length of the tenure of audit partner (in years) | <ul style="list-style-type: none"> • Audit partner tenure of 5 years or less • Audit partner tenure of more than 5 years |
| 8. Remuneration Committee Composition | Proportion of independent directors on the Remuneration Committee | <ul style="list-style-type: none"> • Less than 75% independent directors on the remuneration committee • Between 75% and 100% independent directors on the remuneration committee • 100% independent directors on the remuneration committee |
| 9. Chief Executive Officer Duality | Whether Chief Executive Officer and Chair of the Board are the same person | <ul style="list-style-type: none"> • CEO and Chair of the Board are the same person • CEO and Chair of the Board are not the same person |

4.5.2 Results of pilot study

As mentioned earlier, the survey questionnaire was pilot tested by 13 members of Faculty of Business and Economics at Macquarie University in order to ensure the appropriateness of the survey instrument. The results of this pilot test are summarised in Table 4.3.

This study analysed the responses using Sawtooth's SMRT Software and this analysis produced two components of the results. The first component is the relative importance score (RIS), which is calculated using the following formula:

$$RI_i = \frac{(MaxU_i - MinU_i)}{\sum_i^n (MaxU_i - MinU_i)}$$

Where:

RI_i : the relative importance of the i^{th} attribute

$MaxU_i$: the maximum utility of i^{th} attribute

$MinU_i$: the minimum utility of i^{th} attribute

i : number of attributes

n : number of respondents

A RIS indicates how respondents perceive the relative importance of an attribute. A higher RIS indicates that the attribute is relatively more important compared to the others. By construction, the scores are ratio scaled, calculated to sum to 100 across all

attributes, and directly comparable. As these scores are ratio scaled, an attribute with a score of 10 is twice as important as another attribute with the relative importance score of 5 (RIS will be explained in more detail in Chapter 5). Using “Remuneration Committee Composition” and “Board Meeting Frequency” as an example in this pilot test, it can be concluded that “Remuneration Committee Composition” is perceived to be approximately twice as important as “Board Meeting Frequency” since their relative importance scores are 10.94 and 5.31 respectively.

As shown in Table 4.3, the respondents to the pilot test considered several attributes to be relatively more important than the others. These attributes are *Audit Committee Composition*, *Board Composition*, *Remuneration Committee Composition*, *CEO Duality*, and *Provision of Non-audit Services by the Auditor*.

Secondly, the SMRT analysis also produced average utility values (AUV), which indicates respondents’ preferences for levels within each attribute. The detail about how AUV are calculated is explained in Chapter 5. AUV are interval data, rather than ratio data, which renders them invalid for direct comparison across attributes. However, AUV can be compared across levels within each attribute. Specifically, the direction of the AUV scores determines which levels are preferable within each attribute, that is, the levels that are more preferable are scored positively and those less preferable obtain negative scores.

For example (as shown in Table 4.3), for the attribute *Board Composition*, the average utility values for the levels of “Less than 50% of the board are independent directors”, “Between 50% and 75% of the board are independent directors”, and “More than 75% of the board are independent directors” are – 66.57, 38.59, and 27.98 respectively. This result can be interpreted in the following way, all other things being equal, the attribute

levels of “Between 50% and 75% of the board are independent directors” and “More than 75% of the board are independent directors” are more preferable than “Less than 50% of the board are independent directors” since the average utility values are positive. However, this conclusion does not mean that “Less than 50% of the board are independent directors” is not acceptable to all respondents. Instead, it only indicates that this attribute level is relatively less preferable compared to other levels within the attribute.

Table 4.3**Pilot Tests Results: Relative Importance Scores of Attributes and Average Utility Values of Attribute Levels (N = 13)**

| Attribute | Relative Importance Scores (RIS) | Attribute Levels | Average Utility Values (AUV) |
|-----------------------------|---|--|-------------------------------------|
| Board Composition | 11.85 | Less than 50% of the board are independent directors | -66.57 |
| | | Between 50% and 75% of the board are independent directors | 38.59 |
| | | More than 75% of the board are independent directors | 27.98 |
| Board Size | 7.45 | Less than 5 board members | -35.49 |
| | | Between 5 and 8 board members | 23.74 |
| | | More than 8 board members | 11.75 |
| Board Meeting Frequency | 5.31 | Less than 11 board meetings in a year | -9.73 |
| | | 11 or more board meetings in a year | 9.73 |
| Multiple Directorships | 7.77 | Less than 30% of the board hold multiple directorships | 24.77 |
| | | Between 30 and 60% of the board hold multiple directorships | 1.29 |
| | | More than 60% of the board hold multiple directorships | -26.05 |
| Audit Committee Composition | 13.30 | Less than 50% of the Audit Committee are independent directors | -60.05 |
| | | Between 50% and 75% of the Audit Committee are independent directors | 15.87 |
| | | More than 75% of the Audit Committee are independent directors | 44.18 |

| | | | |
|--|--------------|---|---|
| Audit Committee Size | 7.66 | 3 or less Audit Committee members More than 3 Audit Committee members | -35.79 35.79 |
| Audit Committee Meeting Frequency | 8.24 | Less than 4 audit committee meetings in a year 4 or more audit committee meetings in a year | -40.29 40.29 |
| Provision of Non-audit services by the Auditor | 9.75 | Less than 30% ratio of non-audit fees to total audit fees Between 30% and 60% ratio of non-audit fees to total audit fees More than 60% ratio of non-audit fees to total audit fees | 34.05 10.63 -44.68 |
| Audit Partner Tenure | 7.58 | Audit partner tenure of 5 years or less Audit partner tenure of more than 5 years | 21.48 -21.48 |
| Remuneration Committee Composition | 10.94 | Less than 75% independent directors on the remuneration committee Between 75% and 100% independent directors on the remuneration committee 100% independent directors on the remuneration committee | -57.61 6.33 51.28 |
| CEO Duality | 10.14 | CEO and Chair of the Board are the same person CEO and Chair of the Board are not the same person | -55.79 55.79 |

4.6 Conclusion

This chapter discusses the data collection process used in this study. In particular, it explains the choice of interview and survey as the data collection methods. Furthermore, this chapter also outlines the pilot test conducted, the changes to the survey instruments which are incorporated after the test, and the results of the pilot test. The data descriptives in this study are presented and discussed in Chapter 5.

CHAPTER 5

DATA DESCRIPTION

5.1 Introduction

This chapter describes the data used in this study. Section 5.2 discusses the data sources. Section 5.3 presents demographic information on the respondents. Section 5.4 provides details on data descriptives, including descriptive statistics for ACA raw utility data, discussion on average utility values (AUV), and relative importance scores (RIS). Section 5.5 concludes this chapter.

5.2 Data sources

After the survey instrument was finalised, the next stage was obtaining responses from potential participants. As explained in previous chapters, this study aims to analyse perceptions of the relative importance of corporate governance attributes in assessments of effective corporate governance from two groups of stakeholders, namely (i) Shareholders and (ii) Directors. Consequently, this study targets respondents from associations that represent these groups, the Australian Shareholders Association (ASA) and the Australian Institute of Company Directors (AICD). In order to obtain their responses, a direct approach was made to these organisations, whose representatives agreed to assist in circulating the survey questionnaire among their members. The data collection process involving AICD commenced in November 2012 and concluded in February 2013 whilst the process involving ASA started in September 2013 and was

completed in October 2013. While these data collection processes were conducted in different time periods, no significant corporate governance events or changes occurred that might affect the results of the study. Respondent recruitment process is explained in more detail in the following sections.

5.2.1 Shareholders

In regard to recruiting shareholders as participants, a direct approach was initiated with the Australian Shareholders Association (ASA) as it is a large representative association of shareholders in Australia with around 4,000 members. ASA is a not-for-profit organisation that was established in 1960 to protect shareholders' interest and act as a shareholder lobby group. ASA members are generally retail investors in publicly listed entities who have significant portfolio holdings; they also include self-managed super funds (SMSF) trustees. A representative of this organisation agreed to circulate the link to the survey questionnaire developed for this study to its members through email. The response rate was approximately 5.75% as 230 completed responses were received from ASA members out of a membership of 4,000. As it cannot be known how many members opened or read the email, the effective response rate may be higher.

5.2.2 Directors

In regard to recruiting directors, the study targets respondents from the membership of the Australian Institute of Company Directors (AICD) as this organisation is a prominent industry representative of directors in Australia. AICD was established in 1960 as a not-for-profit organisation for directors and has around 34,000 members.

Members of this organisation are primarily directors of Australian listed public companies. A representative from the AICD agreed to assist in recruiting respondents for this study by providing a link to the survey questionnaire developed for the study in the fortnightly online newsletter that is accessible to its members. In total, 46 completed responses were received from AICD members. Due to the indirect nature of the approach to directors, it is not possible to know how many accessed the newsletter or read the invitation to complete the questionnaire. Therefore, it is not possible to estimate a response rate.

5.3 Demographic information of respondents

The respondents were asked several questions in the survey questionnaire in order to obtain their demographic characteristics. These characteristics consist of the gender, age, and educational level of the participants. Table 5.1, Figure 5.1, 5.2, and 5.3 provide a summary of the demographic characteristics of both respondent groups.

In aggregate, the respondents are composed mostly of shareholders, who account for 83.33% of the total participants. Both respondent groups are composed predominantly of males (83.70%), who comprise 86.09% of shareholders and 71.74% of directors. The demographic results also reveal overall that respondent directors are younger than respondent shareholders. As shown in Table 5.1 and Figure 5.2, 93.48% of directors who participated in this study are under 65 years old. Conversely, the majority of the respondent shareholders (65.22%) are 65 years old or over. In particular, 25.22% of shareholders are 75 years old or over, while none of the directors belong to this age group.

In terms of educational level, the results reveal that directors are somewhat more highly educated than shareholders, which is not surprising as they are required to have some expertise and qualifications to exercise their roles as directors. While 9.13% of shareholders have high school as their highest educational level, none of the directors have qualifications lower than a diploma.

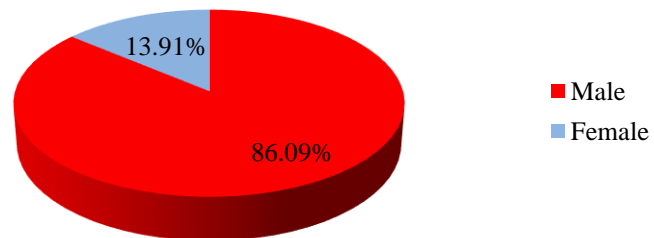
The majority of shareholders and directors hold at least a bachelor's degree, comprising 70.87% and 86.96% of the respective groups. Directors have a higher proportion of master's and MBA qualifications relative to shareholders. The directors' profiles in this study are consistent with Recommendation 2.4 of ASX POGCG which recommends that directors need to possess an appropriate range of skills and expertise (competencies) in order to exercise their roles.

Table 5.1
Demographics for All Respondents (N=276)

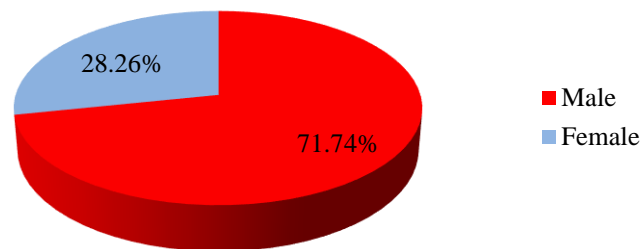
| | | Shareholders | | Directors | | All Respondents | |
|-------------------|--------------|--------------|---------------|-----------|---------------|-----------------|-------------|
| Variables | Categories | No. | Percentage | No. | Percentage | No. | Percentage |
| Gender | Male | 198 | 86.09% | 33 | 71.74% | 231 | 83.70% |
| | Female | 32 | 13.91% | 13 | 28.26% | 45 | 16.30% |
| | | | | | | | |
| Age | 18-24 | 1 | 0.43% | 0 | 0.00% | 1 | 0.36% |
| | 25-34 | 0 | 0.00% | 1 | 2.17% | 1 | 0.36% |
| | 35-44 | 3 | 1.30% | 6 | 13.04% | 9 | 3.26% |
| | 45-54 | 16 | 6.96% | 17 | 36.96% | 33 | 11.96% |
| | 55-64 | 60 | 26.09% | 19 | 41.30% | 79 | 28.62% |
| | 65-74 | 92 | 40.00% | 3 | 6.52% | 95 | 34.42% |
| | 75 and over | 58 | 25.22% | 0 | 0.00% | 58 | 21.01% |
| | | | | | | | |
| Highest Education | High School | 21 | 9.13% | 0 | 0.00% | 21 | 7.61% |
| | Diploma | 46 | 20.00% | 6 | 13.04% | 52 | 18.84% |
| | Bachelor | 81 | 35.22% | 13 | 28.26% | 94 | 34.06% |
| | Masters | 28 | 12.17% | 9 | 19.57% | 37 | 13.41% |
| | MBA | 15 | 6.52% | 10 | 21.74% | 25 | 9.06% |
| | PhD | 12 | 5.22% | 3 | 6.52% | 15 | 5.43% |
| | Others | 27 | 11.74% | 5 | 10.87% | 32 | 11.59% |
| | | | | | | | |
| | Total | 230 | 83.33% | 46 | 16.67% | 276 | 100% |

Figure 5.1
Demographics of Respondents by Gender

**Demographic of Shareholders
by Gender (N=230)**



**Demographic of Directors by
Gender (N=46)**



**Demographic of All
Respondents by Gender
(N=276)**

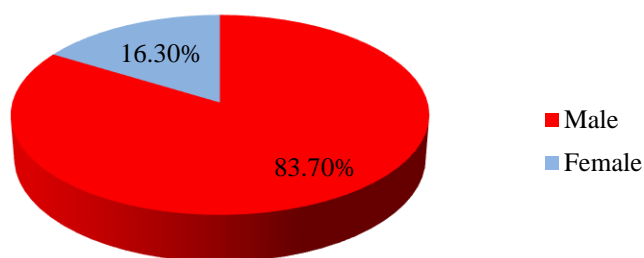
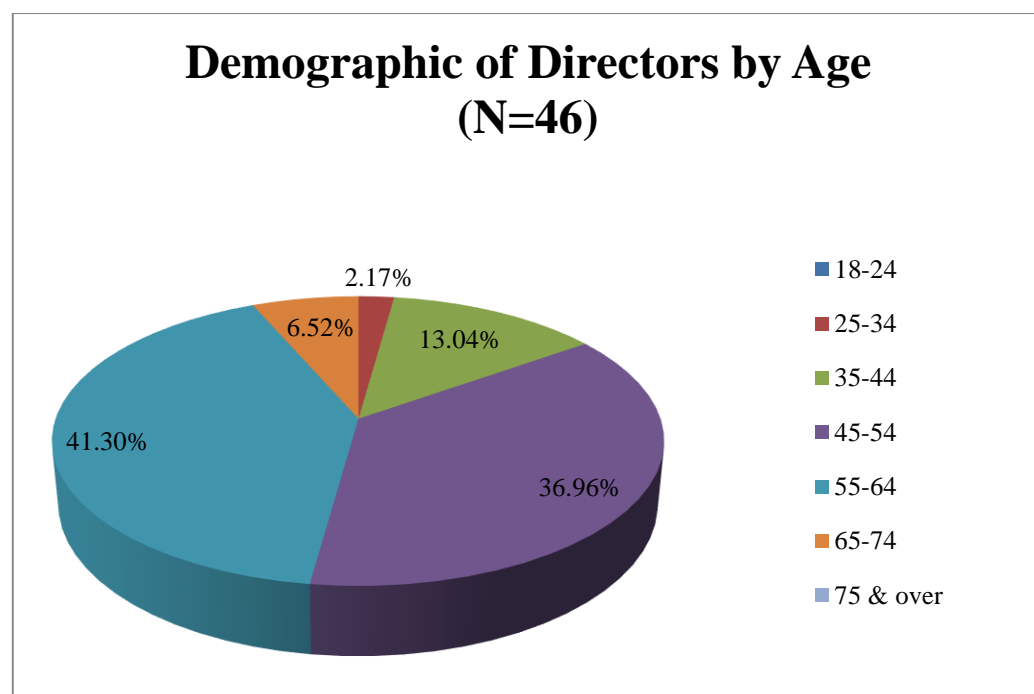
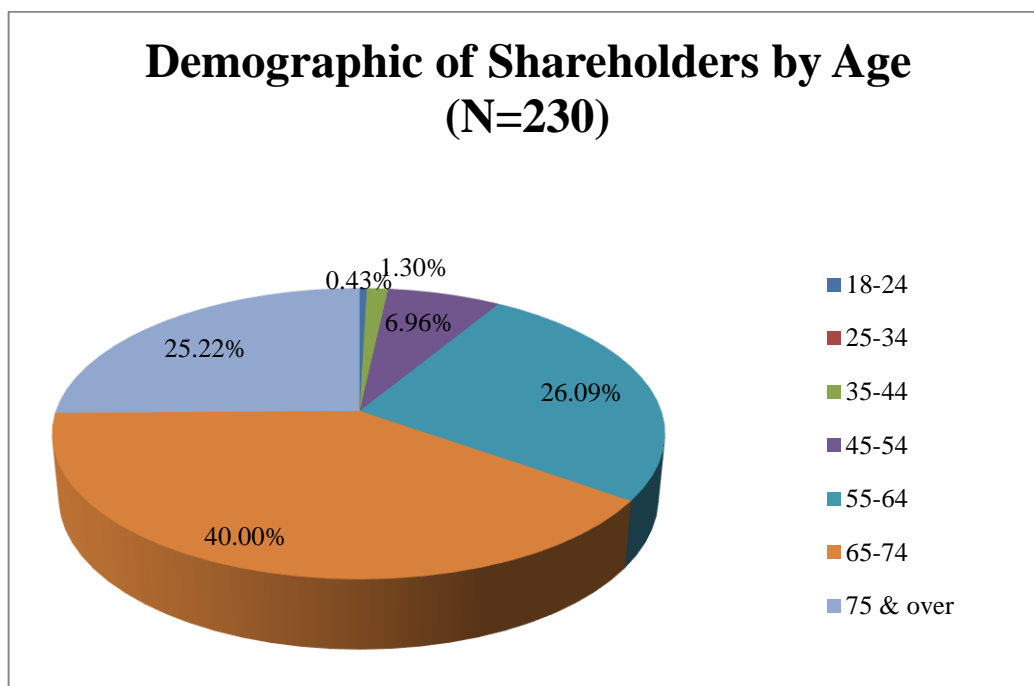


Figure 5.2
Demographics of Respondents by Age



Demographic of All Respondents by Age (N=276)

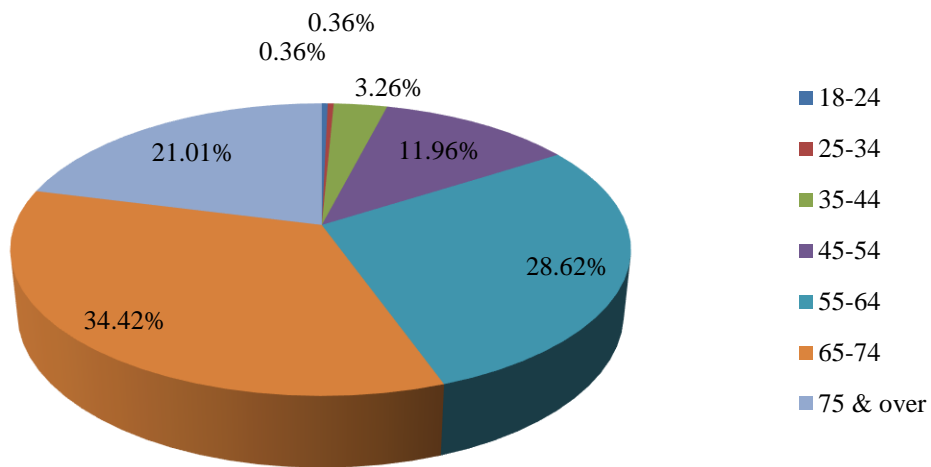
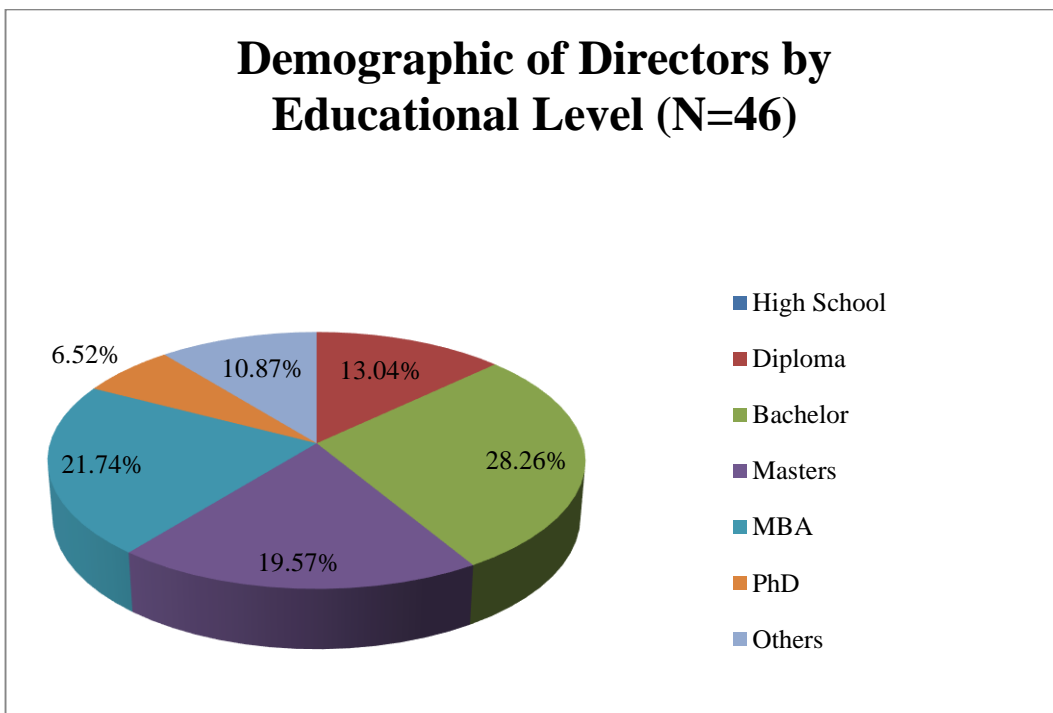
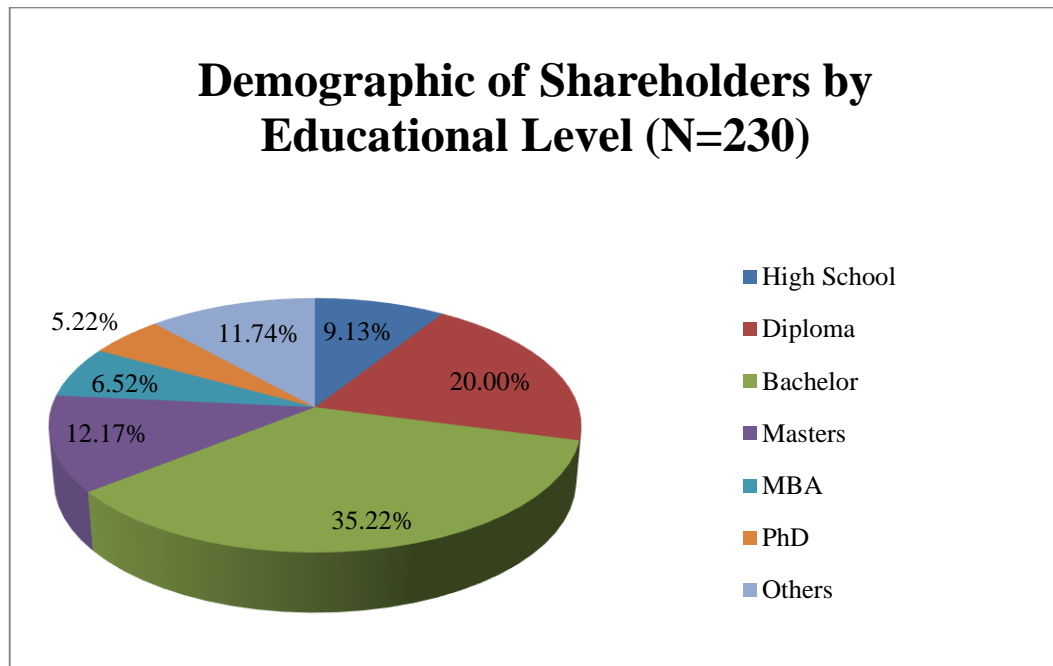
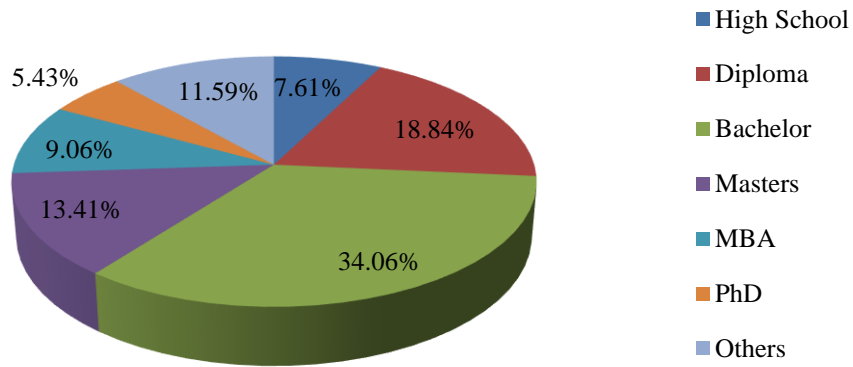


Figure 5.3
Demographics of Respondents by Educational Level



Demographic of All Respondents by Educational Level (N=276)



5.4 Data descriptives

As explained in Section 5.2, the overall data collection process involving both the ASA and AICD started in November 2012 and was completed in October 2013. The complete responses from the respondents were accumulated for processing through Sawtooth Software Market Research Tools (SMRT), which is a market simulator that has been widely used in the market research industry to analyse participants' responses.

This section presents details of data descriptives, which include a discussion of the ACA utility data (Section 5.4.1), average utility values (Section 5.4.2) and relative importance scores (Section 5.4.3) for all respondents, shareholders, and directors respectively.

5.4.1 Descriptive statistics on ACA raw utility data

As explained, complete responses from the participants in this study were processed through Sawtooth Software Market Research Tools (SMRT) Software, which involves computation of ACA raw utility data. Raw utility data are based on respondents' desirability ratings for attribute levels; they are interval in nature and natural-scaled from utility estimation (Sawtooth Software, 2009). Table 5.2 shows the raw utility data for one of the respondents, indicating how this respondent performed the task and showing the utility values for each level within each attribute.

Using the raw utility data for all respondents, the descriptive statistics (mean, standard deviation, maximum, and minimum values) for the raw utility were computed. The raw utility data descriptive statistics for all respondents, shareholders, and directors are reported in Tables 5.3, 5.4, and 5.5 respectively.

Table 5.2
ACA Raw Utility Data for Respondent No. 1

| Attribute | Attribute Levels | Raw Utility |
|--|--|--------------------|
| Board Composition | Less than 50% of the board are independent directors | - 1.149 |
| | Between 50% and 75% of the board are independent directors | 0.296 |
| | More than 75% of the board are independent directors | 0.494 |
| Board Size | Less than 5 board members | - 0.414 |
| | Between 5 and 8 board members | 0.061 |
| | More than 8 board members | - 0.007 |
| Multiple Directorship | Individual board members hold only 1 directorship | - 0.097 |
| | Individual board members hold 2-3 directorships | - 0.152 |
| | Individual board members hold more than 3 directorships | - 0.111 |
| Audit Committee Composition | Less than 50% of the Audit Committee are independent directors | - 1.227 |
| | Between 50% and 75% of the Audit Committee are independent directors | 0.295 |
| | More than 75% of the Audit Committee are independent directors | 0.573 |
| Audit Committee Size | 3 or less Audit Committee members | - 0.492 |
| | More than 3 Audit Committee members | 0.253 |
| Provision of Non-audit services by the Auditor | Less than 30% ratio of non-audit fees to total audit fees | 0.486 |
| | Between 30% and 60% ratio of non-audit fees to total audit fees | - 0.298 |
| | More than 60% ratio of non-audit fees to total audit fees | - 0.547 |
| Audit Partner Tenure | Audit partner tenure of 5 years or less | 0.203 |
| | Audit partner tenure of more than 5 years | - 0.443 |
| Remuneration Committee Composition | Less than 75% independent directors on the remuneration committee | - 0.100 |
| | Between 75% and 100% independent directors on the remuneration committee | - 0.492 |
| | 100% independent directors on the remuneration committee | 0.233 |
| CEO Duality | CEO and Chair of the Board are the same person | - 0.881 |
| | CEO and Chair of the Board are not the same person | 0.641 |

Table 5.3
Descriptive Statistics for ACA Raw Utility Data for All Respondents
(N=276)

| Attribute | Attribute Levels | Min | Max | Mean | Std. Dev |
|--|-------------------------------|--------|-------|--------|----------|
| Board Composition | < 50% independent directors | -1.333 | 0.614 | -0.427 | 0.378 |
| | 50-75% independent directors | -0.672 | 0.965 | 0.125 | 0.274 |
| | > 75% independent directors | -0.664 | 1.295 | 0.190 | 0.355 |
| Board Size | < 5 members | -1.072 | 0.596 | -0.248 | 0.282 |
| | 5-8 members | -0.561 | 1.122 | 0.247 | 0.252 |
| | > 8 members | -1.309 | 0.673 | -0.111 | 0.298 |
| Multiple Directorship | 1 directorship | -0.956 | 1.530 | 0.020 | 0.374 |
| | 2-3 directorships | -0.931 | 0.948 | 0.191 | 0.260 |
| | > 3 directorships | -1.216 | 0.586 | -0.284 | 0.322 |
| Audit Committee Composition | < 50% independent directors | -1.517 | 0.737 | -0.436 | 0.327 |
| | 50-75% independent directors | -0.655 | 0.730 | 0.080 | 0.256 |
| | > 75% independent directors | -0.700 | 1.094 | 0.243 | 0.301 |
| Audit Committee Size | 3 or less members | -0.956 | 0.485 | -0.135 | 0.265 |
| | > 3 members | -0.707 | 0.698 | 0.060 | 0.277 |
| Provision of Non-audit services by the Auditor | < 30% NAF/total AF | -0.854 | 1.310 | 0.331 | 0.353 |
| | 30%-60% NAF/total AF | -0.766 | 0.604 | -0.088 | 0.236 |
| | > 60% NAF/total AF | -1.126 | 0.544 | -0.356 | 0.315 |
| Audit Partner Tenure | 5 years or less | -0.613 | 0.999 | 0.172 | 0.272 |
| | > 5 years | -1.084 | 0.529 | -0.247 | 0.294 |
| Remuneration Committee Composition | < 75% independent directors | -1.265 | 0.524 | -0.344 | 0.342 |
| | 75-100% independent directors | -0.895 | 0.933 | 0.066 | 0.260 |
| | 100% independent directors | -0.782 | 1.073 | 0.164 | 0.341 |
| CEO Duality | Same person | -1.478 | 0.408 | -0.597 | 0.358 |
| | Different person | -0.405 | 1.432 | 0.522 | 0.334 |

Table 5.4
Descriptive Statistics for ACA Raw Utility Data for Shareholders
(N=230)

| Attribute | Attribute Levels | Min | Max | Mean | Std. Dev |
|--|-------------------------------|--------|-------|--------|----------|
| Board Composition | < 50% independent directors | -1.333 | 0.614 | -0.432 | 0.385 |
| | 50-75% independent directors | -0.672 | 0.965 | 0.131 | 0.276 |
| | > 75% independent directors | -0.664 | 1.074 | 0.180 | 0.359 |
| Board Size | < 5 members | -1.072 | 0.596 | -0.250 | 0.281 |
| | 5-8 members | -0.561 | 1.122 | 0.245 | 0.260 |
| | > 8 members | -1.309 | 0.673 | -0.115 | 0.299 |
| Multiple Directorship | 1 directorship | -0.956 | 1.530 | 0.015 | 0.380 |
| | 2-3 directorships | -0.931 | 0.948 | 0.188 | 0.270 |
| | > 3 directorships | -1.216 | 0.586 | -0.324 | 0.317 |
| Audit Committee Composition | < 50% independent directors | -1.316 | 0.737 | -0.430 | 0.313 |
| | 50-75% independent directors | -0.655 | 0.730 | 0.077 | 0.262 |
| | > 75% independent directors | -0.700 | 1.041 | 0.232 | 0.296 |
| Audit Committee Size | 3 or less members | -0.956 | 0.485 | -0.130 | 0.270 |
| | > 3 members | -0.707 | 0.698 | 0.050 | 0.283 |
| Provision of Non-audit services by the Auditor | < 30% NAF/total AF | -0.854 | 1.310 | 0.334 | 0.359 |
| | 30%-60% NAF/total AF | -0.766 | 0.604 | -0.101 | 0.240 |
| | > 60% NAF/total AF | -1.126 | 0.544 | -0.354 | 0.319 |
| Audit Partner Tenure | 5 years or less | -0.613 | 0.999 | 0.168 | 0.275 |
| | > 5 years | -1.084 | 0.529 | -0.248 | 0.294 |
| Remuneration Committee Composition | < 75% independent directors | -1.265 | 0.524 | -0.356 | 0.347 |
| | 75-100% independent directors | -0.608 | 0.933 | 0.076 | 0.260 |
| | 100% independent directors | -0.782 | 1.073 | 0.159 | 0.350 |
| CEO Duality | Same person | -1.426 | 0.408 | -0.583 | 0.357 |
| | Different person | -0.405 | 1.432 | 0.503 | 0.335 |

Table 5.5
Descriptive Statistics for ACA Raw Utility Data for Directors (N=46)

| Attribute | Attribute Levels | Min | Max | Mean | Std. Dev |
|--|-------------------------------|--------|-------|--------|----------|
| Board Composition | < 50% independent directors | -1.149 | 0.276 | -0.405 | 0.346 |
| | 50-75% independent directors | -0.408 | 0.795 | 0.093 | 0.265 |
| | > 75% independent directors | -0.472 | 1.295 | 0.238 | 0.331 |
| Board Size | < 5 members | -0.956 | 0.444 | -0.237 | 0.286 |
| | 5-8 members | -0.138 | 0.858 | 0.256 | 0.211 |
| | > 8 members | -0.825 | 0.656 | -0.092 | 0.293 |
| Multiple Directorship | 1 directorship | -0.887 | 0.258 | -0.194 | 0.288 |
| | 2-3 directorships | -0.174 | 0.747 | 0.202 | 0.209 |
| | > 3 directorships | -0.750 | 0.428 | -0.081 | 0.268 |
| Audit Committee Composition | < 50% independent directors | -1.517 | 0.384 | -0.467 | 0.396 |
| | 50-75% independent directors | -0.583 | 0.500 | 0.095 | 0.224 |
| | > 75% independent directors | -0.350 | 1.094 | 0.299 | 0.324 |
| Audit Committee Size | 3 or less members | -0.569 | 0.339 | -0.161 | 0.238 |
| | > 3 members | -0.462 | 0.550 | 0.112 | 0.240 |
| Provision of Non-audit services by the Auditor | < 30% NAF/total AF | -0.585 | 1.131 | 0.314 | 0.323 |
| | 30%-60% NAF/total AF | -0.530 | 0.437 | -0.023 | 0.208 |
| | > 60% NAF/total AF | -0.913 | 0.294 | -0.364 | 0.293 |
| Audit Partner Tenure | 5 years or less | -0.248 | 0.778 | 0.194 | 0.256 |
| | > 5 years | -0.820 | 0.426 | -0.242 | 0.294 |
| Remuneration Committee Composition | < 75% independent directors | -0.955 | 0.387 | -0.281 | 0.311 |
| | 75-100% independent directors | -0.895 | 0.387 | 0.018 | 0.257 |
| | 100% independent directors | -0.578 | 0.887 | 0.190 | 0.291 |
| CEO Duality | Same person | -1.478 | 0.141 | -0.668 | 0.361 |
| | Different person | -0.036 | 1.277 | 0.619 | 0.317 |

5.4.2 Average utility values (AUV)

Respondent ratings for the desirability of attribute levels and attribute importance ratings determine the initial utility estimates (Sawtooth Software, 2007). These estimates are updated as the survey progresses (Menichetti, 2010¹), which causes the initial position of utility estimation to be different for each respondent (Luthi and Wustenhagen, 2012²). Therefore, in order for utilities to be comparable across respondents, raw utilities (part-worth utilities) are scaled using zero-centred differentials normalisation. This method scales the utility values so that each respondent's total sum of the utility differences between the best and worst levels for each attribute across attributes is equal to the number of attributes times 100 (Orme, 2010a). Specifically, estimated raw utilities are scaled so that the sums of all average utility values (AUV) within each attribute are zero. This normalisation process results in each respondent having an equal impact on the computation of the utility values, hence the results between respondents can be compared.

AUVs represent the desirability of attribute levels by the respondents. AUVs are interval data and the direction of the scores within each attribute determines which levels are preferable, that is, the levels that are more preferable are scored positively (higher) and those less preferable obtain lower positive and/or negative scores. On the other hand, AUVs are not ratio data, therefore they cannot be compared across attributes. For instance, the attribute level of "More than 75% of the board are independent directors" within *Board Composition* cannot be directly compared to the level of "Between 5 and 8 board members" within *Board Size*. The AUVs for all

¹ Menichetti (2010) used Adaptive Conjoint Analysis (ACA) in examining investors' preferences for wind energy policy. It provides a clear explanation on the process of utility estimation.

² Luthi and Wustenhagen (2012) used Adaptive Conjoint Analysis (ACA) in investigating the price of policy risk.

respondents, shareholders, and directors are reported in Table 5.6. These results are discussed in detail in Chapter 6.

Table 5.6
Results: Average Utility Values of Attribute Levels

| Attribute | Attribute Levels | AUV (All Respondents) | AUV (Shareholders) | AUV (Directors) |
|--|-------------------------------|-----------------------|--------------------|-----------------|
| Board Composition | < 50% independent directors | -49.09 | -48.89 | -50.09 |
| | 50-75% independent directors | 21.51 | 22.89 | 14.58 |
| | > 75% independent directors | 27.58 | 26.00 | 35.51 |
| Board Size | < 5 members | -26.71 | -26.79 | -26.31 |
| | 5-8 members | 38.26 | 38.07 | 39.21 |
| | > 8 members | -11.55 | -11.28 | -12.90 |
| Multiple Directorships | 1 directorship | 2.63 | 7.42 | -21.28 |
| | 2-3 directorships | 30.98 | 30.56 | 33.05 |
| | > 3 directorships | -33.61 | -37.98 | -11.77 |
| Audit Committee Composition | < 50% independent directors | -49.11 | -47.60 | -56.65 |
| | 50-75% independent directors | 14.96 | 15.14 | 14.08 |
| | > 75% independent directors | 34.15 | 32.46 | 42.57 |
| Audit Committee Size | 3 or less members | -11.87 | -10.20 | -20.21 |
| | > 3 members | 11.87 | 10.20 | 20.21 |
| Provision of Non-audit services by the Auditor | < 30% NAF/total AF | 46.75 | 47.76 | 41.73 |
| | 30%-60% NAF/total AF | -4.90 | -6.53 | 3.24 |
| | > 60% NAF/total AF | -41.85 | -41.22 | -44.96 |
| Audit Partner Tenure | 5 years or less | 25.70 | 25.81 | 25.15 |
| | > 5 years | -25.70 | -25.81 | -25.15 |
| Remuneration Committee Composition | < 75% independent directors | -36.71 | -37.32 | -33.66 |
| | 75-100% independent directors | 13.25 | 14.45 | 7.26 |
| | 100% independent directors | 23.46 | 22.88 | 26.40 |
| CEO Duality | Same person | -73.29 | -70.57 | -86.87 |
| | Different person | 73.29 | 70.57 | 86.87 |

5.4.3 Relative importance scores (RIS)

The RIS for each attribute is calculated by considering the difference in the range in the attribute's utility values, that is, the level of relative importance is affected by the attribute levels that are preferred by the respondents (Orme, 2010b). According to Luthi and Wustenhagen (2012), RIS show how much difference each attribute could make in the overall utility of the product. A greater range of an attribute's utility value exhibits the higher importance of the attribute. Specifically, RIS are calculated as the difference between the maximum and minimum utilities of a specific attribute divided by the sum of the differences between maximum and minimum utilities for all attributes. This is illustrated by the following formula which is used to calculate RIS.

$$RI_i = \frac{(MaxU_i - MinU_i)}{\sum_i^n (MaxU_i - MinU_i)}$$

Where:

RI_i : the relative importance of the i^{th} attribute

$MaxU_i$: the maximum utility of i^{th} attribute

$MinU_i$: the minimum utility of i^{th} attribute

i : number of attributes

n : number of respondents

As discussed in Chapter 4, RIS are ratio scaled and calculated to sum to 100 across all attributes. The magnitude of the score of each attribute is relative to other attributes used in the study, that is, RIS can be compared across attributes used in the same study and are comparable to another study with the same attributes. As these scores are ratio scaled, an attribute with a score of 10 is considered twice as important as another attribute with a relative importance score of 5. The RIS for each attribute for all respondents, shareholders, and directors are reported in Table 5.7, 5.8, and 5.9 respectively. Figure 5.4, 5.5, and 5.6 also illustrate the difference in RIS between attributes. These findings are analysed in details in Chapter 6.

Table 5.7
Results on All Respondents: Relative Importance Scores of Attributes
(N=276)

| Attribute | Relative Importance Scores (RIS) |
|------------------------|----------------------------------|
| Board Composition | 12.97 |
| Board Size | 10.51 |
| Multiple Directorships | 10.69 |
| Audit Committee | 12.03 |
| Audit Committee Size | 6.57 |
| Provision of Non-audit | 11.68 |
| Audit Partner Tenure | 7.86 |
| Remuneration Committee | 11.04 |
| CEO Duality | 16.66 |

Figure 5.4
Results on All Respondents: Relative Importance Scores of Attributes
(N=276)

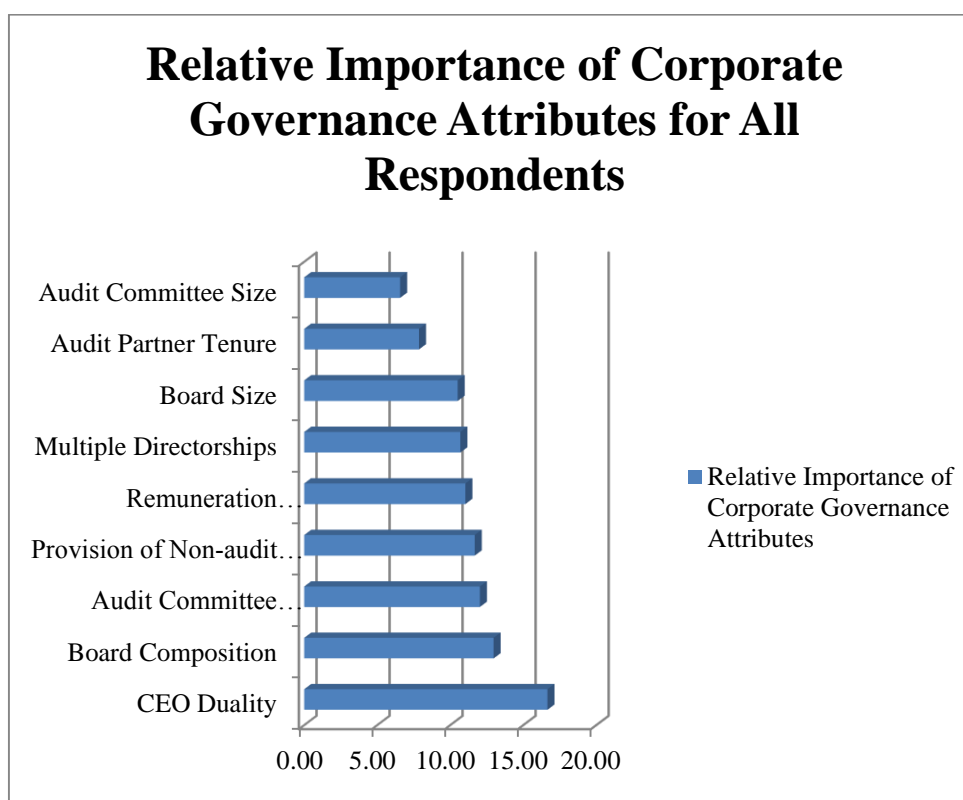


Table 5.8
Results on Shareholders: Relative Importance Scores of Attributes
(N=230)

| Attribute | Relative Importance Scores (RIS) |
|------------------------|----------------------------------|
| Board Composition | 13.10 |
| Board Size | 10.46 |
| Multiple Directorships | 11.03 |
| Audit Committee | 11.91 |
| Audit Committee Size | 6.56 |
| Provision of Non-audit | 11.72 |
| Audit Partner Tenure | 7.85 |
| Remuneration Committee | 11.25 |
| CEO Duality | 16.12 |

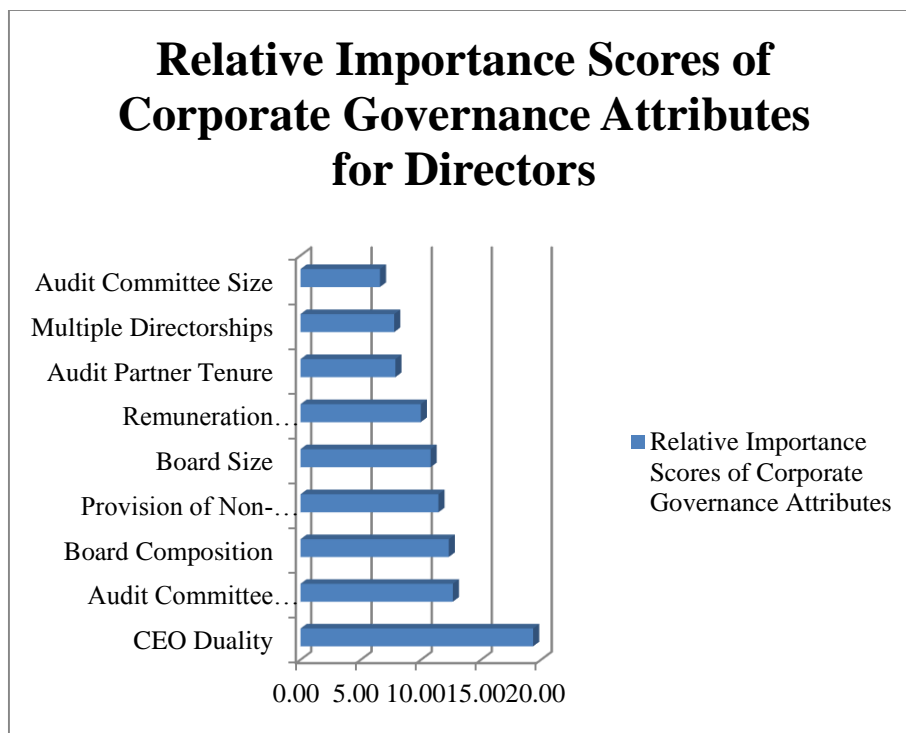
Figure 5.5
Results on Shareholders: Relative Importance Scores of Attributes
(N=230)



Table 5.9
Results on Directors: Relative Importance Scores of Attributes (N=46)

| Attribute | Relative Importance Scores (RIS) |
|------------------------|----------------------------------|
| Board Composition | 12.31 |
| Board Size | 10.79 |
| Multiple Directorships | 9.03 |
| Audit Committee | 12.65 |
| Audit Committee Size | 6.59 |
| Provision of Non-audit | 11.45 |
| Audit Partner Tenure | 7.87 |
| Remuneration Committee | 9.98 |
| CEO Duality | 19.34 |

Figure 5.6
Results on Directors: Relative Importance Scores of Attributes (N=46)



5.5 Conclusion

This chapter outlines the data sources, demographic information of the respondents, and data descriptives. In particular, it provides details of the descriptive statistics for raw utility data, average utility values, and relative importance scores.

Chapter 6 provides a detailed discussion of the findings of the study, including several statistical tests (both univariate and multivariate tests) in examining whether shareholders and directors have similar perceptions of attributes in their assessments of effective corporate governance.

CHAPTER 6

RESULTS

6.1 Introduction

This chapter presents the results of the study. Section 6.2 presents findings for Hypotheses 1a and 1b, which investigate shareholders' assessments of effective corporate governance. Specifically, these hypotheses examine which corporate governance attributes shareholders perceive to be relatively more and less important. Results for Hypotheses 2a and 2b, which examine directors' perceptions of corporate governance attributes, are discussed in Section 6.3. Robustness tests to address potential nonresponse bias that could affect the results for Hypotheses 1 and 2 are presented in Section 6.4. Section 6.5 discusses the results relating to Hypothesis 3, which compares the results for shareholders and directors. This hypothesis is concerned with the extent to which shareholders' and directors' relative preferences correspond. In analysing differences between these groups, this chapter presents the results of several statistical tests (both univariate and multivariate tests). Section 6.6 concludes the chapter.

6.2 Hypothesis 1 (shareholders' assessments of effective corporate governance)

Recall that in Chapter 2 the first set of hypotheses (H1a and H1b) investigates shareholders' assessments of effective corporate governance. Specifically, they examine which attributes are relatively more important to shareholders. The hypotheses are stated as follows:

H1a: *Shareholders perceive corporate governance attributes related to the board of directors to be relatively more important in their assessments of effective corporate governance.*

H1b: *Shareholders perceive corporate governance attributes related to the audit committee and audit independence to be relatively less important in their assessments of effective corporate governance.*

As discussed in Chapter 5, the results from the data collection using ACA show the relative importance scores (RIS) for each attribute. Recall that relative importance scores reflect how respondents perceive each attribute. These scores are calculated to sum to 100 across all attributes and are directly comparable. As an indicator of which attributes are relatively more important than the others, following Kilgore, Radich and Harrison (2011) and Kilgore, Harrison and Radich (2014), this study uses the average importance score as a benchmark. Any attributes with RIS greater than this benchmark will be deemed to be relatively more important. As nine attributes are examined in the study, the cut-off importance score is 11.11, that is, 100 divided by 9.

Recall, too, that several attributes are expected to be relatively more important for shareholders, namely (i) **Board size**, (ii) **Board composition**, (iii) **Multiple directorships**, (iv) **Remuneration committee composition**, and (v) **CEO duality**. The ACA results provide partial support for these expectations. As reported in Table 6.1 (Column 2) and Figure 6.1, the results reveal that five attributes with RIS greater than 11.11 are perceived therefore to be relatively more important by shareholders in their perceptions of effective corporate governance. These attributes are: (i) *CEO Duality*

(RIS=16.12), (ii) *Board Composition* (RIS=13.10), (iii) *Audit Committee Composition* (RIS=11.91), (iv) *Provision of Non-audit Services by the Auditor* (RIS=11.72), and (v) *Remuneration Committee Composition* (RIS=11.25). While these attributes are all considered to be relatively more important, it is worth noting that the attributes *Provision of Non-audit Services by the Auditor* and *Remuneration Committee Composition* have reported RIS that are only marginally above 11.11, that is, close to average. On the other hand, shareholders rate *Multiple Directorships* (RIS=11.03), *Board Size* (RIS=10.46), *Audit Partner Tenure* (RIS=7.85), and *Audit Committee Size* (RIS=6.56) as relatively less important in their perceptions of effective corporate governance.

The results also show the average utility values (AUV) of the respondents for each attribute level. As explained in Chapter 5, AUVs are interval data and the direction of the scores within each attribute determines which levels are preferable, that is, the levels that are more preferable are scored positively (higher) and those less preferable obtain lower positive and/or negative scores. On the other hand, AUVs are not ratio data, therefore they cannot be compared across attributes. The following section explains the results for each attribute. The attributes are explained in the order of importance to shareholders from the most to the least important attributes. AUVs for shareholders are presented in Table 6.1 (Column 7).

6.2.1 CEO duality

This attribute was perceived by shareholders as the most important corporate governance attribute as it has the highest RIS (RIS=16.12). In terms of attribute levels, shareholders indicate that they strongly prefer separation of roles between the CEO and Chairman

(AUV=70.57) compared to the same person exercising both roles (AUV=-70.57), which they strongly dislike.

6.2.2 Board composition

The shareholders perceived board composition as the second most important attribute (RIS=13.10). Within the attribute, shareholders prefer a board that comprises a majority of independent directors, as indicated by the positive AUVs for the levels of “more than 75% of the board are independent directors” (AUV=26.00) and “between 50% and 75% of the board are independent directors” (AUV=22.89). While these positive scores show that shareholders prefer a more independent board, the scores for these two levels are similar, indicating no strong preference for either level. On the other hand, they do not prefer a board consisting of less than 50% independent directors (AUV=-48.89).

6.2.3 Audit committee composition

This attribute was perceived as the third most important (RIS=11.91). This result is consistent with the way shareholders view board composition. With regard to attribute levels, the results for this attribute are also aligned with the overall results for board composition. As reported, both attribute levels of “more than 75% of the audit committee are independent directors” (AUV=32.46) and “between 50% and 75% of the audit committee are independent directors” (AUV=15.14) have positive AUVs. While these findings indicate that shareholders value an audit committee that has a majority of independent directors, the AUVs indicate a clear preference for an audit committee that is highly independent (more than 75% independent directors on the committee). Conversely, shareholders do not favour an audit committee with less than 50% independent directors (AUV=-47.60).

6.2.4 Provision of non-audit services by the auditor

Provision of non-audit services by the auditor was perceived as the fourth most important attribute by shareholders in their assessments of effective corporate governance (RIS=11.72). Within this attribute, shareholders expressed a strong preference for a reduced OR lower level of provision of non-audit services, as shown by the positive AUVs for “less than 30% ratio of non-audit fees to total audit fees” (AUV=47.76). The other two attribute levels, “between 30% and 60% ratio of non-audit fees to total audit fees” and “more than 60% ratio of non-audit fees to total audit fees” are less desirable to shareholders, as indicated by negative AUVs (-6.53 and -41.22 respectively). Specifically, this indicates that shareholders strongly regard a high level of non-audit fees (more than 60% ratio of non-audit fees to total audit fees) to be undesirable.

6.2.5 Remuneration committee composition

The shareholders perceived this attribute as the fifth most important corporate governance attribute relative to others, with a RIS that is only marginally above 11.11 (RIS=11.25). Shareholders indicate a preference for a remuneration committee that consists of a majority of independent directors, as shown by the preference for the levels “100% independent directors on the remuneration committee” (AUV=22.88) and “between 75% and 100% independent directors on the remuneration committee” (AUV=14.45). This result implies that shareholders prefer a fully independent remuneration committee compared to a committee that has a small proportion of executive directors. The finding also indicates that shareholders strongly dislike a remuneration committee with less than 75% independent directors on it (AUV=-37.32).

6.2.6 Multiple directorships

Multiple directorships was perceived sixth in relative importance with a RIS slightly below 11.11, indicating that it is somewhat less important from the perspective of the shareholders (RIS=11.03). Within this attribute, shareholders indicate that they prefer mid-level multiple directorships, namely the level “individual board members hold 2-3 directorships” (AUV=30.56). While the level “individual board members hold only 1 directorship” (AUV=7.42) is still acceptable for shareholders, they clearly indicate that they do not prefer individual board members to hold more than three directorships (AUV=-37.98).

6.2.7 Board size

Size of the board was perceived seventh in relative importance (RIS=10.46), indicating that this attribute is perceived by shareholders to be relatively less important than other attributes as the score is below the average. With regard to the attribute levels, shareholders prefer a medium sized board of between five and eight members (AUV=38.07) rather than a smaller board (less than five members; AUV=-26.79) or a larger board (more than eight members; AUV=-11.28). Their dislike for a smaller board is stronger than their dislike for a larger board.

6.2.8 Audit partner tenure

The length of audit partner tenure was considered to be a relatively less important corporate governance attribute (perceived eighth with RIS=7.85). Within this attribute, shareholders prefer shorter audit partner tenure as indicated by the positive AUVs of “audit partner tenure of 5 years or less” (AUV=25.81), compared to an audit partner tenure of more than 5 years (AUV=-25.81).

6.2.9 Audit committee size

Audit committee size was perceived as the least important attribute in terms of relative importance from the perspective of shareholders (RIS=6.56) and only half as important as most other attributes with RIS close to 12, such as board and audit committee composition. Shareholders prefer to have more than three audit committee members (AUV=10.20) rather than three or less audit committee members (AUV=-10.20).

6.2.10 Summary of results for shareholders

In relation to Hypotheses 1a and 1b, the results of this study indicate that shareholders value several attributes as relatively more important than other attributes in their assessments of effective corporate governance. As shown in Table 6.1 (Column 2), based on the RIS calculations, several attributes have RIS considerably higher than 11.11, namely **CEO duality**, and **board and audit committee composition**. While provision of non-audit services and remuneration committee composition are also perceived to be important, they only have reported RIS marginally higher than 11.11. This indicates that shareholders have no strong preferences in respect of these attributes. Based on RIS, attributes such as multiple directorships, board and audit committee size, and audit partner tenure are perceived to be relatively less important.

Overall, these results provide partial supports to Hypotheses 1a and 1b. Consistent with expectation, CEO duality and board composition are perceived to be important in shareholders' assessments of effective corporate governance. However, the results indicate that multiple directorships and board size are relatively less important in the perceptions of shareholders, and are contrary to expectations. With regard to attributes that are expected to be less important (H1b), results on both audit partner tenure and audit

committee size provide partial supports for this hypothesis. On the other hand, audit committee composition and provision of non-audit services by the auditor are perceived by shareholders to be important corporate governance attributes, which is contrary to the hypothesis.

Table 6.1
Comparative Results of the Adaptive Conjoint Analysis and Univariate Results for Shareholders and Directors

| Attribute | Relative Importance Scores and Ranking | | | | Attribute Levels | Average Attribute Level Utility Values | | Significance | |
|-----------------------------|--|-----------------|------------------|-----------------|--|--|------------------|--------------|----------|
| | Shareholders (N=230) | | Directors (N=46) | | | Shareholders (N=230) | Directors (N=46) | t-value | p-value |
| | Score | Rank | Score | Rank | | | | | |
| Board Composition | 13.10 | 2 nd | 12.31 | 3 rd | Less than 50% of the board are independent directors | -48.89 | -50.09 | -0.204 | 0.838 |
| | | | | | Between 50% and 75% of the board are independent directors | 22.89 | 14.58 | -1.597 | 0.111 |
| | | | | | More than 75% of the board are independent directors | 26.00 | 35.51 | 1.342 | 0.181 |
| Board Size | 10.46 | 7 th | 10.79 | 5 th | Less than 5 board members | -26.79 | -26.31 | 0.082 | 0.935 |
| | | | | | Between 5 and 8 board members | 38.07 | 39.21 | 0.250 | 0.803 |
| | | | | | More than 8 board members | -11.28 | -12.90 | -0.258 | 0.797 |
| Multiple Directorships | 11.03 | 6 th | 9.03 | 7 th | Individual board members hold only 1 directorship | 7.42 | -21.28 | -5.092 | 0.000*** |
| | | | | | Individual board members hold 2-3 directorships | 30.56 | 33.05 | 0.492 | 0.623 |
| | | | | | Individual board members hold more than 3 directorships | -37.98 | -11.77 | 4.339 | 0.000*** |
| Audit Committee Composition | 11.91 | 3 rd | 12.65 | 2 nd | Less than 50% of the Audit Committee are independent directors | -47.60 | -56.65 | -1.475 | 0.141 |
| | | | | | Between 50% and 75% of the Audit Committee are independent directors | 15.14 | 14.08 | -0.215 | 0.830 |

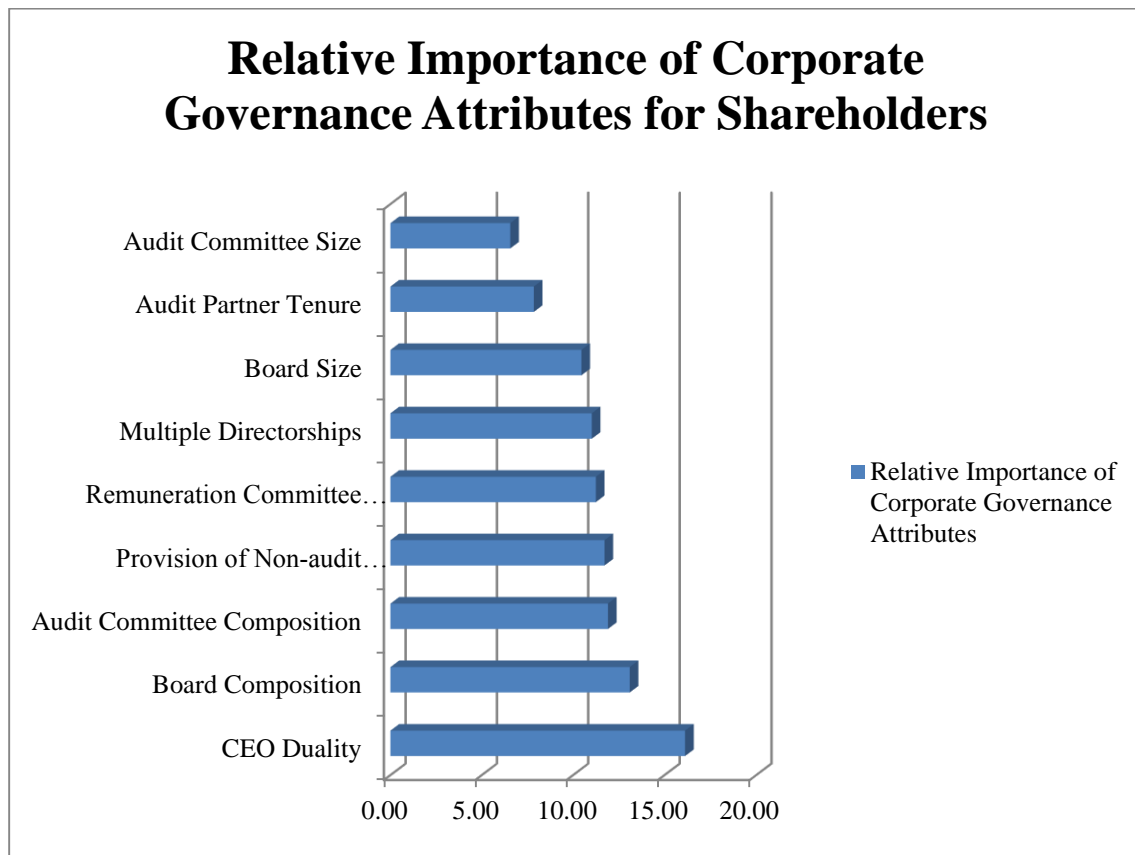
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|--|-------|-----------------|-------|-----------------|--|--------|--------|--------|----------|
| | | | | | More than 75% of the Audit Committee are independent directors | 32.46 | 42.57 | 1.693 | 0.092* |
| Audit Committee Size | 6.56 | 9 th | 6.59 | 9 th | 3 or less Audit Committee members | -10.20 | -20.21 | -2.050 | 0.044** |
| | | | | | More than 3 Audit Committee members | 10.20 | 20.21 | 2.050 | 0.044** |
| Provision of Non-audit services by the Auditor | 11.72 | 4 th | 11.45 | 4 th | Less than 30% ratio of non-audit fees to total audit fees | 47.76 | 41.73 | -0.890 | 0.374 |
| | | | | | Between 30% and 60% ratio of non-audit fees to total audit fees | -6.53 | 3.24 | 2.274 | 0.024** |
| | | | | | More than 60% ratio of non-audit fees to total audit fees | -41.22 | -44.96 | -0.683 | 0.495 |
| Audit Partner Tenure | 7.85 | 8 th | 7.87 | 8 th | Audit partner tenure of 5 years or less | 25.81 | 25.15 | -0.122 | 0.903 |
| | | | | | Audit partner tenure of more than 5 years | -25.81 | -25.15 | 0.122 | 0.903 |
| Remuneration Committee Composition | 11.25 | 5 th | 9.98 | 6 th | Less than 75% independent directors on the remuneration committee | -37.32 | -33.66 | 0.545 | 0.586 |
| | | | | | Between 75% and 100% independent directors on the remuneration committee | 14.45 | 7.26 | -1.451 | 0.148 |
| | | | | | 100% independent directors on the remuneration committee | 22.88 | 26.40 | 0.568 | 0.572 |
| CEO Duality | 16.12 | 1 st | 19.34 | 1 st | CEO and Chair of the Board are the same person | -70.57 | -86.87 | -3.137 | 0.002*** |
| | | | | | CEO and Chair of the Board are not the same person | 70.57 | 86.87 | 3.137 | 0.002*** |

*Significant at the < 0.1 level

**Significant at the < 0.05 level

*** Significant at the < 0.01 level

Figure 6.1
Results on Shareholders: Relative Importance Scores of Attributes
(N=230)



6.3 Hypothesis 2 (directors' assessments of effective corporate governance)

Recall from Chapter 2 that hypotheses H2a and H2b investigate directors' perceptions of effective corporate governance and are stated as follows:

H2a: Directors perceive corporate governance attributes related to their reputation to be relatively more important in their assessments of effective corporate governance.

H2b: *Directors perceive corporate governance attributes related to audit committee and audit independence to be relatively less important in their assessments of effective corporate governance.*

As discussed in Chapter 2, this study expects directors to perceive the following three attributes to be relatively more important: (i) **Board composition**, (ii) **Multiple directorships**, and (iii) **CEO duality**. Furthermore, directors are expected to be relatively less concerned with attributes related to the audit committee and audit independence, such as the size and composition of the audit committee, the provision of non-audit services and audit partner tenure. There are no expectations regarding the relative importance of the remaining corporate governance attributes (board size and remuneration committee composition).

The ACA results provide partial support for these expectations. As shown in Table 6.1 (Column 4) and Figure 6.2, for directors, the following attributes have reported RIS higher than 11.11 and consequently are perceived to be relatively more important than the others, namely (i) *CEO Duality* (RIS=19.34), (ii) *Audit Committee Composition* (RIS=12.65), (iii) *Board Composition* (RIS=12.31), and (iv) *Provision of Non-audit Services by the Auditor* (RIS=11.45). However, the result on *Provision of Non-audit Services by the Auditor* is only marginally higher than the average. Conversely, directors perceive *Board Size* (RIS=10.79), *Remuneration Committee Composition* (RIS=9.98), *Multiple Directorships* (RIS=9.03), *Audit Partner Tenure* (RIS=7.87), and *Audit Committee Size* (RIS=6.59) to be relatively less important. Similar to the results for shareholders, the results are discussed in the order of importance from the most to the

least important attributes. RIS for directors are presented in Table 6.1 (Column 4) and Figure 6.2 with AUVs for directors presented in Table 6.1 (Column 8).

6.3.1 CEO duality

This attribute was perceived as the most important corporate governance attribute by directors as the RIS is considerably higher than 11.11 (RIS=19.34), which is consistent with prior expectations. Within this attribute, directors strongly prefer that the CEO and Chair of the Board positions are held by different persons (AUV=86.87) compared to being held by the same person (AUV=-86.87).

6.3.2 Audit committee composition

Audit committee composition was perceived as the second most important corporate governance attribute (RIS=12.65), which is contrary to expectations. With regard to attribute levels, directors have indicated that they prefer an audit committee that has a majority of independent directors. In particular, they strongly prefer an audit committee with “more than 75% of the members being independent directors” (AUV=42.57), followed by a smaller preference for “between 50% and 75% independent directors on the audit committee” (AUV=14.08). On the other hand, directors do not prefer an audit committee that consists of less than 50% independent directors (AUV=-56.65).

6.3.3 Board composition

Directors perceived board composition as the third most important corporate governance attribute (RIS=12.31). This finding supports prior expectations that directors would perceive board composition to be relatively more important. Directors prefer a board that is composed substantially of independent directors, as indicated by the AUVs for the level

of “more than 75% of the board independent directors” (AUV=35.51). They have a weaker preference for the level of “between 50% and 75% of the board are independent directors” (AUV=14.58). They do not prefer a board that consists of less than 50% independent directors (AUV=-50.09).

6.3.4 Provision of non-audit services by the auditor

This attribute was perceived fourth in terms of its relative importance compared to the other attributes, with RIS marginally higher than the average (RIS=11.45). This finding is not consistent with the expectation that this attribute would be relatively less important than the others. Directors strongly prefer the lowest percentage of non-audit fees to total audit fees (less than 30% (AUV=41.73), with a slight preference for between 30% and 60% (AUV=3.24)), and do not prefer a ratio more than 60% of non-audit fees to total audit fees (AUV=-44.96).

6.3.5 Board size

Directors perceived board size as the fifth most important corporate governance attribute relative to the other attributes (RIS=10.79), indicating that it is somewhat less important from the perspective of directors as the RIS is lower than 11.11. Directors do not prefer either small (less than five members (AUV=-26.31)) or large board size (more than eight members (AUV=-12.90)) as both levels have negative AUVs. Instead, they prefer that a board has between five and eight members (AUV=39.21).

6.3.6 Remuneration committee composition

Remuneration committee composition was perceived sixth in relative importance with a RIS that is below 11.11 (RIS=9.98). Directors also indicate that they prefer a

remuneration committee that comprises 100% independent directors (AUV=26.40) with a lower preference for a committee that consists of between 75% and 100% independent directors (AUV=7.26), and do not prefer a committee with less than 75% independent directors (AUV=-33.66).

6.3.7 Multiple directorships

Directors perceived multiple directorships as the seventh most important corporate governance attribute (RIS=9.03), indicating that this attribute is relatively less important than many others considered in this study as the RIS is below 11.11. Directors prefer individual board members holding two or three directorships (AUV=33.05) rather than selecting either extreme option, namely individual board members holding one directorship (AUV=-21.28) or more than three directorships (AUV=-11.77).

6.3.8 Audit partner tenure

Audit partner tenure was perceived eighth in relative importance as a corporate governance attribute, (RIS=7.87) which is consistent with expectations. Directors indicated that they prefer that the audit partner be rotated after five years, as auditor tenure of five years or less (AUV=25.15) is preferred to long tenure of more than five years (AUV=-25.15).

6.3.9 Audit committee size

The size of audit committee was perceived ninth in relative importance, indicating that directors regarded this to be the least important corporate governance attribute of those considered in this study (RIS=6.59). This finding is not surprising and confirms expectations that directors would perceive this attribute to be relatively less important

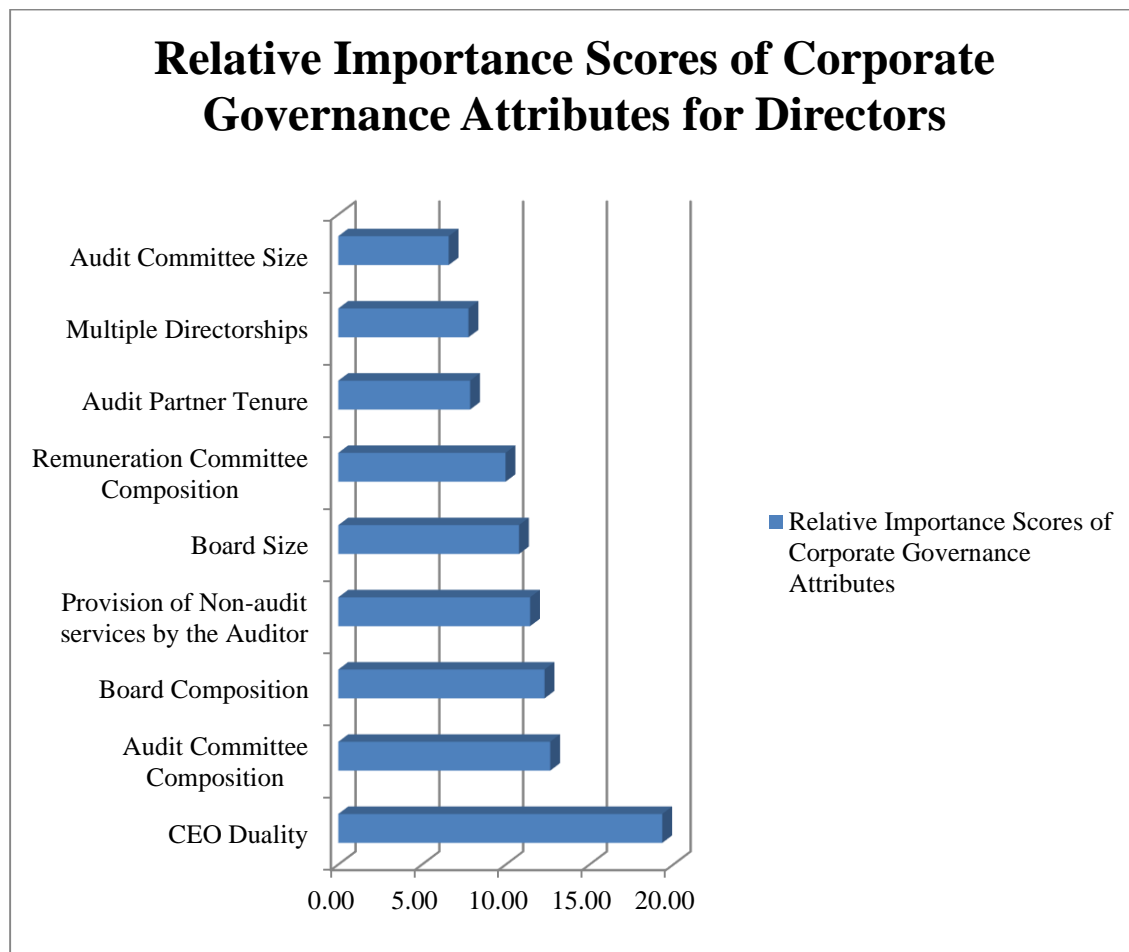
than the others. Within the attribute, directors prefer an audit committee that comprises more than three members (AUV=20.21) compared to an audit committee consisting of three or less members (AUV=-20.21).

6.3.10 Summary of results for directors

Recall that Hypotheses 2a and 2b investigate directors' perceptions of effective corporate governance. To answer them, relative importance of corporate governance attributes is examined from the perspective of directors. The results show that, based on the reported RIS, three attributes are perceived to be relatively more important by directors: **CEO duality, board and audit committee composition**. While provision of non-audit services is also perceived to be important, its reported RIS is only marginally higher than 11.11. That is, there is no strong preference by directors on this attribute.

Overall, these results provide partial supports to Hypotheses 2a and 2b. CEO duality and board composition are perceived to be important from the perspectives of directors. On the other hand, the results show that, contrary to expectations, directors perceive multiple directorships to be relatively less important in their assessments of effective corporate governance. With regard to H2b, results on both audit partner tenure and audit committee size confirm earlier expectations. On the other hand, contrary to this hypothesis, directors perceive audit committee composition and provision of non-audit services by the auditor to be important corporate governance attributes in their assessments of effective corporate governance.

Figure 6.2
Results on Directors: Relative Importance Scores of Attributes (N=46)



6.4 Robustness tests to address potential nonresponse bias

One of the common problems associated with survey research is nonresponse bias, that is, a problem that arises when the characteristics of respondents are different from those of non-respondents (Sax, Gilmartin and Bryant, 2003; Hudson, Seah, Hite and Haab, 2004). One possible way to mitigate this problem is by comparing the results between early and late respondents to the survey. This method is conducted with the underlying assumption that the respondents who respond late to the survey have similar characteristics to those who did not respond at all (Kypri, Stephenson and Langley, 2004). In corporate governance research, this approach has also been used by several

previous studies, such as Bartlett and Chandler (1997), Ho and Wong (2001), and Poppo and Zenger (2002) in addressing this problem.

This study uses the same approach to address the nonresponse bias by comparing the results between early and late responses within each group of respondents, namely (i) shareholders and (ii) directors. Specifically, each group of respondents was equally divided into two sub-groups based on the order of responses. That is, “earlier respondents” represent 50% of the sample who responded to the survey earlier than the median respondent, and “later respondents” correspond to the remaining 50% of the sample who responded later than the median respondent. The comparisons of the results are summarised in Table 6.2 and 6.3 for shareholders and directors respectively.

Table 6.2
Comparison between Results on Shareholders (Earlier vs Later Respondents)

| | Shareholders (Earlier Respondents; N=115) | | Shareholders (Later Respondents; N=115) | |
|---|---|-----------------|---|-----------------|
| | Score | Rank | Score | Rank |
| CEO Duality | 15.79 | 1 st | 16.46 | 1 st |
| Board Composition | 13.73 | 2 nd | 12.46 | 2 nd |
| Audit Committee Composition | 12.10 | 3 rd | 11.71 | 3 rd |
| Remuneration Committee Composition | 11.97 | 4 th | 10.52 | 7 th |
| Provision of Non-audit services by the Auditor | 11.79 | 5 th | 11.65 | 5 th |
| Multiple Directorships | 10.35 | 6 th | 11.71 | 4 th |
| Board Size | 10.23 | 7 th | 10.68 | 6 th |
| Audit Partner Tenure | 7.19 | 8 th | 8.53 | 8 th |
| Audit Committee Size | 6.84 | 9 th | 6.28 | 9 th |
| Spearman Ranking Correlation Coefficient: 0.862 (p-value 0.003) | | | | |

Table 6.3
Comparison between Results on Directors (Earlier vs Later Respondents)

| | Directors (Earlier Respondents; N=23) | | Directors (Later Respondents; N=23) | |
|---|--|-----------------|--|-----------------|
| | Score | Rank | Score | Rank |
| CEO Duality | 16.71 | 1 st | 21.98 | 1 st |
| Board Composition | 14.43 | 2 nd | 10.19 | 5 th |
| Audit Committee Composition | 13.75 | 3 rd | 11.55 | 2 nd |
| Provision of Non-audit services by the Auditor | 11.47 | 4 th | 11.43 | 3 rd |
| Remuneration Committee Composition | 10.87 | 5 th | 9.08 | 7 th |
| Board Size | 10.68 | 6 th | 10.89 | 4 th |
| Multiple Directorships | 8.89 | 7 th | 9.17 | 6 th |
| Audit Partner Tenure | 7.29 | 8 th | 8.46 | 8 th |
| Audit Committee Size | 5.92 | 9 th | 7.26 | 9 th |
| Spearman Ranking Correlation Coefficient: 0.833 (p-value 0.005) | | | | |

As shown in Table 6.2, using the average importance score of 11.11 as a benchmark (discussed in Section 6.2), two attributes differ significantly between earlier and later shareholders' responses, namely (i) Remuneration committee composition and (ii) Multiple directorship. While remuneration committee composition is considered important by earlier responding shareholders, it is not perceived to be as important by shareholders who responded later. On the contrary, multiple directorships is regarded as important by later responding shareholders, although not by shareholders who responded earlier. Overall, both earlier and later shareholder groups consistently perceive CEO duality, board composition, audit committee composition, and provision of non-audit services by the auditor as important corporate governance attributes. Furthermore, the

results on attributes that are less important are also consistent, that is, both groups regard audit partner tenure and audit committee size as the two least important attributes.

Whilst the results appear to be relatively similar for both groups, this conclusion needs to be confirmed by further tests that indicate whether the differences are statistically significant. Prior studies, such as Wojcik (2006), Cheung, Connelly, Limpaphayom and Zhou (2007), and Kilgore, Harrison and Radich (2014), have used a Spearman Ranking Correlation test¹ to compare the rankings between groups. The Spearman Ranking Correlation test revealed a correlation coefficient of 0.862 (p-value 0.003), indicating that there is a very strong positive and significant (at 1% confidence level) correlation between earlier and later responding shareholders in their perceptions of the relative importance of corporate governance attributes.

With regard to directors, as shown in Table 6.3, the results on board composition show that the directors who responded later perceive this attribute to be relatively less important whilst the earlier respondents regard this as one of the relatively most important attributes. The overall results for both groups are consistent, in which they perceive CEO duality, audit committee composition, and provision of non-audit services by the auditor as important corporate governance attributes. The results on audit partner tenure and audit committee size are also consistent across both groups, that is, these attributes are relatively less important in their assessments of effective corporate governance. These consistent results are confirmed by the Spearman Ranking Correlation test which shows

¹ A correlation coefficient of 1 indicates that both groups are perfectly correlated, while a coefficient of 0 shows there is no correlation between them.

a strong positive and significant (at 1% confidence level) correlation between earlier and later responding directors in their perceptions of the relative importance of corporate governance attributes (correlation coefficient 0.833; p-value 0.005).

Overall, the results are broadly consistent across earlier and later respondents for both shareholders and directors. This indicates that the characteristics of respondents and non-respondents are relatively similar, so, nonresponse bias is unlikely to have affected the results. Therefore, the results are generalisable to the target population.

6.5 Hypothesis 3 (comparison of the results for shareholders and directors)

As discussed in Chapter 2, Hypothesis 3 examines whether there are differences between shareholders' and directors' perceptions of effective corporate governance. Specifically, this comparison provides insights into whether and how their views differ or are aligned, and whether directors on the whole have their interests aligned to those of shareholders and therefore are likely also to be good monitors of managers. Hypotheses 3a and 3b are stated as follows:

H3a: Shareholders and directors have similar perceptions of attributes that are relatively more important in their assessments of effective corporate governance.

H3b: Shareholders and directors have similar perceptions of attributes that are relatively less important in their assessments of effective corporate governance.

Analysis of differences between shareholders and directors is conducted in two ways. Firstly, this study analyses differences in the relative importance of attributes (RIS)

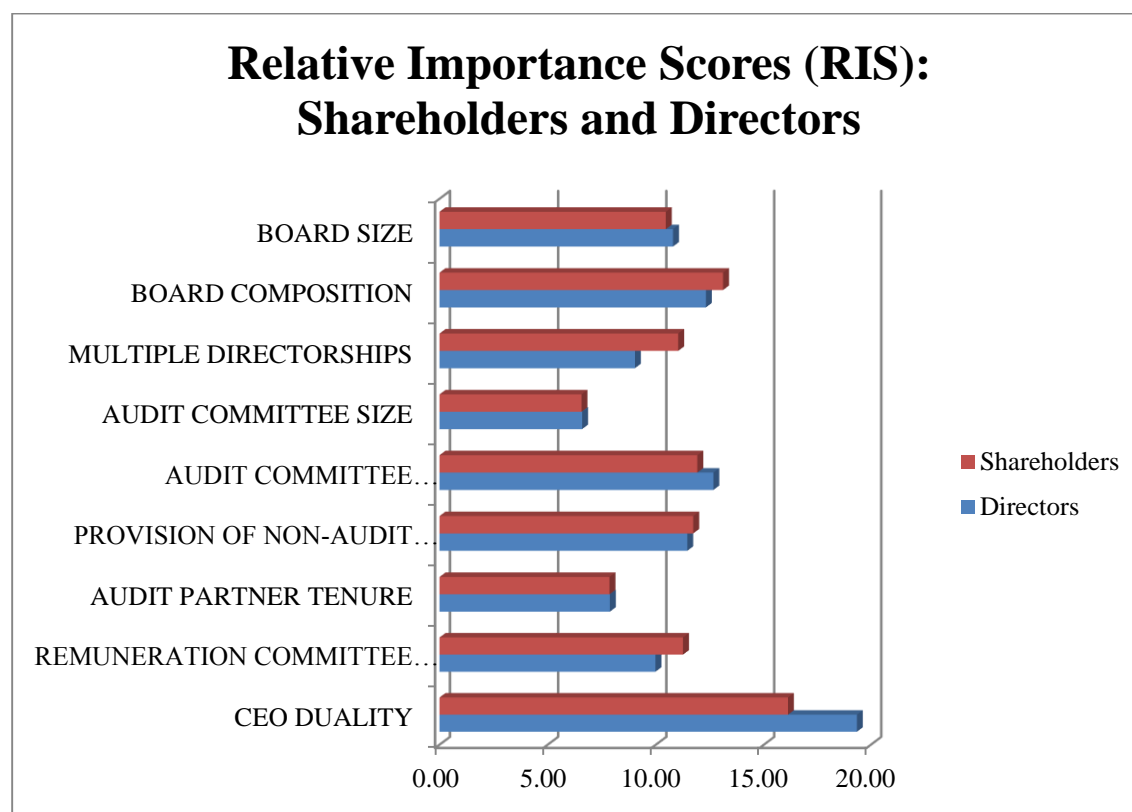
between these two groups. Secondly, differences in preference for attribute levels (AUV) are also examined. While this study finds some differences between shareholders' and directors' perceptions of corporate governance attributes, the overall results provide partial support to Hypothesis 3. That is, shareholders and directors have relatively similar perceptions of attributes in their assessments of effective corporate governance. Analyses on Hypotheses 3 are explained in detail in the following sections.

6.5.1 Differences in the relative importance of attributes

As explained in the previous section, there are slight differences between shareholders' and directors' perceptions of corporate governance attributes. Nevertheless, the overall results for the relative importance of attributes to shareholders and directors are generally consistent with each other. As shown in Table 6.1 (Columns 2-5), both groups perceive the attribute *CEO duality* to be the most important. The attributes *Audit Committee Composition*, *Board Composition*, and *Provision of Non-audit Services by the Auditor* are also seen as important by both directors and shareholders with reported RIS higher than 11.11, although there is a difference in the ranking for two of the attributes, *Audit Committee Composition* and *Board Composition*. There is a difference in the rankings between shareholders and directors for the attributes *Board Size*, *Remuneration Committee Composition*, and *Multiple Directorships*. While directors ranked *Board Size* as the 5th most important attribute, it was placed 7th by the shareholders. Similarly, the results are also different for *Remuneration Committee Composition* (ranked 5th by shareholders and 6th by directors) and *Multiple Directorships* (ranked 6th by shareholders and 7th by directors). With regard to *Audit Partner Tenure* and *Audit Committee Size*, the results are consistent across both groups as they ranked them as the two least important attributes.

Whilst the results appear to be relatively similar for both groups, this conclusion needs to be confirmed by further tests that indicate whether the differences are statistically significant. The Spearman Ranking Correlation test revealed a correlation coefficient of 0.933 (p-value 0.000), indicating that there is a very strong positive and significant (at 1% confidence level) correlation between shareholders and directors in their perceptions of the relative importance of corporate governance attributes. Whilst there are some small differences between them as indicated in Table 6.1 (Column 2-5) and Figure 6.3, they are not significant enough to distinguish between the groups. These results indicate that shareholders and directors have similar perceptions of the relative importance of corporate governance attributes presented in this study.

Figure 6.3
Comparison between Relative Importance Scores (RIS) – Shareholders
and Directors



6.5.2 Differences in preferences for attribute levels

The results in Section 6.2 and Section 6.3 indicate that, overall, shareholders and directors have similar preferences for attribute levels. Nevertheless, there are slight differences that arise between these groups, such as differences in preference for levels within multiple directorships (as reported in Table 6.1 (Column 7 and 8)). Therefore, it is necessary to conduct further statistical tests, namely (i) the Univariate test (Independent t-tests) and (ii) the Multivariate test (Discriminant Analysis), in order to determine whether the differences between these groups in their preference for levels within attributes are significant. These approaches were used by Kilgore, Harrison and Radich (2014) in comparing perceptions of audit quality by two groups of audit services' users, namely (i) Audit committee chairs/members and (ii) Financial analysts/fund managers.

Univariate testing (Independent t-tests)

Independent t-tests indicate that the results (preferences for levels within attributes) for both groups show several significant differences. Firstly, significant differences at the 1% confidence level are found for the attribute levels of **“Individual board members hold only 1 directorship”** (p-value 0.000) and **“Individual board members hold more than 3 directorships”** (p-value 0.000) within the attribute *Multiple Directorships*. Specifically, shareholders prefer directors to hold only one directorship rather than more than three directorships while directors prefer the opposite.

Secondly, the attribute level **“More than 75% of the Audit Committee are independent directors”** within the attribute *Audit Committee Composition* was also found to be significant at the 10% level (p-value 0.092). While the overall results are

consistent, the findings show that directors have a stronger preference for an audit committee that consists of more than 75% independent directors.

Thirdly, the t-tests also show significant differences at the 5% level (p-value 0.044) for both levels **“3 or less Audit Committee members”** and **“More than 3 Audit Committee members”** within the attribute of *Audit Committee Size*. While the overall results are consistent, these findings indicate that directors have a stronger preference for an audit committee that has more than three members.

Fourthly, it was found that for both groups there are differences for the attribute level of **“Between 30% and 60% ratio of non-audit fees to total audit fees”** within the attribute *Provision of Non-audit services by the Auditor* at the 5% level (p-value 0.024). These results show that it is, to some extent, more acceptable to directors than shareholders for the ratio of non-audit fees to total audit fees to be between 30-60%.

Lastly, there was a statistically significant difference at the 1% level for both levels **“CEO and Chair of the Board are the same person”** and **“CEO and Chair of the Board are not the same person”** within the attribute *CEO Duality* (p-value 0.002). This result is interesting as although both groups are statistically different in viewing CEO duality, they are economically similar in that they both prefer a separation of roles between the CEO and Chairman. The results for independent t-tests in examining differences between shareholders and directors are summarised in Table 6.1 (Column 10).

While independent t-tests are useful in examining differences between groups, according to Hair (2006), repeated independent t-tests are subject to several limitations. Firstly,

repeated t-tests are subject to multiple comparison problems. Specifically, they increase the probability of a type 1 error occurring when the null hypothesis is rejected when it is true. Secondly, multiple individual t-tests might also lead to inaccurate comparisons of groups. This problem might occur as they ignore the possibility that differences between groups may arise when the dependent variables are combined instead of being tested separately. In relation to the study, this problem might result in the possibility that differences between shareholders and directors in their preferences for attribute levels are not captured if they are tested separately rather than as a group of variables.

Multivariate testing (Discriminant Analysis)

One possible way to mitigate the limitations associated with independent t-tests as outlined above is by conducting discriminant analysis to investigate variables that result in differences between groups. This method tests the differences between groups by analysing the combination of all variables to determine which factors provide the strongest evidence of these differences. Due to the above limitations of independent t-tests, this study also uses discriminant analysis in investigating factors that might discriminate between shareholders and directors in their perceptions of effective corporate governance.

The outputs of discriminant analysis are eigenvalues, which show the proportion of variance that is explained by the discriminant function. Specifically, an eigenvalue is the ratio of between-groups sum of squares to within-groups sum of squares. Eigenvalues indicate the discriminatory power of the discriminant function. That is, larger eigenvalues indicate that the function differentiates the group better, although it should be interpreted with caution as eigenvalues have no upper limits. The discriminant tests reported a

relatively low eigenvalue of 0.132, which might indicate that the shareholders and directors are very similar in their preferences for attribute levels.

Another output of discriminant analysis is Wilk's Lambda, which shows the significance of a discriminant function. Wilk's Lambda, calculated as the ratio of within-groups sums of squares to the total sums of squares, shows the total variance in discriminant scores that cannot be explained by the differences between groups. Wilk's Lambda score ranges from 0 to 1 with larger scores indicating that both groups are not different. As shown in Table 6.4, the discriminant analysis also generates a Wilk's Lambda of 0.883 which indicates that both shareholders and directors tend to be similar in their preference for attribute levels.

Discriminant analysis also generates a canonical correlation coefficient, which is calculated as the square root of the ratio of the between-groups sum of squares to the total sum of squares. Canonical correlation measures the association between the discriminant function and the dependent variable, that is, a higher correlation coefficient implies that the function discriminates better. As shown in Table 6.4, the discriminant function has a moderate level of canonical correlation (0.342), which could also indicate that both groups are very similar.

The predictive accuracy of the discriminant function in classifying the respondents is shown by the hit ratio, 70.4% and 69.6% for shareholders and directors respectively. These results provide an indication that the majority of the respondents in both groups have been correctly classified.

The discriminant analysis produces an equation that indicates factors that contribute to the differences between the groups. This equation is stated as follows.

Discriminant function: Multiple directorships (Individual board members hold only 1 directorship) + Provision of non-audit services by the auditor (Between 30% and 60% ratio of non-audit fees to total audit fees) + Remuneration committee composition (Between 75% and 100% independent directors on the remuneration committee) + CEO duality (CEO and Chair of the Board are the same person).

Based on the above equation, four attribute levels are important factors in distinguishing between both groups. Firstly, differences are found in the level **“Individual board members hold only 1 directorship”** within the attribute *Multiple Directorships*. Specifically, it is acceptable among shareholders to have directors holding only one directorship while directors strongly do not prefer this particular attribute level. The discriminant function also generates standardised discriminant function coefficients for these attribute levels. Larger absolute value of standardised discriminant function coefficients might indicate that the variables, namely attribute levels, have greater ability in discriminating between the groups. This attribute level has the largest absolute value of the coefficient (0.765), which might indicate that both groups have large differences on that variable.

Secondly, the level **“Between 30% and 60% ratio of non-audit fees to total audit fees”** within *Provision of Non-audit Services by the Auditor* is also reported to be another differentiating factor between shareholders and directors. These results show that it is, to some extent, more acceptable to directors than shareholders to have a ratio of non-audit

fees to total audit fees between 30-60%. This attribute level has a moderate absolute value of the coefficient (0.397), which might indicate that there is not a large difference between shareholders and directors.

Thirdly, the discriminant function also identifies the level **“Between 75% and 100% independent directors on the remuneration committee”** within *Remuneration Committee Composition* as an important factor to distinguish both respondent groups. In particular, shareholders have a stronger preference than directors for having a remuneration committee that consists of between 75% and 100% independent directors. This attribute level has a moderate absolute value of the coefficient (0.387), indicating that both groups are relatively similar.

Lastly, the level **“CEO and Chair of the Board are the same person”** within *CEO Duality* is also found to be an important factor in distinguishing both groups. While the overall results are consistent, directors show a stronger preference on the separation of roles between CEO and Chairman. This attribute has a moderate absolute value of the coefficient (0.392), which shows that the difference appears to be relatively small.

Summary of results for univariate and multivariate testing

The results of the discriminant analysis are generally consistent with the univariate t-tests with the addition of **“Between 75% and 100% independent directors on the remuneration committee”** within *Remuneration Committee Composition* as another discriminating factor between these groups. Overall, the differences between shareholders and directors appear to be small, despite some significant differences reported in the univariate t-tests and discriminant analysis. These differences are found

to be significant for the following attribute levels: (i) **“Individual board members hold only 1 directorship”** within the attribute *Multiple Directorships*, (ii) **“Between 30% and 60% ratio of non-audit fees to total audit fees”** within *Provision of Non-audit Services by the Auditor*, (iii) **“Between 75% and 100% independent directors on the remuneration committee”** within *Remuneration Committee Composition*, and (iv) **“CEO and Chair of the Board are the same person”** within *CEO Duality*.

From the four mentioned differences identified in both univariate and multivariate tests, the only attribute which shareholders and directors have contrasting views on is multiple directorships. Specifically, the findings indicate that it is acceptable to shareholders to have directors holding only one directorship while directors strongly do not prefer this particular attribute level. With regard to the other three attributes, the results indicate that the differences that arise between shareholders and directors result from differences in strength of preferences on particular attribute levels. That is, although there are statistical differences between the groups’ views of these attributes, the order of preferences is consistent as the differences only arise in the strength of their preferences rather than their directionality.

Table 6.4
Comparison between Results on Shareholders and Directors:
Discriminant Analysis

| Corporate Governance Attribute and Attribute Levels | Standardised Discriminant Function Coefficients |
|---|--|
| Multiple Directorships – Individual board members hold only 1 directorship | 0.765 |
| Provision of Non-audit Services by the Auditor – Between 30% and 60% ratio of non-audit fees to total audit fees | 0.397 |
| Remuneration Committee Composition – Between 75% and 100% independent directors on the remuneration committee | -0.387 |

| | |
|--|---------------------------------|
| CEO Duality – CEO and Chair of the Board are the same person | -0.392 |
| | |
| Wilks Lambda: 0.883 | Hit ratio (Shareholders): 70.4% |
| Eigenvalue: 0.132 | Hit ratio (Directors): 69.6% |
| Canonical Correlation: 0.342 | Hit ratio (Overall): 70.3% |
| Chi-square: 33.732 | |
| p-value: 0.000*** | |

*** Significant at the < 0.01 level

Discriminant function: Multiple directorships (Individual board members hold only 1 directorship) + Provision of non-audit services by the auditor (Between 30% and 60% ratio of non-audit fees to total audit fees) + Remuneration committee composition (Between 75% and 100% independent directors on the remuneration committee) + CEO duality (CEO and Chair of the Board are the same person).

6.6 Conclusion

This chapter discusses the findings of the study. In particular, it presents the findings for the three hypotheses developed in Chapter 2 in examining shareholders' and directors' perceptions of effective corporate governance. Moreover, it discusses robustness tests in addressing the nonresponse bias in the survey. Lastly, it also outlines the comparisons between these groups by conducting appropriate statistical tests (both univariate and multivariate tests) to examine whether shareholders and directors have similar perceptions of attributes in their assessments of effective corporate governance. A discussion of these findings and their relations to existing corporate governance requirements, and the implications and limitations of the study are discussed in Chapter 7.

CHAPTER 7

DISCUSSIONS, IMPLICATIONS AND LIMITATIONS

7.1 Introduction

This chapter presents the discussion of the results and implications of the study, as well as its limitations and suggestions for future research. Section 7.2 provides discussions of the results for each corporate governance attribute and the levels within each attribute. Specifically, this section discusses in detail the differences between shareholders and directors in their perceptions of effective corporate governance and how the results correspond to the corporate governance requirements and literature. Section 7.3 outlines the implications of this study. Lastly, Section 7.4 discusses the limitations of the study and suggestions for future research.

7.2 Discussions of results

This section outlines the results for each corporate governance attribute and the levels within each attribute. Specifically, it discusses in detail the differences between shareholders and directors in their perceptions of effective corporate governance and how the results correspond to the corporate governance requirements and literature.

7.2.1 CEO duality

This attribute was perceived by both shareholders and directors as the most important corporate governance attribute in their assessments of effective corporate governance in Australia. This result confirms the importance of recommendations against CEO duality as a component of board independence. CEO duality has been an important aspect of corporate governance in Australia for many years, as a part of ASX POGCG requirements since 2003 and as common practice prior to regulation (He, Wright, Evans and Crowe, 2009). This result is also consistent with Rechner and Dalton (1991) who suggest that CEO duality increases agency costs and reduces the shareholders' wealth.

In terms of attribute levels, both shareholders and directors prefer the separation of roles between CEO and Chairman compared to the situation when the same person exercises both roles. These results are consistent with agency theory propositions and the recommendation 2.3 of ASX POGCG which suggest that the positions of CEO and Chairman should not be held by the same person to ensure a separation of duty in the top management of the company. While the results are consistent across both groups, the t-test results indicate that there is significant difference between both groups in rating the attribute levels, with directors showing stronger preference than shareholders for separating these roles. This is supported by the discriminant analysis that also shows that both groups are different in their rating of the level "CEO and Chair of the Board are the same person". Nevertheless, the overall findings indicate that both groups are economically similar in preferring the separation between these roles, that is, the difference is the strength of their preference rather than the option they prefer.

7.2.2 Board composition

The shareholders perceived the composition of boards as the second most important attribute while it was perceived third by the directors. Similar to the results on CEO duality, the importance of this attribute is consistent with the concept of directors' independence. The robustness test comparing earlier and later responses shows that directors who responded later perceive this attribute to be relatively less important whilst the earlier responding directors regard this as one of the most important attributes. This difference might be attributed to the relatively small number of directors who participated in this study (23 responses in each group) which causes each individual response to have a strong influence on the overall results. In addition, the fact that the later responding directors are composed predominantly of females and younger directors might also contribute to this difference. Nevertheless, the Spearman Ranking Correlation test between earlier and later responding directors show that in general, both groups have similar perceptions of the relative importance of corporate governance attributes.

Within the attribute, both shareholders and directors prefer a board that comprises a majority of independent directors, as indicated by the positive AUV for the levels of "more than 75% of the board are independent directors" and "between 50% and 75% of the board are independent directors". This is also consistent with recommendation 2.1 of ASX POGCG that a board should be composed of a majority of independent directors. It is interesting to note that for shareholders, there is only a slightly stronger preference for almost completely independent boards over a weaker majority of independent directors. This indicates that shareholders also value the presence of executive directors on the board. The results for both groups are statistically similar as no significant difference was identified in either univariate or multivariate analyses. Overall, the results are consistent with previous studies, such as Rosenstein and Wyatt (1990), Brickley, Coles, and Terry

(1994), and Dechow, Sloan, and Sweeney (1995), who find that the existence of independent directors is associated with positive outcomes of corporate governance.

7.2.3 Audit committee composition

This attribute was perceived as the third and second most important attribute by shareholders and directors respectively. This result is somewhat consistent with how the respondents value board composition, with the respondents also perceiving board composition to be an important aspect of effective corporate governance. As the audit committee is a subset of the board, there is a high possibility that its independence and performance also affect how the board performs its monitoring role.

Aligned with the results on board composition, both respondent groups also indicate that they prefer an audit committee that is dominated by independent directors. As shown in Table 6.1 (Columns 7 and 8) in Chapter 6, both attribute levels of “more than 75% of the audit committee are independent directors” and “between 50% and 75% of the audit committee are independent directors” have positive AUVs. Conversely, shareholders and directors do not favour an audit committee with less than 50% independent directors. This result is also consistent with recommendation 4.2 of ASX POGCG.

The t-test results show that both respondent groups are significantly different at the 10% level in rating the level “More than 75% of the Audit Committee are independent directors”. Although this finding is not supported by the discriminant analysis, this result indicates that while shareholders and directors have relatively similar preferences, there is a difference in the magnitude of their preference in that directors have a stronger preference for independence. The overall result is consistent with previous studies, such as Abbott, Park, and Parker (2000) and Klein (2002).

7.2.4 Provision of non-audit services by the auditor

Provision of non-audit services by the auditor was fourth in relative importance for both shareholders and directors. Substantial fees for the provision of non-audit services, it is argued, result in auditors becoming financially dependent on the clients, therefore reducing their ability to detect material misstatements. Excessive amounts of non-audit fees are also argued to have contributed to significant corporate collapses, such as Enron. This concern is based on the assumption that auditors are willing to compromise their independence in exchange for large non-audit fees paid by clients (DeFond, Raghunandan and Subramanyam, 2002). Hence, it is not surprising that stakeholders value this attribute, as a monitoring activity, to be important for corporate governance practice.

In terms of the levels within the attribute, shareholders prefer less provision of non-audit services, as shown by the positive average utility values for “less than 30% ratio of non-audit fees to total audit fees”. This finding is unsurprising as substantial amounts of non-audit fees are argued to impair auditor independence. The AUVs of the other two attribute levels (“Between 30% and 60% ratio of non-audit fees to total audit fees” and “More than 60% ratio of non-audit fees to total audit fees”) are negative. While directors also prefer lower non-audit service fees, to a limited extent, it is still acceptable to them to have a moderate level of non-audit service provision, as indicated by a small and positive AUV for the level “Between 30% and 60% ratio of non-audit fees to total audit fees”. This difference between shareholders and directors is statistically confirmed by both t-test and discriminant analysis. A possible argument why directors might accept a moderate level of non-audit fees is that the provision of such services might enhance auditors’ knowledge which might lead to cost savings for the clients, namely lower audit fees (Simunic, 1984). Overall, the results on this attribute support the recommendation made by CLERP 9 which aims to limit non-audit services provision and are also consistent with Frankel,

Johnson, and Nelson (2002) and Larcker and Richardson (2004) who find a negative association between non-audit service fees and financial reporting quality.

7.2.5 Remuneration committee composition

The shareholders and the directors perceived this attribute as the fifth and sixth most important corporate governance attributes respectively. As the remuneration committee serves important roles in the company, it is argued that its members should be independent from the management to fulfil their roles effectively. The robustness tests show that while remuneration committee composition is considered important by earlier responding shareholders, it is not perceived to be important by shareholders who responded later.

Consistent with ASX POGCG (Recommendation 8.1), both shareholders and directors prefer a remuneration committee that is comprise only independent directors, followed by “between 75% and 100% independent directors on the remuneration committee” and “less than 75% independent directors on the remuneration committee”. While the t-test results do not report any significant differences between these groups in rating the levels within this attribute, the discriminant analysis identifies the level “Between 75% and 100% independent directors on the remuneration committee” as a factor that differentiates the groups. This finding indicates that shareholders and directors have different magnitudes of preference on this attribute level, with shareholders showing the stronger preference. The overall result is that shareholders and directors generally prefer more a independent remuneration committee, which supports the findings of Williamson (1985) and Newman and Mozes (1999).

7.2.6 Multiple directorships

The multiple directorships attribute was perceived sixth and seventh in relative importance by shareholders and directors respectively. Among shareholders, multiple directorships were regarded as important by shareholders who responded later, and not to be important by earlier respondents.

Within the attribute, shareholders show that there are two attribute levels that are acceptable to them: (i) “individual board members hold 2-3 directorships” and (ii) “individual board members hold only 1 directorship”. On the other hand, shareholders indicate that they do not prefer individual board members to hold more than three directorships, possibly as they would like directors not to be overcommitted with other firms which might affect their performance in exercising their duties as a director. This is consistent with agency theory, which posits that multiple directorships might impair the effectiveness of the boards, resulting in the interests of directors not being aligned with those of shareholders.

While directors also assign higher AUV for the level “individual board members hold 2-3 directorships”, they indicate that they do not favour holding only one directorship. A possible explanation is that directors do not prefer to be limited to hold only one directorship as it will impact them financially. Moreover, by holding more than one directorship, directors might expand their perspectives and obtain useful information to be used in exercising their roles on all boards.

The t-test results indicate that both groups are significantly different at 0.01 confidence level in rating the levels “individual board members hold only 1 directorship” and “individual board members hold more than 3 directorships”. This result is partially

consistent with discriminant analysis that identifies the former as a significant factor that distinguishes shareholders' and directors' perceptions of effective corporate governance. This contrasting view between shareholders and directors on multiple directorships reflects a longstanding debate in the media between the Australian Shareholders Association (ASA) and the Australian Institute of Company Directors (AICD) as the respective representatives of shareholders and directors. Almost a decade ago, the ASA expressed its concerns about the fact that directors with multiple directorships might have a negative impact on companies by referring to the case of Amcor Limited. In response to these concerns, through the release of policy submissions in January 2005, the AICD CEO argued that multiple directorships are valuable to the companies as directors can bring wide experience to the board, which will add value to the firms. This longstanding debate between shareholders and directors is reflected in their contrasting views on the optimal number of directorships a director should hold.

7.2.7 Board size

Size of the board was perceived seventh by shareholders indicating that this attribute is less important relative to others. On the other hand, directors rated it as the fifth most important attribute. With regard to attribute levels, the results are consistent for both groups as they prefer medium-sized boards comprising between five and eight members rather than a small board (less than five members) or a large (more than eight board members). Specifically, shareholder and director dislike for a smaller board is stronger than dislike of both for a larger board.

No significant differences are found in either t-test or discriminant analysis. This result is consistent with Coles, Daniel and Naveen (2008) who suggest that neither a very small

nor a very large board is an optimal size. They argue that the relationship between board size and firm performance is U-shaped, an argument that is consistent with the results of this study.

7.2.8 Audit partner tenure

The length of audit partner tenure was considered to be the eighth most important corporate governance attribute by both groups, which is rather surprising. On the one hand, it is apparent that both shareholders and directors value auditor independence to be an important aspect of corporate governance as they ranked provision for non-audit services by the auditor as the fourth most important attribute. While the respondents perceive auditor independence to be essential, they do not consider audit partner tenure to be as important as limiting provision for non-audit services as a means of improving auditor independence.

Consistent with CLERP 9, both groups prefer a short audit partner tenure as indicated by positive AUV of “audit partner tenure of 5 years of less”. This finding indicates that both shareholders and directors value the advantage of short auditor tenure (auditor rotation) for auditor independence more than the advantage of auditor expertise as a result of auditor retention. This is consistent with some prior studies, such as Vanstraelen (2000) and Myers, Myers, Palmrose, and Scholz (2005) who report problems associated with long auditor tenure. With regard to the differences between shareholders and directors, both t-test and discriminant analysis do not indicate any significant differences in preferences for levels within this attribute.

7.2.9 Audit committee size

Audit committee size was perceived as the least important attribute by both groups. Consistent with ASX POGCG (Recommendation 4.2) and the Blue Ribbon Committee, both shareholders and directors prefer to have more than three audit committee members. Interestingly, t-test results report significant difference in both attribute levels, which might indicate a different degree of preference by both respondent groups. However, the discriminant analysis does not find evidence that either level is a discriminating factor for both groups. Overall, the results for both groups are economically similar and this result is consistent with Kent, Routledge, and Stewart (2005) and Yang and Krishnan (2005), who find a positive association between audit committee size and financial reporting quality.

7.3 Implications of the study

The results of the study provide input to the regulators, such as the ASX and the ASIC, with regard to potential amendments to corporate governance requirements in Australia. In particular, those regulatory bodies might consider omitting those attributes that are perceived to be less important by the shareholders and directors, such as audit partner tenure and audit committee size. Furthermore, the study also adds an extra dimension to the existing corporate governance literature by using an innovative approach that has rarely been applied in this area. Specifically, the findings of this study will help future corporate governance research in refining which corporate governance attributes are relatively more important for stakeholders. Previous studies in the corporate governance area have focused more on the association between recommended corporate governance attributes and outcomes of effective corporate governance. Brown, Beekes and

Verhoeven (2011) have identified the problem of endogeneity that is prevalent in some corporate governance studies. This study extends the literature by using a qualitative approach in examining stakeholders' perceptions of those attributes, in which endogeneity problem can be minimised, although not fully eliminated.

From the practical point of view, there are at least three major implications of the findings of this study. They are (i) examining the relationship between shareholders and directors in corporate governance, (ii) the importance of the independence of various key corporate governance players, and (iii) implications of the results on audit partner tenure and audit committee size. These implications are discussed in the following sections.

7.3.1 The relationship between shareholders and directors in corporate governance

Tensions between shareholders and directors have been prevalent for many years and the critical issue that underpins this growing tension is that whether shareholders' and directors' interests are aligned. As stated by Millstein, Gregory, and Grapsas (2013), tensions between shareholders and directors are inherent in any corporate governance system. They believe that preserving a balance on both sides is essential to ensure alignment in interests of both parties. It has been acknowledged in the literature that boards of directors and shareholders might not share the same interest, as also suggested by the agency theory. An interesting comment was made by one of the interview respondents, that the corporate governance requirements have placed too much focus on protecting shareholders from directors' supposed wrongdoing, that is, directors have always been perceived as parties who have different agendas and interests from shareholders.

The results of the study show that in fact there are only small differences between shareholders' and directors' perceptions of effective corporate governance. Firstly, to some extent, shareholders and directors have different perceptions regarding directors' roles. On the one hand, shareholders are concerned about directors' busyness and focus as shown by their relative preference on directors holding one directorship rather than more than three directorships. On the other hand, directors tend to place more emphasis on experience on other boards, as indicated by a moderate preference to hold more than three directorships. Secondly, the results also imply that, relative to directors, shareholders place more focus on a lower level of non-audit service fees in an attempt to enhance auditor independence, while directors would accept a moderate level of non-audit fees. As previously explained in Section 7.2.4, a possible argument why directors might accept a moderate level of non-audit fees is that the provision for such service might enhance auditors' knowledge which might in turn lead to cost savings for the clients, namely lower audit fees (Simunic, 1984).

The findings of this study suggest that, while there are some small differences between shareholders and directors as outlined above, their overall views of factors that constitute effective corporate governance are remarkably similar. These findings imply that directors' views are broadly aligned to those of shareholders, which might suggest that their interests are also aligned. Consequently, this study suggests that future debates between shareholders and directors are likely to be relatively minor.

7.3.2 Importance of independence of various key players in corporate governance

The findings of the study also provide evidence that, to some extent, both stakeholder groups value the independence of various parties involved in corporate governance,

namely the board of directors, audit committee, remuneration committee, and auditors. These results provide assurance that the current recommendations on these attributes are consistent with their views. In particular, this study provides insight on the importance of CEO duality, perceived as the most important attribute, as an essential component of board independence. The importance of separation between CEO and Chairman is confirmed by one of the interviewees for this study, who emphasised the importance of the chairman as the independent voice for shareholders, which is one of the main reasons why the role has to be separated from that of CEO. Overall, the findings might indicate the need for regulators, such as the ASX, to impose more stringent requirements on the independence of various parties. That is, the ASX might consider imposing these attributes as mandatory requirements rather than just guidelines that are currently not mandatory for all Australian firms. Nevertheless, ASX might also consider the views of other stakeholder groups to make better-informed suggestions and recommendations.

7.3.3 Results on audit partner tenure and audit committee size

Thirdly, this study also finds that both respondent groups consistently perceive audit partner tenure and audit committee size as the two least important attributes. These lower relative preferences might provide suggestions to the regulator to remove the requirements for these attributes. The results on audit partner tenure are particularly interesting. While shareholders and directors value auditor independence highly, as shown in their preference for provision for non-audit services, this finding indicates that they do not consider the length of audit partner tenure to be important in enhancing auditor independence. CLERP 9 mandated limitations on audit partner tenure and while this requirement was able to reduce the length of audit partner tenure, this effort appears to be

unsuccessful in enhancing stakeholders' perceptions of this element in effective corporate governance. These findings could be used in conjunction with information on perceptions of other stakeholder groups to provide suggestions to the ASIC, if ASIC is re-considering the imposition of mandatory audit partner rotation.

7.4 Limitations of the study and suggestions for future research

The results of the study need to be interpreted with caution, as this study is subject to four limitations. The first limitation of this study is related to the generalisability problem inherent in the method. Firstly, the results will reflect the events that influence shareholders' and directors' perceptions of effective corporate governance at the time of the study. Secondly, as it is not possible to assess how the demographics of the respondents correlate to the demographics of the ASA and AICD memberships, the response samples might not be representative of their respective populations. That is, because the respondents who chose to partake in this study are more likely to be those who are interested in the issue of effective corporate governance, there is a concern that these respondents may differ systematically to their underlying populations. However, the profiles of shareholders who participated in this study are generally consistent with the results of Australian Share Ownership Study conducted by the ASX in 2010, which shows that the propensity to own shares in Australia increases with age (ASX, 2011). Thirdly, this study focuses on private rather than institutional shareholders, who are the largest grouping of shareholders. While institutional shareholders can have significant influence over corporate matters, the use of a survey methodology means that it is only possible to examine the perceptions of individuals, and it is not possible to examine those of an institution. Fourthly, as this study examines perceptions of corporate governance in

Australia, the results are generalisable to the Australian setting, but might only be generalisable to other jurisdictions to a limited extent.

The second limitation is related to the fact that the views of shareholders and directors in this study may be influenced by their knowledge of the corporate governance requirements specified in ASX POGCG and CLERP 9. While this study elicits shareholders' and directors' views on effective corporate governance, these views might not represent the independent and unconstrained views of these respondent groups.

The third limitation of this study is related to multiple directorships attribute. This study did not make distinctions on whether the additional directorships that a director holds are limited to or beyond the corporate network. This may limit the reliability of responses to this attribute, as different respondents may use different definitions of a multiple directorship.

The fourth limitation is related to the different time periods in which the survey was conducted for shareholders and for directors, that is, the non-overlapping survey periods for both groups which were due to reasons of access. As discussed in Chapter 5, the data collection process involving the AICD commenced in November 2012 and concluded in February 2013 whilst the process involving the ASA started in September 2013 and was completed in October 2013. While these data collection processes were conducted in different time periods, no significant corporate governance events or changes occurred during those periods or between them that might affect the results of the study. This is also confirmed by the overall results of the study which show consistent results across shareholders and directors despite the survey being conducted in different time periods.

The fifth limitation of the study is related to the practical limitations of the research method. While ACA can work with a maximum of 30 attributes, it works optimally with

approximately ten to avoid respondent overload and fatigue, which can lead to inaccurate survey results. As a result, the selection of corporate governance attributes in this study may not fully represent all important factors affecting stakeholders' perceptions of effective corporate governance. This general limitation has been controlled to some extent by conducting interviews to ascertain the inclusion of the nine attributes examined and to ensure the appropriateness of these attributes in reflecting the concept of effective corporate governance.

Further research in this area could be undertaken to examine the perceptions of effective corporate governance for other stakeholder groups that might also be affected by corporate governance practice, such as creditors, auditors or analysts. This would allow comparisons with previous results which would lead to better-informed suggestions and recommendations to the policy makers. In addition, future research using ACA could be conducted in different areas of corporate governance. For instance, future studies could examine factors that contribute to effective sustainability practice.

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APPENDIX A

Interview Questions

The aim of my study is to examine the relative importance of corporate governance attributes in assessments of good corporate governance by obtaining evidence from various corporate stakeholders. The purpose of the interview is to gain insights into the effectiveness of current corporate governance practices, and in particular which attributes you think are important in enhancing corporate governance and the extent to which the existing regulations have effectively addressed these attributes.

1. How do you define effective corporate governance?
2. Following on from your answer in question 1, what factors do you think result in effective corporate governance?
3. What is your assessment of regulations in Australia, i.e. ASX Principles of Good Corporate Governance and Corporate Law Economic Reform Program 9, and their effectiveness in enhancing corporate governance? Taking them as a package, do you think they cover all the factors you mentioned in question 2?
4. From the existing regulations, there are several corporate governance attributes included in them. What attributes included in this list are more important? Why do you think they are important?
5. Are these attributes useful for your definition in measuring effective corporate governance? Do you think these attributes capture effective corporate governance well? If not, why not?
6. Are there any other attributes of corporate governance that have not been included in the current regulations that you would like to add? Why are these attributes included?

7. Is there anyone else you think we should talk to?
8. Please indicate the charity to which you would like me to make a \$50 donation as a result of your participation in this survey
- Alzheimers' Australia
 - Barnardos Australia
 - CareFlight
 - Care Australia
 - Catholic Mission
 - Guide Dogs
 - Royal Flying Doctor Service
 - Sydney Cancer Centre
 - The Salvation Army
 - The Smith Family
 - World Vision Australia

APPENDIX B

Adaptive Conjoint Analysis (ACA) Survey Questionnaire

INFORMATION AND CONSENT FORM

Factors associated with Effective Corporate Governance

Dear Sir or Madam,

Thank you for agreeing to participate in this research project which will contribute to our understanding of the importance of factors perceived to affect corporate governance. Given your significant experience, your response is very important. The outcomes of the project will provide suggestions to regulatory bodies and the accounting profession in developing regulations and policies that may optimally define the attributes required for effective corporate governance.

As previously indicated, I am a Doctor of Philosophy (PhD) candidate at Macquarie University in Sydney and this research is being conducted to meet the requirements for the degree of Doctor of Philosophy under the supervision of Associate Professor Sue Wright (Phone: 02 9850 8521, email: sue.wright@mq.edu.au) and Dr Alan Kilgore (Phone: 02 9850 8564, email: alan.kilgore@mq.edu.au). I would be grateful if you could assist with data collection by completing the following survey, which should take no more than 20 minutes.

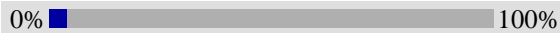
Your participation is entirely voluntary and you can withdraw from participation at any time without having to give a reason and without consequence. The study is not associated with any commercial product or company and all answers will be used solely for the purpose of academic research. Access to the data will be limited to myself and my supervisors and will remain confidential. Only aggregated data will be used and no individual respondent or their company will be able to be identified in the final report. If you would like to obtain a summary of the results of the study, please contact me at christofer.adrian@students.mq.edu.au.

Please note that the ethical aspects of this study have been approved by the Macquarie University Ethics Review Committee (Human research). If you have any complaints or reservations about any ethical aspect of your participation in this research you may contact the Committee through the Director, Research Ethics (Phone: 02 9850 7854, email: ethics@mq.edu.au). Any complaint you make will be treated in confidence and investigated, and you will be informed of the outcome.

Christofer Adrian
PhD Candidate
Department of Accounting and Corporate Governance
Macquarie University

Please click the Next button below to continue...

Next

0%  100%

This survey should take approximately 20 minutes of your time. There are four sections in this survey. The survey asks some questions about factors related to your perception of effective corporate governance for top 500 ASX-listed companies.

You will be asked to provide responses regarding the following factors:

Board Size: number of directors on the board

Board Composition: proportion of independent directors on the board

Multiple Directorships: the number of directorships a director hold

Audit Committee Size: number of directors on the audit committee

Audit Committee Composition: proportion of independent directors on the audit committee

Provision of Non-audit Services by the Auditor: ratio of non-audit fees to total audit fees

Audit Partner Tenure: length of the tenure of audit partner (in years)

Remuneration Committee Composition: the proportion of independent directors on the remuneration committee

CEO Duality: whether CEO and Chair of the Board are the same person

Click the Next button below to continue...

Intro

Next

0%  100%

This section of the survey asks you to rate the factors to your perception of effective corporate governance.

You will be shown a list of the factors on the left side of the screen, with two or three alternative levels for each factor. For example, the factor "Board Composition" has three levels "less than 50%, between 50-75%, and more than 75% of the board are independent directors".

You will be asked to rate each alternative, using a scale from "extremely desirable" to "not desirable at all".

Click the Next button to continue...

IntroRating

Next



BOARD SIZE

Please rate the following in terms of how desirable it is to your perception of effective corporate governance.

| | Not Desirable | | Somewhat Desirable | | Very Desirable | | Extremely Desirable |
|-------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|------------------------|
| Less than 5 board members | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> |
| Between 5 and 8 board members | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> |
| More than 8 board members | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> |

BOARD COMPOSITION

Please rate the following in terms of how desirable it is to your perception of effective corporate governance.

| | Not Desirable | | Somewhat Desirable | | Very Desirable | | Extremely Desirable |
|---|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|------------------------|
| Less than 50% of the board are independent directors | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> |
| Between 50 and 75% of the board are independent directors | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> |
| More than 75% of the board are independent | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> |

MULTIPLE DIRECTORSHIPS

Please rate the following in terms of how desirable it is to your perception of effective corporate governance.

| | Not Desirable | | Somewhat Desirable | | Very Desirable | | Extremely Desirable |
|---|-----------------------|--|-----------------------|--|-----------------------|--|------------------------|
| Individual board members hold only 1 directorship | <input type="radio"/> | | <input type="radio"/> | | <input type="radio"/> | | <input type="radio"/> |
| Individual board members hold 2-3 directorships | <input type="radio"/> | | <input type="radio"/> | | <input type="radio"/> | | <input type="radio"/> |
| Individual board members hold more than 3 directorships | <input type="radio"/> | | <input type="radio"/> | | <input type="radio"/> | | <input type="radio"/> |

AUDIT COMMITTEE SIZE

Please rate the following in terms of how desirable it is to your perception of effective corporate governance.

| | Not Desirable | | Somewhat Desirable | | Very Desirable | | Extremely Desirable |
|-------------------------------------|-----------------------|--|-----------------------|--|-----------------------|--|------------------------|
| 3 or less audit committee members | <input type="radio"/> | | <input type="radio"/> | | <input type="radio"/> | | <input type="radio"/> |
| More than 3 audit committee members | <input type="radio"/> | | <input type="radio"/> | | <input type="radio"/> | | <input type="radio"/> |

AUDIT COMMITTEE COMPOSITION

Please rate the following in terms of how desirable it is to your perception of effective corporate governance.

| | Not Desirable | | Somewhat Desirable | | Very Desirable | | Extremely Desirable |
|---|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|------------------------|
| Less than 50% of the audit committee are independent directors | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> |
| Between 50 and 75% of the audit committee are independent directors | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> |
| More than 75% of the audit committee are independent directors | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> |

PROVISION OF NON-AUDIT SERVICES BY THE AUDITOR

Please rate the following in terms of how desirable it is to your perception of effective corporate governance.

| | Not Desirable | | Somewhat Desirable | | Very Desirable | | Extremely Desirable |
|---|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|------------------------|
| Less than 30% ratio of non-audit fees to total audit fees | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> |

| | | | | | | | |
|--|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| Between 30 and 60% ratio of non-audit fees to total audit fees | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> |
| More than 60% ratio of non-audit fees to total audit fees | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> |

AUDIT PARTNER TENURE

Please rate the following in terms of how desirable it is to your perception of effective corporate governance.

| | | | | | | | |
|--|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|------------------------|
| | Not Desirable | | Somewhat Desirable | | Very Desirable | | Extremely Desirable |
| Audit partner tenure of 5 years or less | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> |
| Audit partner tenure of more than 5 years | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> |

REMUNERATION COMMITTEE COMPOSITION

Please rate the following in terms of how desirable it is to your perception of effective corporate governance.

| | Not Desirable | | Somewhat Desirable | | Very Desirable | | Extremely Desirable |
|---|-----------------------|--|-----------------------|--|-----------------------|--|------------------------|
| Less than 75% independent directors on the remuneration committee | <input type="radio"/> | | <input type="radio"/> | | <input type="radio"/> | | <input type="radio"/> |
| Between 75 and 100% independent directors on the remuneration committee | <input type="radio"/> | | <input type="radio"/> | | <input type="radio"/> | | <input type="radio"/> |
| 100% independent directors on the remuneration committee | <input type="radio"/> | | <input type="radio"/> | | <input type="radio"/> | | <input type="radio"/> |

CEO DUALITY

Please rate the following in terms of how desirable it is to your perception of effective corporate governance.

| | Not Desirable | | Somewhat Desirable | | Very Desirable | | Extremely Desirable |
|--|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|------------------------|
| CEO and Chair of the Board are the same person | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> |
| CEO and Chair of the Board are not the same person | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> |

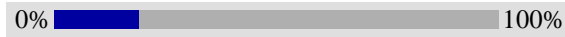
Next

0%  100%

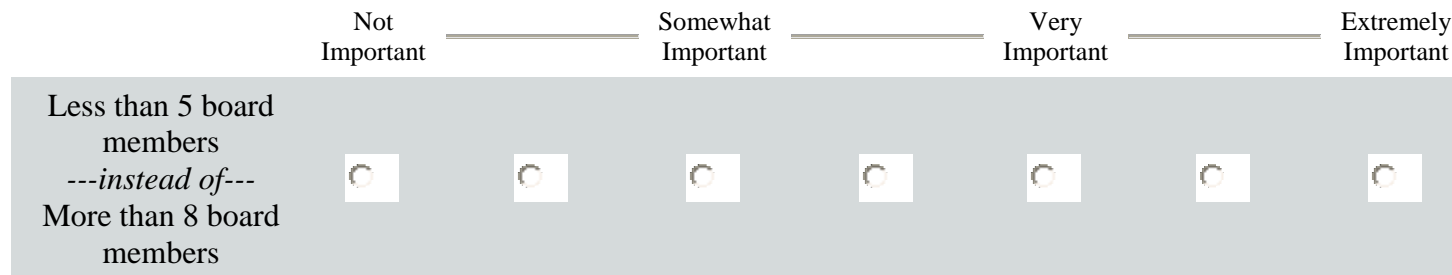
You have now finished Section 1 of the survey. This section asks you to indicate how important each factor is in relation to your perception of effective corporate governance.

Click the Next button below to continue...

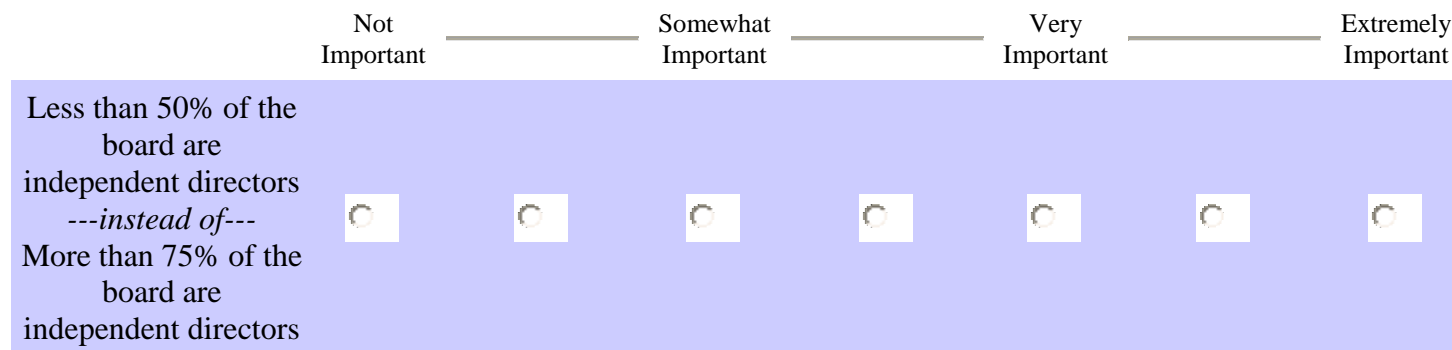
Next



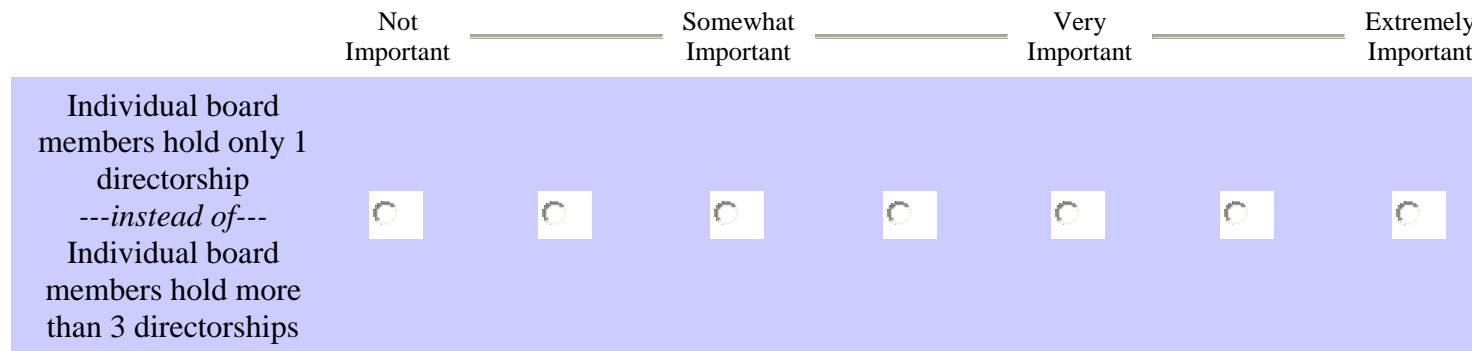
If the corporate governance of two companies were equally effective in all other ways, how important would the following difference be to you?



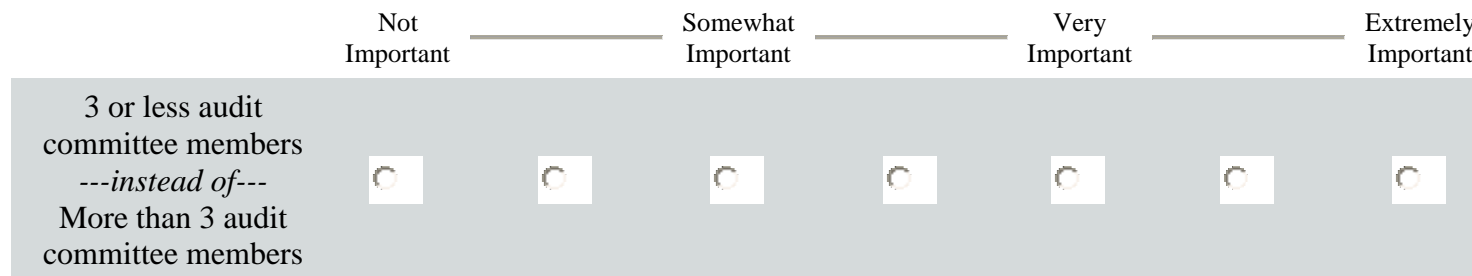
If the corporate governance of two companies were equally effective in all other ways, how important would the following difference be to you?



If the corporate governance of two companies were equally effective in all other ways, how important would the following difference be to you?



If the corporate governance of two companies were equally effective in all other ways, how important would the following difference be to you?



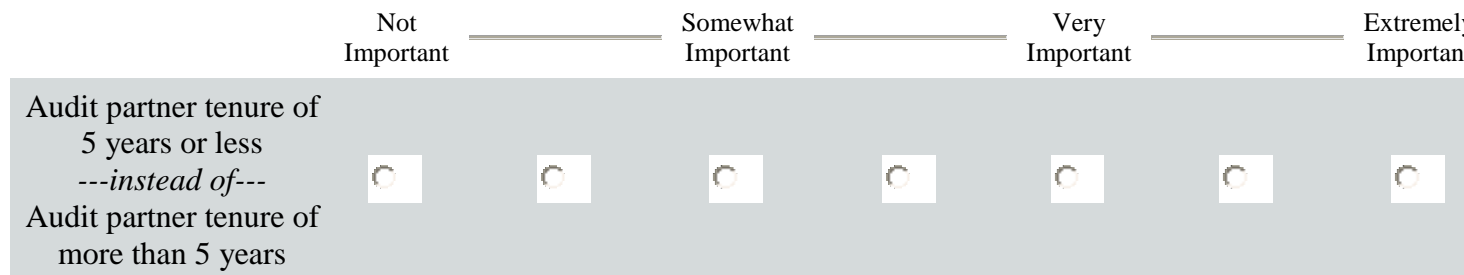
If the corporate governance of two companies were equally effective in all other ways, how important would the following difference be to you?

| | Not Important | | Somewhat Important | | Very Important | | Extremely Important |
|--|-----------------------|--|-----------------------|--|-----------------------|--|------------------------|
| Less than 50% of the audit committee are independent directors ---instead of--- More than 75% of the audit committee are independent directors | <input type="radio"/> | | <input type="radio"/> | | <input type="radio"/> | | <input type="radio"/> |

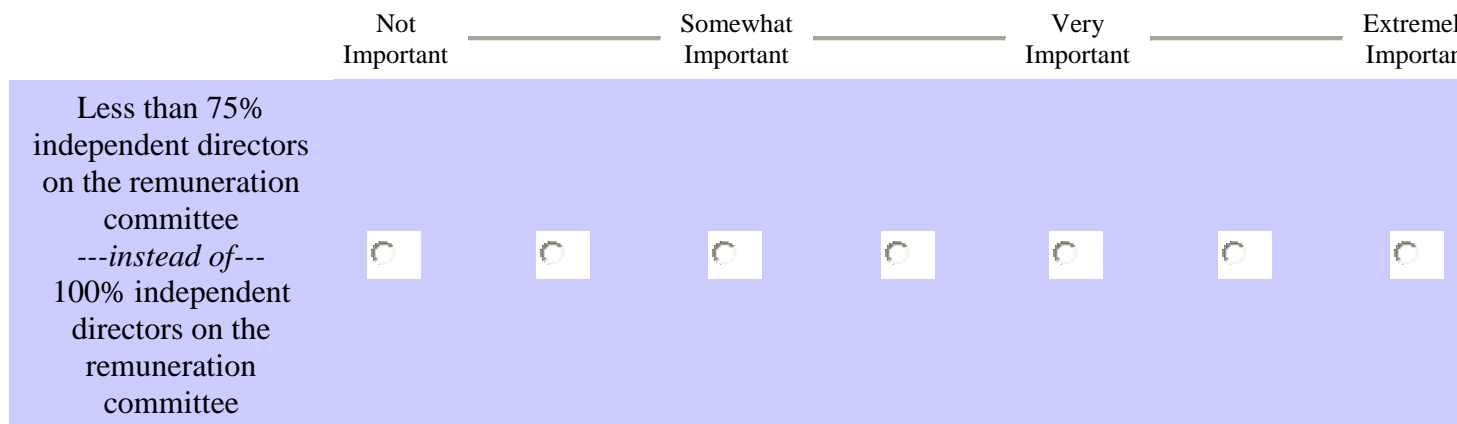
If the corporate governance of two companies were equally effective in all other ways, how important would the following difference be to you?

| | Not Important | | Somewhat Important | | Very Important | | Extremely Important |
|--|-----------------------|--|-----------------------|--|-----------------------|--|------------------------|
| Less than 30% ratio of non-audit fees to total audit fees ---instead of--- More than 60% ratio of non-audit fees to total audit fees | <input type="radio"/> | | <input type="radio"/> | | <input type="radio"/> | | <input type="radio"/> |

If the corporate governance of two companies were equally effective in all other ways, how important would the following difference be to you?



If the corporate governance of two companies were equally effective in all other ways, how important would the following difference be to you?



If the corporate governance of two companies were equally effective in all other ways, how important would the following difference be to you?

| | Not Important | | Somewhat Important | | Very Important | | Extremely Important |
|--|------------------|--|-----------------------|--|-------------------|--|------------------------|
| CEO and Chair of the Board are the same person | | | | | | | |
| ---instead of--- | | | | | | | |
| CEO and Chair of the Board are not the same person | | | | | | | |

Next



Thank you for completing sections 1 and 2.

I still need some more information to learn which factors you value most.

In this section, I will construct some questions based on your responses to the previous questions.

You will be asked to indicate your preference between combinations of several corporate governance factors, and also to indicate the strength of your preference.

I will only be asking you to compare a few factors at a time. The first group of questions will compare two factors at a time, and the second group of questions will ask you to compare three factors at a time. Please assume that the corporate governance in two companies is identical in every other way except for the differences presented.

Click the Next button to continue

Next

0%  100%

If the corporate governance of two companies were equally effective in all other ways, which combination would you prefer?

Less than 50% of the board are independent directors
Between 5 and 8 board members

or

Between 50 and 75% of the board are independent directors
More than 8 board members



If the corporate governance of two companies were equally effective in all other ways, which combination would you prefer?

More than 75% of the board are independent directors
Individual board members hold more than 3 directorships

or

Between 50 and 75% of the board are independent directors
Individual board members hold 2-3 directorships



If the corporate governance of two companies were equally effective in all other ways, which combination would you prefer?

| | | | | |
|---|--|----|---|--|
| Individual board members hold 2-3 directorships | | or | Individual board members hold only 1 directorship | |
| More than 3 audit committee members | | | 3 or less audit committee members | |

| | | | | | | | | |
|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> |
| Strongly Prefer Left | | Somewhat Prefer Left | | Indifferent | | Somewhat Prefer Right | | Strongly Prefer Right |

If the corporate governance of two companies were equally effective in all other ways, which combination would you prefer?

| | | | | |
|--|--|----|--|--|
| 3 or less audit committee members | | or | More than 3 audit committee members | |
| Less than 50% of the audit committee are independent directors | | | More than 75% of the audit committee are independent directors | |

| | | | | | | | | |
|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> |
| Strongly Prefer Left | | Somewhat Prefer Left | | Indifferent | | Somewhat Prefer Right | | Strongly Prefer Right |

If the corporate governance of two companies were equally effective in all other ways, which combination would you prefer?

Between 50 and 75% of the audit committee
are independent directors
Between 30 and 60% ratio of non-audit fees to
total audit fees

or

More than 75% of the audit committee are
independent directors
More than 60% ratio of non-audit fees to total
audit fees



If the corporate governance of two companies were equally effective in all other ways, which combination would you prefer?

Audit partner tenure of more than 5 years
More than 60% ratio of non-audit fees to total
audit fees

or

Audit partner tenure of 5 years or less
Less than 30% ratio of non-audit fees to total
audit fees



If the corporate governance of two companies were equally effective in all other ways, which combination would you prefer?

Between 75 and 100% independent directors on the remuneration committee
Audit partner tenure of more than 5 years

or

Less than 75% independent directors on the remuneration committee
Audit partner tenure of 5 years or less



If the corporate governance of two companies were equally effective in all other ways, which combination would you prefer?

Less than 75% independent directors on the remuneration committee
CEO and Chair of the Board are the same person

or

100% independent directors on the remuneration committee
CEO and Chair of the Board are not the same person



If the corporate governance of two companies were equally effective in all other ways, which combination would you prefer?

CEO and Chair of the Board are the same person
Less than 5 board members

or

CEO and Chair of the Board are not the same person
Between 5 and 8 board members



Next



Thank you for completing the first group of questions in section 3. The next group of questions are in the same format except that they contain three factors instead of two.

Click on the Next button below to continue...

Next



If the corporate governance of two companies were equally effective in all other ways, which combination would you prefer?

| | | |
|---|----|---|
| Individual board members hold more than 3 directorships Between 30 and 60% ratio of non-audit fees to total audit fees 100% independent directors on the remuneration committee | or | Individual board members hold only 1 directorship Less than 30% ratio of non-audit fees to total audit fees Between 75 and 100% independent directors on the remuneration committee |
|---|----|---|

| | | | | | | | | |
|----------------------------|-----------------------|----------------------------|-----------------------|-----------------------|-----------------------|-----------------------------|-----------------------|-----------------------------|
| <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> |
| Strongly Prefer Left | | Somewhat Prefer Left | | Indifferent | | Somewhat Prefer Right | | Strongly Prefer Right |

If the corporate governance of two companies were equally effective in all other ways, which combination would you prefer?

| | | |
|---|----|--|
| Less than 50% of the audit committee are independent directors Less than 50% of the board are independent directors Audit partner tenure of 5 years or less | or | Between 50 and 75% of the audit committee are independent directors More than 75% of the board are independent directors Audit partner tenure of more than 5 years |
|---|----|--|

| | | | | | | | | |
|----------------------------|-----------------------|----------------------------|-----------------------|-----------------------|-----------------------|-----------------------------|-----------------------|-----------------------------|
| <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> |
| Strongly Prefer Left | | Somewhat Prefer Left | | Indifferent | | Somewhat Prefer Right | | Strongly Prefer Right |

If the corporate governance of two companies were equally effective in all other ways, which combination would you prefer?

| | | |
|---|----|---|
| More than 3 audit committee members More than 8 board members Between 75 and 100% independent directors on the remuneration committee | or | 3 or less audit committee members Less than 5 board members Less than 75% independent directors on the remuneration committee |
|---|----|---|

| | | | | | | | | |
|----------------------------|-----------------------|----------------------------|-----------------------|-----------------------|-----------------------|-----------------------------|-----------------------|-----------------------------|
| <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> |
| Strongly Prefer Left | | Somewhat Prefer Left | | Indifferent | | Somewhat Prefer Right | | Strongly Prefer Right |

If the corporate governance of two companies were equally effective in all other ways, which combination would you prefer?

| | | |
|---|----|---|
| CEO and Chair of the Board are the same person 3 or less audit committee members Less than 50% of the board are independent directors | or | CEO and Chair of the Board are not the same person More than 3 audit committee members More than 75% of the board are independent directors |
|---|----|---|

| | | | | | | | | |
|----------------------------|-----------------------|----------------------------|-----------------------|-----------------------|-----------------------|-----------------------------|-----------------------|-----------------------------|
| <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> |
| Strongly Prefer Left | | Somewhat Prefer Left | | Indifferent | | Somewhat Prefer Right | | Strongly Prefer Right |

If the corporate governance of two companies were equally effective in all other ways, which combination would you prefer?

| | | |
|---|----|--|
| Between 50 and 75% of the audit committee are independent directors More than 8 board members Individual board members hold more than 3 directorships | or | Less than 50% of the audit committee are independent directors Between 5 and 8 board members Individual board members hold only 1 directorship |
|---|----|--|

☐ ☐ ☐ ☐ ☐ ☐ ☐ ☐ ☐

Strongly Prefer Left Somewhat Prefer Left Indifferent Somewhat Prefer Right Strongly Prefer Right

If the corporate governance of two companies were equally effective in all other ways, which combination would you prefer?

| | | |
|--|----|---|
| Less than 30% ratio of non-audit fees to total audit fees Individual board members hold only 1 directorship CEO and Chair of the Board are the same person | or | Between 30 and 60% ratio of non-audit fees to total audit fees Individual board members hold 2-3 directorships CEO and Chair of the Board are not the same person |
|--|----|---|

☐ ☐ ☐ ☐ ☐ ☐ ☐ ☐ ☐

Strongly Prefer Left Somewhat Prefer Left Indifferent Somewhat Prefer Right Strongly Prefer Right

If the corporate governance of two companies were equally effective in all other ways, which combination would you prefer?

| | | |
|---|-----------------------|--|
| Between 50 and 75% of the board are independent directors More than 3 audit committee members Audit partner tenure of more than 5 years | or | Less than 50% of the board are independent directors 3 or less audit committee members Audit partner tenure of 5 years or less |
| <input type="radio"/> | <input type="radio"/> | <input type="radio"/> |
| Strongly Prefer Left | Indifferent | Strongly Prefer Right |

If the corporate governance of two companies were equally effective in all other ways, which combination would you prefer?

| | | |
|--|-----------------------|--|
| Less than 75% independent directors on the remuneration committee Less than 5 board members Between 30 and 60% ratio of non-audit fees to total audit fees | or | 100% independent directors on the remuneration committee Between 5 and 8 board members More than 60% ratio of non-audit fees to total audit fees |
| <input type="radio"/> | <input type="radio"/> | <input type="radio"/> |
| Strongly Prefer Left | Indifferent | Strongly Prefer Right |

If the corporate governance of two companies were equally effective in all other ways, which combination would you prefer?

More than 75% of the audit committee are independent directors
CEO and Chair of the Board are not the same person
100% independent directors on the remuneration committee

or

Between 50 and 75% of the audit committee are independent directors
CEO and Chair of the Board are the same person
Between 75 and 100% independent directors on the remuneration committee



Strongly
Prefer
Left

Somewhat
Prefer
Left

Indifferent

Somewhat
Prefer
Right

Strongly
Prefer
Right

Next



This is section 4, the last section. In this section, you will be shown a set of corporate governance factors.

Please indicate your preference for this combination by providing a score between "0" to "100" where "100" means that you are completely satisfied with this combination and "0" means you are completely NOT satisfied with it.

Click the Next button below to continue...

Next



Please type a number between 0 and 100 where 100 means "Definitely satisfied with this combination" and 0 means "Definitely NOT satisfied with this combination"

Would you be satisfied with the following combination of corporate governance factors?

More than 8 board members

More than 75% of the board are independent directors

Individual board members hold more than 3 directorships

More than 3 audit committee members

More than 75% of the audit committee are independent directors

Please type a number between 0 and 100 where 100 means "Definitely satisfied with this combination" and 0 means "Definitely NOT satisfied with this combination"

Would you be satisfied with the following combination of corporate governance factors?

Less than 5 board members

Less than 50% of the board are independent directors

Individual board members hold only 1 directorship

3 or less audit committee members

Less than 50% of the audit committee are independent directors

Please type a number between 0 and 100 where 100 means "Definitely satisfied with this combination" and 0 means "Definitely NOT satisfied with this combination"

Would you be satisfied with the following combination of corporate governance factors?

More than 8 board members

More than 75% of the board are independent directors

Individual board members hold more than 3 directorships

3 or less audit committee members

Between 50 and 75% of the audit committee are independent directors

Please type a number between 0 and 100 where 100 means "Definitely satisfied with this combination" and 0 means "Definitely NOT satisfied with this combination"

Would you be satisfied with the following combination of corporate governance factors?

Less than 5 board members

Less than 50% of the board are independent directors

Individual board members hold more than 3 directorships

More than 3 audit committee members

More than 75% of the audit committee are independent directors

Please type a number between 0 and 100 where 100 means "Definitely satisfied with this combination" and 0 means "Definitely NOT satisfied with this combination"

Would you be satisfied with the following combination of corporate governance factors?

More than 8 board members

More than 75% of the board are independent directors

Individual board members hold only 1 directorship

3 or less audit committee members

Between 50 and 75% of the audit committee are independent directors

Next



Finally, I need to obtain some demographic information from you. Please note that this information will be used for statistical purpose only.

Click the Next button below to continue...

Next

0%  100%

Please indicate your gender

- ☐ Male
- ☐ Female

Next

0%  100%

In what age group are you?

- ☐ 18 - 24
- ☐ 25 - 34
- ☐ 35 - 44
- ☐ 45 - 54
- ☐ 55 - 64
- ☐ 65 - 74
- ☐ 75+

Next

0%  100%

What is your highest educational qualification you have obtained?

- ☐ High School
- ☐ Diploma
- ☐ Bachelor Degree
- ☐ Masters Degree
- ☐ Master of Business Administration (MBA)
- ☐ Doctor of Philosophy (PhD)
- ☐ Others (please specify)

Next

0%  100%

You now have completed the survey. I would like to thank you for your participation - it is greatly appreciated.

Finish

Powered by Sawtooth Software, Inc.

0%  100%

APPENDIX C

Final Ethics Approval Letter



4 November 2011

Associate Professor Sue
Wright Faculty of Business
and Economics Macquarie
University, NSW 2109

Reference: 5201100844(D)

Dear Associate Professor Sue Wright

FINAL
APPROVAL

Title of project: The relative importance of corporate governance attributes: Evidence from corporate stakeholders.

Thank you for your recent correspondence. Your response has addressed the issues raised by the Faculty of Business & Economics Human Research Ethics Sub Committee, and you may now commence your research. The following personnel are authorised to conduct this research:

Sue Wright – Chief Investigator/Supervisor
Alan Kilgore - Associate Investigator
Christofer Adrian - Co-Investigator

Please note the following standard requirements of approval:

1. The approval of this project is **conditional** upon your continuing compliance with the *National Statement on Ethical Conduct in Human Research (2007)*.
2. Approval will be for a period of five (5 years) subject to the provision of annual reports. **Your first progress report is due on 04 November 2012.**

If you complete the work earlier than you had planned you must submit a Final Report as soon as the work is completed. If the project has been discontinued or not commenced for any reason, you are also required to submit a Final Report on the project.

Progress Reports and Final Reports are available at the following website:

http://www.research.mq.edu.au/researchers/ethics/human_ethics/forms

3. If the project has run for more than five (5) years you cannot renew approval for the project. You will need to complete and submit a Final Report and submit a new application for the project. (The five year limit on renewal of approvals allows the Committee to fully re-review research in an environment where legislation, guidelines and requirements are continually changing, for example, new child protection and privacy laws).
4. Please notify the Committee of any amendment to the project.
5. Please notify the Committee immediately in the event of any adverse effects on participants or of any unforeseen events that might affect continued ethical acceptability of the project.
6. At all times you are responsible for the ethical conduct of your research in accordance with the guidelines established by the University. This information is available at: <http://www.research.mq.edu.au/policy>

If you will be applying for or have applied for internal or external funding for the above project it is your responsibility to provide Macquarie University's Research Grants Officer with a copy of this letter as soon as possible. The Research Grants Officer will not inform external funding agencies that you have final approval for your project and funds will not be released until the Research Grants Officer has received a copy of this final approval letter.

Yours
sincerely

Alan Kilgore
Chair, Faculty of Business and Economics Ethics Sub-Committee

Final Approval - 5201200737(D)

1 message

Mrs Yanru Ouyang <yanru.ouyang@mq.edu.au> Wed, Oct 10, 2012 at 10:39 AM

To: Dr Alan Kilgore <alan.kilgore@mq.edu.au>

Cc: Dr Sue Wright <sue.wright@mq.edu.au>, Mr Christofer Adrian
<christofer.adrian@mq.edu.au>

Dear Dr Kilgore,

Re: 'The relative importance of corporate governance attributes: Evidence from corporate stakeholders.'

Reference No.:5201200737

The above application was reviewed by the Faculty of Business & Economics Human Research Ethics Sub Committee. Approval of the above application is granted, effective 9 October 2012 and you may now proceed with your research.

This research meets the requirements of the National Statement on Ethical Conduct in Human Research (2007). The National Statement is available at the following web site:

http://www.nhmrc.gov.au/_files_nhmrc/publications/attachments/e72.pdf.

The following personnel are authorised to conduct this research:

Dr Alan Kilgore
Dr Sue Wright
Mr Christofer Adrian

NB. STUDENTS: IT IS YOUR RESPONSIBILITY TO KEEP A COPY OF THIS APPROVAL EMAIL TO SUBMIT WITH YOUR THESIS.

Please note the following standard requirements of approval:

1. The approval of this project is conditional upon your continuing compliance with the National Statement on Ethical Conduct in Human Research (2007).
2. Approval will be for a period of five (5) years subject to the provision of annual reports.

Progress Report 1 Due: 9th Oct 2013

Progress Report 2 Due: 9th Oct 2014

Progress Report 3 Due: 9th Oct 2015

Progress Report 4 Due: 9th Oct 2016

Final Report Due: 9th Oct 2017

NB. If you complete the work earlier than you had planned you must submit a Final Report as soon as the work is completed. If the project has been discontinued or not

commenced for any reason, you are also required to submit a Final Report for the project.

Progress reports and Final Reports are available at the following website:
http://www.research.mq.edu.au/for/researchers/how_to_obtain_ethics_approval/human_research_ethics/forms

3. If the project has run for more than five (5) years you cannot renew approval for the project. You will need to complete and submit a Final

Report and submit a new application for the project. (The five year limit on renewal of approvals allows the Committee to fully re-review research in an environment where legislation, guidelines and requirements are continually changing, for example, new child protection and privacy laws).

4. All amendments to the project must be reviewed and approved by the Committee before implementation. Please complete and submit a Request for Amendment Form available at the following website:

http://www.research.mq.edu.au/for/researchers/how_to_obtain_ethics_approval/human_research_ethics/forms

5. Please notify the Committee immediately in the event of any adverse effects on participants or of any unforeseen events that affect the continued ethical acceptability of the project.

6. At all times you are responsible for the ethical conduct of your research in accordance with the guidelines established by the University. This information is available at the following websites:

<http://www.mq.edu.au/policy/>
http://www.research.mq.edu.au/for/researchers/how_to_obtain_ethics_approval/human_research_ethics/policy

If you will be applying for or have applied for internal or external funding for the above project it is your responsibility to provide the Macquarie University's Research Grants Management Assistant with a copy of this email as soon as possible. Internal and External funding agencies will not be informed that you have final approval for your project and funds will not be released until the Research Grants Management Assistant has received a copy of this email.

If you need to provide a hard copy letter of Final Approval to an external organisation as evidence that you have Final Approval, please do not hesitate to contact the FBE Ethics Committee Secretariat, via fbe-ethics@mq.edu.au or 9850 4826.

Please retain a copy of this email as this is your official notification of final ethics approval.

Yours sincerely

Alan Kilgore

Chair, Faculty of Business and Economics Ethics Sub-Committee