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EFFECTS OF CORPORATE GOVERNANCE MECHANISMS ON THE PERFORMANCE OF PUBLICLY TRADED SMES IN DEVELOPING ECONOMIES

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Abstract

Corporate governance mechanisms are of particularly interest to publicly listed SMEs, as ineffective governance mechanisms, or the nonexistence of effective ones, can lead to the speedy and sure demise of these enterprises, as they generally do not possess the resources to survive as their larger counterparts. This paper examines the role of various governance mechanisms on the performance or market valuation of publicly traded SMEs, using Tobin's Q, as a measure of market valuation. In an effort to stimulate theory building and empirical research in the realm of small firms, the paper proposes a number of propositions regarding the relationship between the governance mechanisms of management share ownership, board composition, institutional investor shareholding, and top management team size, on the one hand; and the performance of publicly listed SMEs, on the other. It makes an important contribution to the literature, as no prior governance studies have been found that examine the governance–performance relationships in publicly listed SMEs in small, open, developing economies, such as Jamaica. The paper concludes by offering important insights and recommendations for further SME-related governance research, such as how structural equation modelling may be applied to this research stream.

Keywords: Corporate governance mechanisms, Market valuation, Tobin's Q, SMEs, Developing economies.

INTRODUCTION and CONTEXTUAL FRAMEWORK

Emergence of corporate governance mechanisms have become an important area in the business and financial sector, with a key focus on accountability from those to whom the firm financial resources are entrusted (Keasey et al. 2005). This growing importance stems from publicized cases of corporate giants such as Enron and WorldCom whose downfall has been attributed to the failure of their governance systems and processes. The 2008 financial crisis and uncertainty in some developed economies have led most corporate governance structures to become more proactive in ensuring that firms can readily identify and react quickly to subsequent or future crisis. Many firms now place a renewed focus on transparency in their overall business processes and financial reporting systems in line with best-practice governance practices (Keasey et al., 2005).

Through new regulations, such the Sarbanes Oxley of 2002 in the USA; improved strategic and operational risk assessment and reporting requirements of firms have been enforced. As a result of past economic turbulence in the developed world, firms in developing countries have renewed their focus on corporate governance mechanisms. Although no studies have been found which speak to the effect of corporate governance on the performance of publicly listed SMEs, this is of growing interest because of the important role SMEs play in the economy of developing countries, such as Jamaica. For publicly listed SMEs, corporate governance mechanisms are of particularly interest, as ineffective governance mechanisms, or the nonexistence of effective ones, can lead to the speedy and sure demise of these enterprises, as they may not have the resources endowment, as their larger counterparts, in order to survive (see Autio, et al., 2000).

According to La Porta et al. (2000), corporate governance refers to a set of mechanisms dealing with, among other things, the composition, monitoring, and control of boards of directors and top managers of the firm to safeguard the financial interest of shareholders. Essentially then, corporate governance can be seen as being primarily concerned with ensuring that that boards of directors and managers implement effective policies and make decisions in pursuit of stakeholders' value (Keasey et al., 2005). It is not surprising therefore that many studies on corporate governance have sought to explain how changes in governance structure or mechanism affect the financial performance of the firm (Brunninge et al., 2007), while, at the same time, insure that managers act in the interest of shareholders (owners), and so mitigate agency problems (e.g., Agrawal and Knoeber, 1996; Coles et al., 2001; Jensen and Meckling, 1976). In this regard, Agrawal and Knoeber (1996) observe that problems of managers pursuing their own interests at the expense of shareholders can be reduced by implementing corporate governance mechanisms such as increasing managerial shareholding in the firm (see also Jensen and Meckling, 1976).

In fact, Coles et al. (2001) have noted that much of the work in corporate governance has focused on the design of governance mechanisms to encourage managers to make choices for the firm that will improve performance. For example, researchers have indicated that the addition of outside directors to the board, as well as facilitating concentrated shareholdings by institutional investors are important corporate governance mechanisms that can increase managerial monitoring and improve firm performance (Agrawal and Knoeber, 1996). Similarly, Rosenstein and Wyatt (1990) find that the addition of outside directors to board can result in a significant positive increase in the stock prices of firms. This is particularly so, in cases where outside directors are able to effectively monitor the performance of the CEOs and/or top management teams (TMTs) because these directors: (a) invest the time and effort to oversee the firm's corporate governance systems; (b) have significant expertise and firm-specific knowledge that they use effectively; (c) often own equity stake or represent shareholders that do (Morck et al., 1998). In fact, Morck et al. (1988) and McConnell and Servaes (1990) find a nonlinear relationship between the level of ownership held by members of the board and firm performance. Their research findings imply, among other things, that greater board shareholding improves firm performance that redounds to the shareholders' benefit.

This paper therefore considers corporate governance as the interrelationship between a firm's ownership, board of directors and top management (Brunninge et al., 2007) to create value for shareholders. It focuses, in general, on internal and external corporate governance mechanisms and their effects on the performance of publicly traded small and medium enterprises (SMEs), which is defined as firm with a workforce of up to 200 employees (Taylor, 2013). It evaluates the internal governance mechanisms of management share ownership (insider shareholding), board composition (outsider representation on the board), and top management team size, as well as the external mechanism of concentration institutional investor shareholding on the one hand and firm performance or the market valuation (see Argawal and Knoeber, 1996) of publicly traded or listed SMEs, particularly in a developing country context, on the other.

Here, firm performance is measured using average Tobin's *Q*, or the ratio of the firm's market value to the replacement cost of its physical assets (see Morck et al., 1988). The ratio is calculated by total market value of the firm divided by its total asset value. In this regard, total market value is the total of the market value of equity; the book value of long-term debt and short-term debt; preferred stock at liquidating value; and the book value of convertible debt and convertible preferred stock. For its part, the replacement of the firm's physical asset is the book value of total assets (Argawal and Knoeber, 1996). Tobin's *Q* has been chosen over accounting profit rate as an appropriate measure of firm performance. This is because Tobin's *Q* accounts for investor psychology relating to forecasts of a number of world events, including the outcome of present business strategies (Demsetz and Villalonga, 2001). It is also considered a transparent measure of firm performance (see Agrawal and Knoeber, 1996).

The paper's primary objective is to contribute to theory building and stimulate empirical inquiry in the area of corporate governance of SMEs. It seeks to achieve this objective by presenting a number of propositions on how different governance mechanisms operate to impact the market valuation of the assets of publicly listed SMEs, especially those in small, open developing economies, such as Jamaica.

While a number of previous SME governance studies have assumed that governance mechanisms operate independent of each other (Rediker and Seth, 1995) this research paper, in contrast, considers how various governance mechanisms are combined and used (to varying degrees) by publicly traded SMEs to maximize firm value (Demsetz and Lehn, 1985). Hence, the paper attempts to fill an important gap in the literature by examining the effect of different governance mechanisms on the market valuation of publicly listed SMEs in small, open developing countries. In fact, much of the existing studies on corporate governance and firm performance have investigated these issues among larger firms in developed economies, such as Sweden. No studies have been found which examine these issues in the context of publicly traded SMEs in small, open, developing countries. It is in filling this gap that this paper makes an important contribution to governance literature.

The rest of the paper is organized as follows. Section 2, provides relevant theoretical underpinnings and related propositions on the corporate governance–performance relationship. Section 3, discusses the propositions in line with the results of past research and current realities of publicly listed SMEs, particularly in the Jamaican context. In this regard, the paper also provides insightful quantitative and qualitative research approaches and guidelines that can be used to evaluate the propositions presented, as well as assist further research on SMEs. Section 4 offers useful insights and avenues for future research, while Section 5 provides concluding comments.

THEORETICAL UNDERPINNINGS AND PROPOSITIONS

Managerial ownership and firm performance

In their seminal work, Berle and Means (1932) outlined the potential conflict of interest between corporate managers and dispersed shareholders when managers do not have an ownership interest in the firm. For their part, Jensen and Meckling (1976) formalize the relationship between corporate value and managerial equity ownership. According to Jensen and Meckling (1976), there is an incentive for managers to adopt investments and financing policies from which they benefit to the extent of their share ownership in the firm. It follows from this reasoning that the greater the number of shares owned by managers, the greater the value of the firm; and the more their incentive to work to increase firm value, and visa versa.

In contrast, Demsetz and Lehn (1985) find no significant correlation between accounting profit rate and different measures of ownership concentration. Some earlier studies on the relationship between stock ownership of top executives and corporate performance indicate that owner-managed firms do not outperform firms that are managed by nonowners (see, for e.g., Kania and McKean, 1976). Moreover, Masson (1971) suggests that managerial aspirations are due less to the amount of a firm’s shares owned by management than to the amount of the manager's salary that is derived from the firm. Masson also noted that managers – whether they possess an ownership stake in the firm or not – may be inclined to pursue noneconomic objectives for the firm if they have sufficient income alternatives.

Notwithstanding, evidence provided by Hermalin and Weisbach (1991), indicates that stock ownership by management can reduce agency problem, since the more stock management owns the greater their motivation to work to raise the value of the firm's stock, which aligns with the interests of other shareholders. Accordingly, as managers' ownership increase, they should be more motivated to pursue value-maximizing objectives, such as product and service innovations, that are likely to increase corporate wealth (Morck et al., 1988).

Like Hermalin and Weisbach (1991), Morck et al. (1988) find that as ownership rises from 0% to 5%, average Tobin's *Q* increases; falls as ownership rises further to 25%; and then continues to increase as ownership rises beyond 25%. In noting that these results apply to board ownership, and individually to ownership by the firm's top managers and outside board members, Morck and et al. (1998, p. 311) comments that "the increases of Tobin's *Q* with ownership reflect the convergence-of-interests between managers and shareholders, while the decline reflects entrenchment of the management team. (1988). Furthermore, Morck et al. (1988) indicate that increases in managers' share ownership and higher firm performance may reflect the fact that managers of high *Q* firms will end up with more stock. According to these researchers, firms that do well are also likely to give managers stock bonuses as incentives for their performance. These researchers also suggest that when the entrepreneurial abilities or ideas of top management are rewarded with higher equity allocation in the firm, publicly traded SMEs with a lot of entrepreneurial-related intangible assets, will enjoy both higher *Q*'s and management ownership.

Likewise, Hermalin and Weisbach (1991) find that smaller firms seem to have higher *Q*'s; thus suggesting that smaller firms may generally possess more entrepreneurial orientation (EO) due to the influence of the founder. Other researchers have also found that EO is positively associated with firm performance (see Lumpkin and Dess, 1996; Taylor, 2013) and, as such, EO is seen as an important control variable in studies concerning the corporate governance–firm performance relationship (Brunninge et al., 2007).

Governance literature indicates that even after becoming publicly listed firms, ownership control of many SMEs often remain in the hands of the founder or found family members (see Brunninge et al., 2007). This situation often perpetuates the inseparability of ownership and management (Brunninge et al., 2007). Notwithstanding, regulatory requirements often stipulate that publicly traded SMEs continuously improve their governance system, and augment their leadership capabilities, by employing professional managers (see Agrawal and Knoeber, 1996).

Increasing these managers' equity or share ownership in SMEs will influence their risk-taking proclivity, which is associated with higher firm performance (see Keasey et al., 2005). As Damodaran (2008, p. 357) puts it, "managers with limited equity stakes in firms not only invest more conservatively, but are more likely to borrow less and hold on to more cash." At the same time, it should be noted that even as the literature acknowledges the positive relationship between increasing managers' share ownership and firm performance, it also cautions that managers tend to become risk averse at higher levels of ownership (see Beatty and Zajac, 1994; Wiklund and Zahra, 2005). This is because they have more of their own wealth tied up in the firm, and worry far more about the consequences of big decisions. As a result, these managers end up not exploiting risks as they should and, as such, inhibit the firm's capacity to maximize value (Damodaran, 2008). Hence:

Proposition 1a: Increasing the share ownership of top managers of publicly listed SMEs, at lower levels of concentration, is associated with increased market valuation of such firms.

Proposition 1b Increasing the share ownership of managers of publicly listed SMEs, at lower levels of concentration, is associated with increased market valuation of such firms

Concentrated Institutional share ownership and firm performance

Although Agrawal and Knoeber (1996) express concern that concentrated shareholdings of the SME by institutional investors raises questions of who will monitor these institutional investors, these researchers observe that more concentrated shareholdings by these outside institutional investors encourage diligent monitoring of the performance of top management, which is associated with positive firm performance. McConnell and Servaes (1990) also find a significant positive association between Tobin's *Q* and level of share ownership by institutional investors, suggesting that corporate value is a function of the structure of equity ownership. Accordingly, institutional investors that possess some nontrivial or noticeable share ownership in the firm are likely to make their presence felt in ensuring that the firm is managed in a matter that protects their interest.

Likewise, Pound (1988) hypothesizes that institutional investors have greater expertise and can monitor management at lower cost than can small shareholders. This hypothesis, thus, predicts a positive relation between institutional ownership and corporate value. Notwithstanding, Pound (1988) also provides two other hypotheses which indicate that because of other profitable business relationships with the firm, institutional investors may be forced to side with management in voting their shares; and may find it mutually advantageous to co-operate with management. According to Pound (1988) this co-operation reduces the beneficial effects on firm value that could result from monitoring by institutional investors.

In spite of the mixed results provided by Pound (1998), other researchers provide strong evidence that suggest a positive relationship between concentrated share ownership of institutional investors and firm performance (Agrawal and Knoeber, 1996; McConnell and Servaes, 1990; Wiklund and Zahra, 2005). For instance, Wiklund and Zahra (2005) find that institutional investors tend to be more knowledgeable, less risk-averse and have higher proclivity to participate in firm decisions that increase the scales and scope of SMEs international business involvement, thereby enhancing firm performance and value creation. Hence:

Proposition 2: The presence of institutional investors, with nontrivial share ownership of publicly listed SMEs, is positively associated with firm value.

Board composition and firm performance

Boards of directors are strategic assets that can enrich and refine firm's strategic decision making and organizational performance (Kim et al., 2009). Thus, boards perform some crucial tasks and through them influence firm performance (Zahra and Pearce, 1989). A number of governance scholars argue that boards of directors are responsible for (a) the control tasks of safeguarding shareholders' interests through the monitoring of top management and the control of the firm's results; and (b) the strategy tasks of providing support and counsel to the management of the firm (e.g., Forbes and Milliken, 1999). Jensen and Meckling (1976) acknowledge that boards of directors are governance mechanisms geared toward solving the problems that arise between owners and managers of the firm. As part of its duties therefore, the board of directors of the publicly traded SMEs monitors the CEO and other members of the top management team (TMT), as well as designs and negotiates managerial compensation to drive and achieve the firm's performance objectives (see Coles et al., 2001).

Notwithstanding its seeming importance, the role of the board in the governance process of the firm has been explored by some researchers with mixed results (Hermalin and Weisbach, 1991). Hermalin and Weisbach (1991) assert that many writers believe that boards generally fail in their responsibility to monitor management and guide their companies. MacAvoy et al. (1983), for example, find no evidence that board composition affects performance. Similarly, Agrawal and Knoeber (1996) report findings indicating, among other things, that fewer outside directors lead to improved firm performance. They also note that these results are consistent with causality running the other way, in that better firm performance may lead to fewer outside directors on the board.

As suggested by Coles et al. (2001), there might be a negative relationship between outside directors and firm performance, because outside directors might not possess sufficient firm specific knowledge to properly discharge their responsibilities. Besides, by maintaining larger shareholdings to keep control over the firm (Agrawal and Knoeber, 1996), founding CEOs often appoint or influence the appointment of outside directors who will champion their interests. As a consequence, these directors may not possess the requisite competency or authority to perform their duties dispassionately and/or effectively (see Coles et al., 2001).

In fact, Fiegener (2005) find that the boards in SMEs are less likely to participate in strategic decisions, and thereby impact firm performance where the CEO is the majority owner. Jensen (1993) has also criticised firms that have made the CEO also chairman, as an inappropriate way to design one of the most important power relationships in the firm. This perspective is based on the premise that the CEO who is also board chairman will have a concentrated power base that will allow him or her to take decisions in his or her own self-interest, and at the expense of shareholders (Coles et al., 2001: Jensen, 1993). Governance literature also suggests that founding chairmen/CEOs may to be more entrenched; risk-averse; and less inclined to take decisions that enable the firm to benefit from risk-taking (see Beatty and Zajac, 1994; Damodaran, 2008, Wiklund and Zahra, 2005).

Notwithstanding the likely influence of the founding CEO, a number of researchers have noted the continued importance of outside directors to publicly traded SMEs and other types of firms. Fama and Jenson (1983) suggest that market pressures and outside directors' desire to protect their reputation motivate these directors to fulfil their responsibilities. Moreover, coupled with direct pay for performance, monitoring by the board are important control mechanisms for top management (Hermalin and Weisbach, 1991). Outside directors, serving on the boards of publicly listed SMEs, will display some independence from top management in discharging their responsibilities to the firm, particularly when they own shares in the firm (Hermalin and Weisbach, 1991).

Additionally, certain legal obligations to shareholders, such as accurate financial disclosures, for which they can be held liable if they fail to meet them, are increasing forcing outside directors to effectively fulfil their fiduciary responsibility to shareholders (Coles et al., 2001). Also, outside directors, desirous to establish or preserve their reputations as excellent monitors and competent business professionals, will act independent of top management in the governance of the affairs of the firm (see Fama and Jenson, 1983). In addition, Hermalin and Weisbach (1991) provide evidence that outside directors will oppose poor performance or bad proposals by top management, and in cases where these directors dominate the board, they are more likely to respond to poor performance by dismissing the CEO.

Accordingly, publicly listed SMEs can benefit from active boards with outside members using the board of directors as a means to develop strategy and improve performance (see Brunninge et al., 2007). Indeed, publicly listed SMEs that have boards with active outside directors, who bring fresh insights and strategic perspectives, are able to contribute effectively to the monitoring and the maximization of firm value (Forbes and Milliken, 1999). Therefore:

Proposition 3a: The presence of outside directors on the board of publicly listed SMEs has a positive effect on firm performance or the market valuation of such firms.

Proposition 3b: Publicly listed SMEs in which outside directors own shares enjoy higher market valuation than those where outside directors have no stock ownership.

Proposition 3c (interaction effect): The presence of outside directors has a stronger positive effect on the market valuation of publicly traded SMEs where the founder is not influential in the management of the firm.

Proposition 3d: Publicly listed SMEs in which the founding CEO is a separate person from the chairman of the board enjoy higher market valuation than publicly listed SMES in which the founding CEO & chairman is the same person.

Board effectiveness and firm performance

Unlike other decision-making groups, boards meet periodically and consist of interdependent groups of people. Given such circumstances, board effectiveness is likely to greatly depend on social-psychological processes, particularly those relating to group participation (effort norms), coordination (use of knowledge and skills), and open discussions (cognitive conflict) (Forbes and Milliken, 1999). Strong effort norms can be expected to enhance the effort of individual board members and so, according to Forbes and Milliken (1999), contribute to the performance of the boards and, by extension, the firm. Effort is reflected in the time directors devote to the board and their attentiveness to and participation in board tasks (Forbes and Milliken, 1999).

In publicly traded SMEs, their boards may provide advice on matters to compensate for managerial deficiencies of the entrepreneurs who founded such firms (see van den Heuvel et al., 2006). Boards of directors of publicly listed SMEs, that take their control and the strategy tasks seriously, will dedicate time and effort to execute such responsibilities well. Their efforts will benefit firm performance and contribute to shareholder wealth creation. Therefore:

Proposition 4: Board effectiveness of listed SMEs is positively related to market valuation of such firms.

Top management teams (TMT) and firm performance

In many SMEs, the owner-manager is the CEO and, hence top manager (Brunninge et al., 2007). Top executives or top management teams (TMTs) matter and their role in the corporate governance of the SME cannot be overemphasised, since they are responsible for implementing corporate strategy and ensuring that the firm achieve planned performance results (Hambrick and Mason, 1984). According to Hambrick and Mason's (1984) upper echelon theory, organizational outcomes – strategic choices and performance levels – are partially predicted by managers' background characteristics. In other words, different types of top managers are associated with different organizational outcomes. Thus, TMT cognitive characteristics, such as values and interests, considerably influence the way firms operate and perform in the marketplace, since TMT backgrounds are reflected in firm performance (Hambrick and Mason, 1984).

Other researchers, such as Amason and Sapienza (1997) find that effective TMTs engage in cognitive conflict which facilitates different approaches to dealing with organizational tasks and performance issues. These differences in approaches can enrich the TMT decision making process in publicly traded SMEs. Further, the relatively smaller size and flatter organizational structures of publicly listed SMEs tend to foster the participation of their TMTs in a range of activities of the firm (Brunninge et al., 2007). Within this context, shared cognition is likely to facilitate consensus among top managers on strategy and performance related issues (Floyd and Woolridge, 2003).

Brunninge et al. (2007) indicate that larger TMTs are likely to have more resources, skills and increased cognitive diversity to result in better decision-making, and ultimately increased valuation of SMEs. According to these researchers, each TMT member may feel more comfortable to suggest alternative ideas to promote strategic change and, hence, enhance firm performance. Stewardship theory also indicate that the longer the tenure of the TMT, the better the performance of the firm. This is based on the premise that TMTs that are good stewards will retain their positions, than TMTs that are not good stewards for the firm (See Davis et al., 1997). Therefore:

Proposition 5a: Larger TMTs in publicly listed SMEs have a positive effect on the market valuation of such firms.

Proposition 5b: As the tenure of the TMT increases, the market valuation of the publicly listed SME will also increase.

DISCUSSION

Governance mechanisms and firm performance

Much of the work in corporate governance has focused on the design of governance mechanisms to encourage managers to make choices for the firm that will improve firm performance or value (Coles et al., 2001). Agrawal and Knoeber (1996) note, for instance, that problems of managers pursuing their own interests at the expense of shareholders can be reduced by increasing managers' ownership in the firm. This is true of other firms as it is of publicly traded SMEs. Hermalin and Weisbach (1991) suggest that firms perform better when managers have an important ownership stake in the firm. Similarly, other researchers reason that increasing managers' ownership in the firm can provide an incentive for them to act in their interest and that of other shareholders to improve the firm's market valuation or performance (Jensen and Meckling, 1976; Morck et al., 1998). In this regard, Morck et al. (1988) also note that significant remuneration, including salaries, bonuses and incentive plans are important reasons why managers are interested in the financial success of the firm (see also Hermalin and Weisbach, 1991).

In general, governance literate outline two broad categories of governance mechanisms that publicly traded SMEs in small, open developing countries can employ to align the interests of managers with those of shareholders, and thereby help address agency problems (Agrawal and Knoeber, 1996; Jenson and Meckling, 1976). These board categories of governance mechanism are (1) organizational monitoring mechanisms (including managerial leadership and board structure) and (2) top management incentive alignment mechanism (including compensation and ownership structure) (Coles et al., 2001). Prior research indicates that as managers of publicly trade SMEs acquire shares in these firms, they should be more motivated to pursue value-maximizing firm objectives (Jensen and Meckling, 1976; Hermalin and Weisbach, 1991; Morck et al., 1988). Evidence has also been found that suggests a positive relationship between concentration of ownership by institutional investors and firm performance (e.g., Agrawal and Knoeber, 1996; McConnell and Servaes, 1990); board composition and effectiveness and performance (e.g., Fama and Jensen, 1983; Forbes and Milliken, 1999; Hermalin and Weisbach, 1991); and top management team size and firm performance (Amason and Sapienza, 1997; Brunninge et al., 2007; Hambrick and Mason; 1984).

Although some researchers have provided evidence to the contrary, Agrawal and Knoeber (1996) observe that more concentrated shareholdings by institutional investors motivates effective monitoring of the performance of top management, which is associated with positive firm performance. In a similar light, Fama and Jenson (1983) argue that market pressures and directors' desire to protect their reputation motivate them to fulfil their board responsibilities, and should thereby contribute positively to the market valuation of publicly traded SMEs.

Organizational and environmental contexts

Firms select different configurations of corporate governance mechanisms to support their strategy and performance objectives, and most effectively deal with their specific organizational and environmental contexts (Coles et al., 2001). Accordingly, care should to be exercised in examining corporate governance and firm performance measures such as Tobin's *Q*, because Tobin's *Q* measure of firm performance and ownership structure are industry-specific (Demsetz and Lehn, 1985). In other words, the performance of publicly traded SMEs might be impacted by the industry in which they operate. Hence, SMEs in high performing industries, such as software technologies, for example, may tend to have higher *Q*'*s* than those in agro-processing.

Additionally, ownership structure may be highly dependent on the firm's industry (McConnell and Servaes, 1990) and industry environment can influence the types of managers found in top ranks. As these researchers note, for example, banking regulations require bank presidents to have significant banking experience. Because of the important effect of industry characteristics, all the propositions that have been presented should be thought to carry the implicit phrase, "within an industry;" and not necessarily across a diverse sample of organizations (Dalton et al, 1998). Likewise, to fully understand governance mechanism, other determinants and organizational characteristics such as market growth, industry concentration and regulation, and national culture should be considered (Coles et al., 2001).

Control variables

In examining the relationship between corporate governance mechanisms and the market valuation of SMEs is important to include relevant control variables that have been found to be important in determining firm performance. These include: firm age, firm size, EO, and industry performance (see Brunninge et al., 2007; Coles et al., 2001). Firm size, for instance, has been shown to be positively associated with CEO compensation, in that larger SMEs would generally tend to reward executives with larger compensation packages, including large share ownership (see Wernerfelt and Montgomery, 1988). Researchers have also provided evidence that industry effects typically predict between 17 and 20% of financial performance (Wernerfelt and Montgomery, 1988; Powell, 1996). For example, publicly traded SMEs in industries where there are growth opportunities or where markets are stable should enjoy higher profits and market valuations, than those in industries that are in decline (Hamel and Prahalad, 1994).

AVENUES FOR FUTURE RESEARCH

Further research will be undertaken to model the relationships indicated by the propositions. In this regard, suitable hypotheses will then be developed to test these relationships using multivariate analysis. For example, hierarchical multiple regression models will be used to evaluate the hypotheses, particularly interaction effects of different governance mechanism and firm performance. In these models, governance mechanisms will be operationalized as independent variables, while firm market valuation or firm performance will be operationalized as the dependent variable.

Moreover, further research could consider use of structural equation modelling (SEM) to investigate the relationships between the variables. This could be done in instances where increases in managerial share ownership is being evaluated to see whether it results in increased firm performance; and/or whether increases in firm performance results in increased managerial share ownership (see for e.g., Morck et al., 1998). Similarly, SEM could be considered in cases where the presence of outside directors is being evaluated to see whether it is positively associated with firm performance; or alternatively whether increased firm performance is positively associated with the presence of outside directors, which could result from SMEs becoming more diversified and/or increasing their international operations. In these instances, the use of SEM aligns with Dalton et al.'s (1998) meta-analytic review of governance literature, which indicates that analysis of governance variables in a univariate context is not particularly useful.

Although the importance of empirical statistical studies that examine the corporate governance–performance relationship within the context of SMEs cannot be discounted, there remains an important place for qualitative empirical studies which can explore the lived experiences of SME founders, family members, outside directors, top management team, institutional investors, and so contribute to our understanding of the corporate governance–performance relationship. In this regard, qualitative research can enhance our understanding of how the leadership of SMEs or the dominant coalition of these forms (see Hambrick and Mean, 1984), consider and implement corporate governance mechanisms to improve firm performance. Such research efforts could also benefit from relevant literature in psychology and social psychology to assess the role of values, attitudes, and culture on board and top management effectiveness, and the performance of SMEs.

Moreover, apart from providing useful insights for theory building in the area of SMEs corporate governance, qualitative research can also provide important guideline for regulators and policy makers to develop and define corporate reporting instruments to enhance transparency of publicly listed SMEs. In the case of Jamaica, for instance, such research could provide insights that could further improve corporate governance policies and reporting instruments among SMEs, listed on the Jamaica Junior Stock Exchange; resulting in improvements to the governance and financial reporting guidelines as set out in the JSE Junior Stock Exchange Rulebook (Jamaica Stock Exchange, 2009). Such research effort could, for example, unearth evidence that could lead to publicly listed SMEs on the Junior Stock Exchange being required to provide real-time, standardized financial updates and corporate governance disclosures that will enable the seamless calculation of Tobin's *Q* for these SMEs. Thus, facilitating the systematic and timely evaluation of the governance mechanisms of performance of these SMEs, while, at the same time, contributing to improvements in the market efficiency of the Junior Stock Exchange.

CONCLUDING REMARKS

This paper has considered the effects of a number of internal and external governance mechanisms on the market valuation or performance of publicly listed SMEs within a developing country context. In this regard, a number of propositions have been proposed regarding ownership structure, board structure, and leadership structure. These propositions have been informed by prior research and logic, and seek to advance theory development regarding how publicly listed SMEs might consider different governance mechanisms as substitutes and complements to maximize firm value (Coles et al., 2001). The propositions are not intended to represent all viable propositions concerning corporate governance and the performance of publicly listed SMEs, nor the only ones that can be advanced from past inquiry or reasoning; but to stimulate serious inquiry into the interrelationships between corporate governance mechanisms and the performance of publicly traded SMEs. These propositions are illustrative and appear to be some of the most supportable and interesting.

Undoubtedly advancing knowledge regarding the corporate governance–performance relationship of publicly traded SMEs, in open, developing economies has the potential to not only provide important insights for researchers, but inform corporate governance policy guidelines and assist policy makers and business owners to improve transparency of governance systems of SMEs. To this end, the leadership of publicly traded SMEs can be informed of possible combinations of governance mechanisms they can consider, within a specific industry context, to enhance firm performance. This paper provides important insights in this regard as it seeks to stimulate further research that will build theory and enhance understanding of how corporate governance mechanisms are associated market valuation or performance of SMEs in small, open, developing economies.

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