Stakeholders and Shareholders Interest: A Balance for Effective Corporate Governance in South Africa

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ABSTRACT

This study aimed to explore the corporate governance mechanisms and the orientation of corporate governance in Small and Medium Enterprises (SMEs) of South Africa. The core objectives of this study were to analyse the shareholder-stakeholder debate and its relationship with corporate governance in South African companies, understand the factors within shareholders and stakeholder interests that obstruct effective corporate governance and to assess whether these companies are effectively taking into account both the shareholders and stakeholders interests. To achieve the objectives, the study was designed as an exploratory, inductive, qualitative and cross-sectional research. 5 managers of SMEs in Pretoria, South Africa, were interviewed. The study found key insights into different areas, such as the Board, the Internal Audit, compliance, CSR, risk management and stakeholder management as implemented in the SMEs of South Africa. This study is significant for business students who are studying shareholder-stakeholder debate and how it impacts corporate governance principally in South African SMEs. The students can utilize the findings of this study to understand the relationship between corporate governance and stakeholders and shareholders. Furthermore, this study has important implications for investigators and researchers who want to explore corporate governance in South Africa. Corporate managers can use the findings in this study to compare their own corporate governance mechanisms to understand their orientation and find opportunities for improvement. Managers can also use recommendations made in this study to make improvement in corporate governance mechanisms and the overall system.
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I would take this opportunity to thank my research supervisor, family and friends for their support and guidance without which this research would not have been possible.
DECLARATION

I [type your full first names and surname here], declare that the contents of this dissertation/thesis represent my own unaided work, and that the dissertation/thesis has not previously been submitted for academic examination towards any qualification. Furthermore, it represents my own opinions and not necessarily those of the University.

Signed __________________  Date _________________
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CHAPTER 1: INTRODUCTION

1.1. Introduction to the Research

This research study aims to explore corporate governance mechanisms in Small and Medium Enterprises (SMEs) in South Africa in order to understand their orientation within the context of shareholder-stakeholder debate. Even though ‘Corporate Governance’ has garnered significant attention from media lately, it is still a relatively newer term in the corporate world. Corporate governance is the system used to direct and control organisations. This system also delineates the rights and responsibilities of the managers and the shareholders as well as the rules, regulations and procedures that facilitate decision making in corporate affairs. But, in a wider sense, corporate governance also takes account of the relationship of the organisation with a wider range of internal and external stakeholders of the firm (Ayuso & Argandoña 2009).

In corporate governance, two strongly opposing concepts have arisen over the last few years, resulting into a dynamic debate i.e. the debate of shareholders vs. stakeholders. One perspective that the advocates of entrepreneurship and free market economy propagate is that shareholder value is an effective formula for the opinion that organisations should work for the interest of the shareholders. The other perspective is propagated by the critics of globalisation who have normative doubts about the value of shareholders and therefore support the value of stakeholders which is achieved through a balance of the interests of various stakeholders in the decisions of management (Waldkirch 2008).

Therefore, this study critically analyses the debate of stakeholders vs. shareholders. The next section provides a brief contextual background of the debate, how corporate governance works in South Africa and the rights of shareholders and stakeholders.
1.2. **Contextual Background**

1.2.1. **Corporate Governance**

One of the most commonly used definition for corporate governance is presented by the Cadbury Committee that defined corporate governance as a system that controls companies and gives directions by (Mallin, 2007). According to Sapra, Subramanian, and Subramanian, (2014), corporate governance is an internal system that includes, but not limited to, processes, policies and people that cater the needs of shareholders as well as other stakeholders by controlling and directing activities by the firm’s management with good objectives and integrity. As such effective corporate governance depends on application and guidance standards in companies in a way that benefit solving issues related to conflicts of interests, control and transparency. Maria (2012) concurs by stating that effective corporate governance can be understood as a set of eight major characteristics such as fair participation, rule of law, transparency, responsiveness, consensus oriented, equity and inclusiveness, effectiveness and accountability.

Corporate governance serves as the means for stakeholders to control and determine the direction as well as performance of a company so that they can protect their interests. Shareholders, for example, adopt corporate governance mechanisms such as executive compensation to ensure that managers are working to maximise their wealth instead of self-serving while compromising interest of shareholders as well as other stakeholders. Thus, corporate governance is essentially aligning the interest of various stakeholders particularly shareholders and other stakeholders.

1.2.2. **The Shareholder vs. Stakeholder Debate**

Traditionally, it was a common belief that the sole aim of a business organisation is to maximise profit and maximise shareholders wealth. It is on the grounds that the owners of the
firms and the investors in the firm are the groups that lose the most in case a company closes and therefore, it is but natural for managers to pursue maximisation of profits to prevent closure of the business and ensure its survival in the long run. Corporate governance, within this context, refers to the systems and procedures that are put in place to ensure that managers are accountable, supervised, and controlled while making decisions for organisation (Diamond and Price 2012).

In addition, corporate governance ensures that managers act in the best interest of shareholders and investors. The primary interest of shareholders is maximisation of profits, however, not at the cost of longevity of the business. Thus, according to shareholder view of corporate governance, managers are responsible for ensuring that they make decisions for the business to achieve maximisation of shareholders wealth while also ensuring that business survives in the long term (Rossouw, Van der Watt, and Rossouw 2012).

Considering the logical and common sense as well as economic perspective, it is obvious that businesses are to make profit as it is their basic economic purpose. Businesses cannot survive and serve their purpose without making profits. But in 1970, one of the most famous economists, Milton Friedman highlighted that it is the responsibility of business managers to ensure compliance with the law and ethical customs of the society besides maximising profit for the shareholders. Friedman argued that corporations are artificial entities and like real people, they have social responsibilities towards the society and its people (Rossouw 2005).

Corporate governance is affected by the relationships among the actors in the system of corporate governance. Shareholders with controlling power, which may be individuals, family partnerships, alliances block or other companies acting through a group of companies or cross shareholdings, can significantly influence the behaviour of society. As owners of
equity, institutional investors are increasingly demanding more strongly to have a voice in the area of corporate governance in some markets (Ntim et al. 2012).

According to the stakeholder’s theory, any individual or group that has influence and is influenced by the operations of a business is a stakeholder. Typically, stakeholders include shareholders, customers, employees, government, suppliers, etc. (Garriga and Melé, 2013). Due to the separation of control (management has control) and ownership (shareholders have ownership), often, interests of various stakeholders in the business clash or contradict and it is important for managers to align varying interests of various stakeholders to ensure the longevity and sustainability of the company.

In addition, aligning stakeholders interests with those of shareholders has also been linked with higher profitability (Bair and Palpacuer, 2015). Creditors play an important role in various systems of government, and supervisors can serve as agents of company earnings. Employees and other stakeholders play an important role in contributing to the successful long-term partnership and the results of the same function, while governments establish the overall institutional and legal framework for corporate governance (Tricker 2015). The role of each of these participants and the interaction between them varies greatly according to the country in which they operate, and the same applies in the case of countries outside this organization. These relationships are subject, in part, to the laws and regulations, but also to voluntary adaptation and, most importantly, to market forces (Fig 2005).

1.2.3. Corporate Governance in South Africa

Corporate governance in South Africa is not a new concept. It gained momentum in early 1990(s), when international investors demanded revision of both corporate structures and corporate governance practices in order protect their investments (Muswaka, 2013). The reform of corporate governance in South Africa began in 1992 with the creation of the King
Committee on Corporate Governance under the auspices of the Institute of Directors in Southern Africa. The Committee, which was chaired by Mervyn King, a former judge and businessman, published the King Report on corporate governance in 1994 (Scholtz and Smit 2015). The report was used to guide the Cadbury Report in the UK, while it had the circumstances in South Africa under due consideration, especially entering the business sector members from communities that previously were disadvantaged in opportunity for a political transition to full democracy. The report focused on the composition of the board and its functions and processes, and covered the decision-making process and information dissemination (King Committee on Corporate Governance and Institute of Directors (South Africa) 2002).

Corporate governance in South Africa enjoys high esteem by many in the community of global investors. South Africa is one of the countries in which corporate governance code is attempting to comprehensively cover all commercial activities. The two King reports (1994 and 2002) resulted from the recognition that the economy dominated the commercial activities of companies not listed on the Johannesburg Stock Exchange (Abor and Fiador 2013). Many developing countries are in a similar situation, with a large number of small and medium enterprises and state enterprises that are not listed on their stock exchanges. In low-income countries, especially the number of listed companies is very small. Consequently, the need for corporate governance codes for the main companies that are not publicly traded, family businesses and banks is even greater (Oman 2003).

The main principles in corporate governance are (Mangena and Chamisa 2008; Ntim, Opong, and Danbolt 2012):

- The aim of a corporate governance framework is to ensure efficiency and transparency in markets, be consistent with the legal system and articulate clearly the
division of responsibilities among different supervisory authorities, regulatory and enforcement (Ntim, Lindop and Thomas 2013).

- A good corporate governance system should be developed with the aim to have impacts on overall economic performance and market integrity. It must create incentives for participants in market to encourage transparency and efficiency in markets (Ibid).
- Legal and regulatory requirements that affect corporate governance practices in a jurisdiction should be consistent with the legal, transparent and enforceable regime (Mangena and Chamisa 2008).
- The division of responsibilities among various authorities within the jurisdiction must be articulated clearly, to ensure that it is serving the public interest (Ibid).
- Supervisory, regulatory and enforcement authorities should have power, integrity and resources to fulfil their duties with professionalism and objectivity. Also, its regulations should be timely, transparent and have a detailed explanation (Ibid).

1.3. Problem Statement

Corporate governance traditionally focused on controlling management particularly directors and CEOs in way that they pursue maximisation of shareholders’ value. Consequently, the interests of the stakeholders were largely ignored and relatively irrelevant in corporate governance mechanisms. However, in last decade there has been a surge in the demand for more accountability as well as focus on stakeholders’ interest. The ideal situation is that corporate governance mechanisms must align interests of both shareholders and stakeholders (Muswaka 2015). In South Africa, the shareholder-stakeholder debate is central to corporate governance objectives as it determines what kind of corporate governance mechanisms are put in place by the board.
1.4. **Aims and Objectives**

This qualitative study aimed to conduct interviews to explore the corporate governance mechanisms in South Africa and explore the orientation of corporate governance system in SMEs of South Africa. The objectives of this study were:

- To explore the shareholder-stakeholder debate and its relation with corporate governance within the context of South Africa
- To identify and understand factors within shareholders and stakeholder interests that hinders effective corporate governance
- To explore corporate governance mechanism in South Africa and assess whether they meet the requirements of shareholder-stakeholder debate

1.5. **Research Questions**

- What are the corporate governance mechanisms in SMEs of South Africa?
- What is the orientation of South African SMEs within the context of shareholder-stakeholder debate?

1.6. **Rationale**

There has been an increasing awareness of corporate governance in business world, particularly after the fall of Enron and similar incidences in last decade. Several studies have explored the corporate governance in South Africa, such as Muswaka (2015), Muswaka (2012), Muswaka (2013), Esser and Dekker (2008), etc. However, most of the studies, including the studies by Muswaka and Esser and Dekker employed the strategy of content analysis of texts and documents to address the issue. Therefore, this research was driven from the observation that there was a lack of primary research exploring the corporate governance of South African companies, especially the Small and Medium Enterprises (SMEs).
1.7. **Significance of Study**

This study is important for business students focusing on shareholder-stakeholder debate and how it affects corporate governance particularly in South African SMEs. The students can use findings of this study to understand the relationship. In addition, this study has significant implications for researchers that are trying to explore corporate governance in South Africa. Corporate managers can use the findings in this study to compare their own corporate governance mechanisms to understand their orientation and find opportunities for improvement. Managers can also use recommendations made in this study to make improvement in corporate governance mechanisms and the overall system.

1.8. **Structure of Study**

Chapter 1 explains research background, rationale, aims and objectives, research questions, and significance of this study.

Chapter 2 presents critical literature review around the research topic and within the context of aims and objectives of this study.

Chapter 3 presents details of all methodological choices undertaken by the researcher in designing and conducting this study. Chapter 3 also presents brief discussion of ethical considerations as well as reliability and validity of this research.

Chapter 4 presents the results and findings of primary research conducted in this study. These results are also discussed within the context of results of secondary research presented in chapter 2.

Chapter 5 presents major conclusions drawn in this research as well as recommendations drawn in this study. This chapter also presents future research opportunities with the research topic.
CHAPTER 2: LITERATURE REVIEW

2.1 Overview of Corporate Governance

Corporate governance’s importance has been on the rise in modern companies due to the separation of management and ownership control in organizations. A widely used definition of corporate governance belongs to the Cadbury Committee which stated that it is a system by which companies are directed and controlled (Mallin 2007). According to O’Donovan (2003), corporate governance is an internal system that includes but is not limited to, processes, policies and people that serve the requirements of shareholders as well as other stakeholders by controlling and directing activities by the firm’s management with good objectives and integrity. As such, effective corporate governance depends on application and guidance standards in companies in a way that facilitates solving issues related to conflicts of interests, control and transparency (Gala 2011). Davani (2010) concurs by stating that effective corporate governance can be understood as a set of eight major characteristics such as fair participation, rule of law, transparency, responsiveness, consensus oriented, equity and inclusiveness, effectiveness and accountability.

A study by Rossouw (2008) about the corporate governance practices in balancing corporate and social interests in African region examined the claim that corporate governance can assist in achieving the balance between the individual, corporate and social interests on two stages. Firstly, the claim is analysed on the theoretical level and secondly, it is analysed on the practical level. On the theoretical level, it was revealed that the models of shareholders of corporate governance promote merely the shareholders’ interests and exclude those stakeholders which oppose the normative concepts of corporate governance, whereas the corporate governance model is most probably backs it. On the level of practicality of corporate governance practices in six regions including Africa, Europe, Latin America, North
America, Asia-Pacific region and Japan, it was found that these regions were almost partial between the orientation of shareholders and stakeholders.

2.2 Internal and External Corporate Governance

There are two aspects of Corporate Governance as argued in the study by Rossouw (2008). Both these aspects are important in understanding the concepts of corporate governance. According to the debate in this study, corporations can be governed from both internally or externally. Concepts of governing the firms from the board and executive management falls under the internal corporate governance while the influence in the functioning of a firm from the external bodies like legislative and regulatory bodies or the market in which the corporation is operating falls in the external corporate governance. Both internal and external controls are significant in influencing the effectiveness of practices and mechanism of corporate governance (Rossouw, 2008).

Corporate Governance has a very narrow scope if argued merely about the internal governance of the corporation. The commonly used definition of the corporate governance provided in the Cadbury report on corporate governance is that ‘the mechanism through which the corporations are lead or governed’ is based on this narrow aspect of corporate governance (Rossouw, 2002). However, the aspect of external corporate governance highlighted by the Rossouw (2008) is widespread and comprehensive. Moreover, the role of external factors which influenced and caused the alteration in mechanisms of corporate governance and conducts has also been highlighted by Malherbe and Segal (2001), according to whom, the external factors such as geology and political aspects affected the corporate conducts and structures in the most of the twentieth century and caused the unravelling of that framework in past few decades.
2.3 Importance of Corporate Governance

The Organization for Economic Cooperation and Development (OECD) has highlighted the importance of effective corporate governance internally and around the globe. Countries which want to have the full benefits of international capital and financial market and to gain the long-term and stable finance, their practices and policies of corporate governance should be adequate and effective across the boundaries. Even for the companies which do not depend on the foreign investments, effective corporate governance practices can boost the local investments (OECD, 2015).

Youssef (2009) described the importance of corporate governance and pointed out that good governance assures that the environment of the company is unbiased and transparent and the business is accountable for their impact and activities. On the contrary, poor corporate governance directs towards the mismanagement, corruption and wastages. It is significant to consider that even the corporate governance has emerged as a manner in which the joint stock and public limited companies manage their operations but it can be equally important for the state-owned companies, cooperatives and family businesses. Apart from the type of company, effective governance can deliver the sustainability for businesses.

Effective corporate governance can help South African capital and private corporate sector in successively gaining the savings specifically in foreign investment inflows and assure that the available capital or finance is allotted and managed effectively as much as possible (Malherbe and Segal 2001). The present South Africa can be considered as the new born baby who is fully aware by the importance of the good corporate governance but lacking the skills of comprehensively implementing and practising the strategies of effective governance (McGregor 2008).
2.4 Features of Good Corporate Governance

Good corporate governance is based on a set of features such as relationships between the company’s management, its Board including Directors and Committee Members, its stakeholders like members, shareholders and the mechanism comprised of policies and procedures which lead the company towards establishing, achieving and monitoring the goals (Australian Government 2010). Furthermore, there are many characteristics and features of the effective corporate governance identified in numerous of researches and literatures. Few of the features of good corporate governance are defined by the Australian Government (2010) as Strategy, Accountability, Performance and Compliance.

2.4.1 Strategy

Development and application of effective and transparent strategy background, planning, monitoring and adapting according to the rapidly changing corporate environment are crucial factors in good corporate governance (Australian Government 2010). Management and the stakeholders are associated strongly with each other in a long-term relation on good governance (UNDP 1997 as cited in Reform Government Surveillance 2015).

2.4.2 Accountability

The management and governing boards should assure the application of core processes of corporate governance in a manner that provide the staff and employees the timely, relevant and credible financial and functional information wherever required (Australian Government 2010: Tiwari 2015).

2.4.3 Performance
The pattern determined by the overall board and the members of board and other officers has a great impact on the integration and alignment of the governing ethics for an organization (Australian Government 2010).

2.4.4 Compliance

Board of directors and board members should assure the implementation of clear and transparent legislatives, contractual and regulatory model in association with roles accountabilities and responsibilities which is financially viable and sustainable in long-term prospect (Australian Government 2010). Transparency should be constructed on smooth flow of information. Furthermore, decision makers should emphasize on accountability in any kind of organization. The accountability can differentiate on the basis of nature of decision, internal or external (UNDP 1997) cited in Reform Government Surveillance (2015). Moreover, UNDP (1997) pointed out few other features of effective corporate governance such as participation, responsiveness, rule of law, orientation of consensus, equity, efficiency and effectiveness (Reform Government Surveillance 2015).

2.4.5 Participation

Each member or stakeholder should have a right to raise voice and participate in decision making of the enterprises (Reform Government Surveillance 2015).

2.4.6 Responsiveness

Enterprises should be responsive in order to work in the interests of all stakeholders (UNDP 1997 cited in Reform Government Surveillance 2015).

2.4.7 Rule of Law
Legislative and regulations should be impartial and in the good interest of each stakeholder of a corporation (UNDP 1997 cited in Reform Government Surveillance 2015).

2.4.8 Orientation of consensus

Good corporate governance arbitrates the distinguished interests of stakeholders to meet. A board must be consensual on what is best for the stakeholders, where and on through which policies and procedures (UNDP 1997 cited in Reform Government Surveillance 2015).

2.4.9 Equity

Each stakeholder has a right to avail opportunities for their wellbeing and interests (UNDP, 1997 cited in Reform Government Surveillance 2015).

2.4.10 Efficiency and effectiveness

Regulations and mechanisms should be effective and efficient enough in order to provide the equal rights and work in the interest of all stakeholders (UNDP 1997 cited in Reform Government Surveillance 2015).

2.5 Principles of Corporate Governance

The Commonwealth Association of Corporate Governance (CACG) outlined a set of 15 guiding principles based on the core guidelines determined by The Organization for Economic Co-operation and Development (OECD) (Commonwealth Association for Corporate Governance, 1999: OECD, 2015). The first principle among the CACG’s fifteen guiding principles argues that the governing and regulatory board should play a role in leadership, enterprising, integration and decision-making in leading the corporation in order to attain stable growth for the business and to work in interests of the whole enterprises and
stakeholders in a transparent, accountable and responsible manner (Commonwealth Association for Corporate Governance 1999: OECD 2015).

The second principle states that the governing committee and the board should assure that by effective and managed systems, board appointment are made which offer a combination of proficient directors all of whom are capable of adding worth and to bring sovereignty in decisions to tackle the decision making procedure (Commonwealth Association for Corporate Governance 1999: OECD 2015).

Third principle highlights that the directors’ board should set purposes and values of the organization, draft the strategies to attain its objectives and apply its values for the purpose of assuring that it persists and prospers, and assure that processes and procedures are in place which safeguard the organization’s image and financial position (Commonwealth Association for Corporate Governance 1999: OECD 2015).

According to the fourth principle, the regulatory board should assess and monitor the process of implementing policies, strategies, criteria of managerial performance and strategic business plans (Commonwealth Association for Corporate Governance 1999: OECD 2015).

The fifth principle states that the board of directors is responsible to work and perform their duties honestly and with complete carefulness and diligence in their corporate transactions and to assure that the business is prudent in each and every stage of the corporation (Commonwealth Association for Corporate Governance 1999: OECD 2015).

The sixth principle argues that the stakeholders require the accessibility to general, reliable and necessary information with obligatory details for them to evaluate the stewardship of their investment in shape of shares and other stocks for the purpose of future investments. Unclear or incomplete information can impact the confidence of stakeholders in corporation, its management and directors, which can result in increase in cost of capital for
the corporation and hinder the efficient allocation of resources (Commonwealth Association for Corporate Governance 1999: OECD 2015).

The seventh principle is that the directors of the corporation should be accountable in providing the legitimate rights and work in a manner towards the good interests of the shareholders of the company. The directors of the company should be accountable towards the stakeholders and they have to assure the stakeholders about their interests and their investments (Commonwealth Association for Corporate Governance 1999: OECD 2015).

Moreover, the eight principle states that for ensuring the interest of stakeholder and shareholders, the board should identify the corporation’s internal and external stakeholders and agree on a policy, or policies, determining how the corporation should relate to them (Commonwealth Association for Corporate Governance 1999: OECD 2015).

The ninth principle is that the governing board should assure that no individual or a group of individuals in corporation has uneven or unnecessary power and there should be an appropriate balance between the authorities and powers on board, which is reflected by the separation of roles of CEO and Chairman and balancing between the executive and non-executive director (Commonwealth Association for Corporate Governance 1999: OECD 2015).

Tenth principle for balancing the shareholders and stakeholders interests in corporation is that the directors should analyse the system and mechanism on regular basis to be sure on the efficiency and efficacy of its organizational controls, and consequently it will help in decision-making and improve its capabilities and accuracy in making decisions and reporting the financial and strategic position properly (Commonwealth Association for Corporate Governance 1999: OECD 2015).

The eleventh principle is that the board of governors should also evaluate its own performance and proficiency as a whole regularly, including each director and member of the
board as well as the chief executive (Commonwealth Association for Corporate Governance 1999: OECD 2015).

The twelfth principle is that the board should employ the CEO or at least contribute and involve itself in the appointment of top management and assure the encouragement and guard of effective capital inherence to the corporation, make sure that there is an apt training system in the organization for upper and lower level employees and management (Commonwealth Association for Corporate Governance 1999: OECD 2015).

The thirteenth principle highlights that directors should assure advancement in technology and innovation according to the changing technological environment around the world in order to operate the corporation in a meaningful manner for the long term interests of shareholders and stakeholders (Commonwealth Association for Corporate Governance 1999: OECD 2015).

According to the fourteenth principle, the directors’ board must determine and identify the potential risk zones and key performance measures for the purpose of evaluation the performance of employees, management and the overall business (Commonwealth Association for Corporate Governance 1999: OECD 2015).

The fifteenth and final principle is that the directors must assure that the corporations should focus on its strategic goals and the interests of each stakeholder in the next fiscal year and onwards (Commonwealth Association for Corporate Governance 1999: OECD 2015).

2.6 Challenges in Corporate Governance

At the moment, several countries are experiencing challenges in their attempt towards developing and designing effective corporate government principles which must be implemented properly and considered reliable as well. When the challenges are not dealt with in a proper manner, it could hinder the administration of the corporate companies
considerably and other vital institutions of the concerned economy. In order to address these challenges, the essential aspects of good corporate governance must be highlighted in a proper manner. The most common vital elements associated with good corporate governance are efficiency, probity, transparency, responsibility and accountability. Though, due to the current economic situation of the world, the implementation of good corporate governance principles is more crucial for having better economic standards in any country (Otuo 2013).

There are unique kinds of corporate challenges experienced by many organisations, where usually it is seen that bank ownership structures are severely complex, they do not have proper transparency level or controlling the shareholder’s exercise creates an inappropriate level of influence on the activities of company. Thus, efforts made to control shareholders can ensure effective beneficial resources for the company. It is though vital that supervisors must undertake all possible efforts in such a way where the ownership structures must not hamper the sound corporate governance measure for any country (Otuo 2013).

Specifically, supervisors must demonstrate strong ability in order to assess the fitness and propriety of significant amount of bank owners that also includes board members and senior managers as well. The general principles related to sound corporate governance need to be applied to either state-owned companies or state-supported banks. Such support can be even done on temporary basis (for instance, during the financial crisis in mid-2007, both national governments and or central banks provided important financial assistance to banks). In such cases, government financing or ownership (even if they are done on temporary basis) might create several governance challenges (Basel Committee on Banking Supervision 2014).

There are some of the countries that might experience special challenges while they are going to undertake measures in enhancing the concept of corporate governance. The existence of the current basic framework and mechanism for corporate governance had
evolved considerably in developed countries. Some of the examples in this regard include effective legal framework and supervisory process (Louw 2002). In many transitioning economies, independent judiciary and efficient capital markets are usually weak. The enhancement of the corporate governance framework and mechanisms can be only possible after acquiring the benefits such as improvement in the operational efficiency, large access to financing at a very low cost and improvement in the reputation of the company. These enhancements would go through an evolution phase with the passage of time as the countries would gradually progress from the level of minimum compliance, with overall regulatory requirements, to high level of commitment associated with sound governance (Basel Committee on Banking Supervision 2014).

2.7 Shareholders/ Stakeholders Interest and Corporate Governance

High levels of debates have taken place related to the shareholders/stakeholders interests since the concept of corporate governance became a management area of interest at a global level. At one end, there were arguments presented by authors such as Linda (2015) who stated that the main aim of the company is maximising the interest of the shareholders while. On the other hand, authors such as Letza, Sun, and Kirkbride (2004) adapted arguments which stated that companies must be managed in accordance with the interest of the stakeholders. From the global perspective, many researchers have adopted the view of Milton Friedman, that effective level of corporate governance basically follows the principles of corporate social responsibility, whose main purpose is to accelerate business activities and under this concept, shareholders’ interest carries high amount of significance. On the other hand, authors; Allen, Carletti and Marquez (2014) have presented a strong argument related to the interests of shareholders in the company’s decision making process in favouring or
giving stakeholders a fair and independent right in order to influence the companies’ activities in a considerable manner.

However, as stated by Muswaka (2013), it is an important fact that most of the traditional doctrine recommends companies to promote the interests and activities of shareholders, which is a part of the overall goals associated with meeting the needs of stakeholders. On a global level, in majority of the countries like USA, UK, China, India, Japan, Germany, Brazil and France, the legal systems provide high assurance that the companies give equal importance to both the interests of shareholders and stakeholders. Any business strategy developed to meet the interests of both stakeholders and shareholders must have a strong alignment with each other (Allen, Carletti and Marquez 2014).

In comparison, South African’s Companies Act does not have a clause in which the companies are supposed to consider stakeholders’ interest during the decision making for important issues. Only the issues related to both economic empowerment and environmental laws are covered in detail. From the above literature, it can be deduced that while this particular study clearly shows that both stakeholders and shareholders’ interest can have opposing views, at the same time, it has been argued by researchers that both these interests have strong compatibility with each other. They have even contributed considerably towards the company’s long-term efficiency and progress.

2.7.1 The Rights of Shareholders

1) The corporate governance framework should ensure equal treatment of all shareholders, including minority and foreign shareholders.

2) All shareholders should have the opportunity for an effective remedy in case of violation of their rights (Ntim, Lindop and Thomas 2013).
3) All shareholders of the same series within a category should enjoy equal treatment. Within any series of a given category, all actions must grant the same rights.

4) All investors should be able to obtain information about the rights attached to each series and class of shares, before making a purchase.

5) Any changes in voting rights should be subject to approval by the categories of actions that are affected negatively (Ntim, Opong, and Danbolt 2012).

6) Minority shareholders should be protected from abusive actions by, or in the interest of shareholders to control, acting directly or indirectly, and should also prescribe effective remedies (Oman 2003).

7) Custodians or depositories of the shares must cast their vote according to the previously agreed upon with the beneficial owner of the action (Fig 2005).

8) Processes and procedures for general shareholder meetings should allow all shareholders enjoy equal treatment.

9) The procedures within companies must not unduly difficult or expensive to cast votes (Rossouw, Van der Watt, and Rossouw 2012).

10) The use of privileged information and abusive treasury operations should be banned (Ntim, Opong, and Danbolt 2012).

2.7.2 The Rights of Stakeholders

1) The corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active cooperation between companies and stakeholders with a view to the creation of wealth and employment, and to facilitate the sustainability of companies healthy from a financial point of view (Abor and Fiador 2013).
2) The rights of stakeholders established by law or through mutual agreements must be respected (Scholtz and Smit 2015). In cases where the interests of stakeholders are protected by law, they should have the opportunity to obtain effective redress for violation of their rights (Tricker 2015).

3) Stakeholders should be allowed to develop mechanisms to encourage employee participation (Ibid). In cases where stakeholders participate in the corporate governance process, they should have prompt and regular access to relevant, sufficient and reliable information (Ibid).

4) Stakeholders, including individual employees and their representative bodies, must be able to freely express their concerns to the Council regarding possible illegal or unethical practices and their rights should not be compromised by making this kind of manifestations (Ntim et al. 2012).

5) The corporate governance framework should be complemented by an effective and efficient insolvency framework and by effective enforcement of creditor rights (Diamond and Price 2012).

2.8 Effectiveness of Corporate Governance

An effective level of director’s oversight has considerable value in any particular industry. Board and management oversight is the basic aspect to ensure a sound and safe organisation. It can be said that the director oversight is recognised as a primary element that enables the organisation to move in a positive direction and it is certainly a critical aspect for them to achieve high level of success (Muswaka 2015). For instance, in USA, the Federal Reserve and other banking regulators had acknowledged the significance of the need associated with having a strong director’s independence and collaborative board interaction (Muswaka 2012). This has been reflected in several supervisory policies and examination
manuals as well, utilised by the examiners at the Federal Banking Agencies. Among the board’s several responsibilities, four areas which have a strong contribution towards the successful performance of the organisation include (Muswaka 2013):

1. Establishing the risk philosophy for the bank, that consists of both the aggregate level of risk and tolerance for risk;
2. Providing high assurance that the bank has adopted several measures related to appropriate risk management framework in order to manage and then mitigate risk as well.
3. Helping the bank to be on the right direction after effectively determining their overall business strategy.
4. Ensuring best possible measures for effective monitoring regarding the implementation of the strategy in order to ensure that the bank’s strategic objectives are being achieved within the structures of risk management framework.

2.9 History of Corporate Governance in South Africa

Corporate governance in South Africa originated in 1994, when international investors demanded overhaul in both corporate structures and corporate governance practices in exchange for their investments (Kakabadse and Korac-Kakabadse 2002). There was an enlargement in the aspect of equity financing by playing a key role in South Africa due to the occurrence of three major events since mid-90s which have encouraged the renovation in the mechanism of corporate governance (Malherbe and Segal 2001):

- First, in mid-90s, South Africa returned to the global market economy.
- The second major event emerged during 1997 and 1998 when the crisis hit the evolving market of South Africa.
• The third major event was the equity issues from 1998 onwards in the local industry of South Africa which caused the halt especially to the small and medium sized organizations.

Although many efforts have been made in the Companies Act to assure the interests of overall stakeholders apart from mere shareholders, apparently the regulations and legislations are far away from effective offering of stakeholders rights (Muswaka 2015). By late 1980s, there was a majority of South African companies who were either distended, had no focus and were run by managers who had poor approach towards their work. These companies had sustained and developed in a totally different environment from the one that is seen in the advanced nations and capital markets. The major element of the South African environment was isolation. The economic measures such as high tariffs and political isolation did not indulge domestic firms to engage in competition with foreign companies.

At the same time, financial sanctions also kept entire international institutions out of the domestic capital market and South African companies out of international capital markets as well. All the corporate practices followed were not compatible with the international norms, as were both laws and regulations. Though after 2001, the situation started to show signs of improvement in South Africa, because of the measures associated with political reforms, engagement and change which marked the first step in replacing the isolation and static element (Stephan & Nick 2001, 98).

All the corporations of South Africa, their managers and domestic shareholders have been exposed in large especially after the succession towards new political system, rapid trade liberalisation and high pace of regulatory reforms. The rapid level of changes is all associated with the development path taken by South Africa after they became a democratic state. When the newly elected government came in power in 1994, they chose to avoid confiscation of property and undertook all possible measures to acquire optimum level of
growth that helped in financing the expansion of social services and generating more employment as well in the economy. To acquire high level of growth, South Africa would need to accelerate the mobilisation of both domestic and foreign capital, along with the efficient utilisation of the capital (Louw 2002).

Therefore, the fundamental role of the capital market and private firms became very important in the government’s plans. It was a surprising policy choice that was achieved at a considerable political cost. Seen from this perspective, the concept of corporate governance became very important for all the companies in the South African economy. In this way, the importance of the quality of corporate monitoring and decision-making creates a strong impact on both the stability and growth prospects of an economy (Louw 2002).

2.10 Analysis of the Corporate Governance in South Africa

The King Reports, along with the legislative developments that have resulted from all these reports, were prepared solely with the aim of strengthening corporate governance standards in South Africa and then increasing their alignment with the international best practice. Before this measure, earlier, the failures in Corporate Governance in South Africa had affected businesses considerably. It strongly damaged the perception associated with the Corporate Governance standards and quality. In regards to the condition related to international investor’s confidence, a continuous review associated with South African corporate governance structure is necessary. The institutional environment in South Africa (i.e. the controlled shareholder environment along with inactive and illiquid markets as well) does not allow the model mechanisms of the US and the UK in playing a much bigger monitoring role (Irene 2014).

Though, there have been further market model mechanisms in this regard which had aimed at promoting the independent monitoring of the management (Irene 2014). These
mechanisms have been largely incorporated into the South African Corporate Governance Framework. Though, the ongoing failures associated with large listed and unlisted organisations that comprises of smaller banks in South Africa have mainly been because of the poor implementation and enforcement measures associated with effective corporate governance in South Africa. For such companies, the concerned authorities have recommended the important monitoring guidelines included in the King Reports. The German and Japanese Bank Governance Model have a very limited application in South Africa. The level of bank’s debt financing is usually lower in comparison with equity financing, thus restricting the ability of the bank to become monitors with the help of debt control rights (Linda 2015).

In accordance with King Reports, directors need to perform various duties. These include statutory duties in terms of the Companies Act 71 of 2008 that includes other legislations as well such as the common law duties which have been partially codified as well in the Act. They are also liable to perform any duty, which the company’s Memorandum of Incorporation (MOI) or a separate agreement would recommend. There are majority of the duties that have been included as a part of case law. In such a situation, all the directors, both executive and non-executive needs to perform their fiduciary duties, duty of care, skill, diligence and law (Alexandrea 2014).

Thus, in relation to all these duties, same legal rules apply for all directors. The Company Act has introduced several numbers of provisions that is related with the standards of conduct of directors. Section 76(3) (b) of the King’s Report states that directors need to exercise their powers and perform the functions of director in the best interests of the company. King’s Report is providing a good direction to all the South African companies for having the right strategy in adopting the best possible Corporate Governance policy in the future (Alexandrea 2014).
2.11 Balancing Act of Corporate Governance

The assessment of global corporate governance practice, in terms of their overall capability in balancing the corporate, societal and individual interests, matters when it comes to the debate for global corporate governance convergence. The reason for the assessment against this specific backdrop is to determine the overall support that the current literature related to global corporate governance practices is providing in accordance with the overall progress in the global convergence of corporate governance regimes around the world. There are many other scholars who are not much optimistic regarding the inevitability of such a convergence (Kevin 2012). Many researchers have cautioned against high level of optimistic expectations associated with convergence and have highlighted the need related to the identification of factors that might constrain a speedy convergence.

For instance, the researchers have been quite dismissive of the idea related to the global convergence in corporate practice. They have rejected this particular idea, which has been termed as “one size fits all” approach and provided an argument that all those people supporting the convergence idea have done it on the basis of a very small unrepresentative sample of countries. Moreover, they also believe that the high amount of cultural differences that exists among several countries and regions further makes the concept of convergence very unlikely and unwanted as well. The researchers’ were also pessimistic regarding the overall prospects associated with idea of convergence. They in fact also identified variety of factors which have strong relationship with resistance related to the convergence of corporate governance principles. The factors that had been identified are ownership structures, corporate rules of a specific country or region along with the cultural values and political ideologies as well. Therefore, there are several for and against arguments related to the balancing act of Corporate Governance. It is an important issue which needs further discussion in the future (Louw 2002).
CHAPTER 3: METHODOLOGY

3.1 Introduction

This chapter presents the methodological framework upon which the research is based. The chapter begins with philosophical assumptions undertaken by the researcher in terms of epistemological considerations and ontological considerations. This is followed by explanation of research approach, research strategy, research design, data collection methods, data analysis methods, sampling method and technique, etc. Ethical considerations and reliability and validity of the study have also been discussed.

3.2 Epistemological Considerations

The epistemological considerations refer to the assumptions undertaken in the study with respect to how the researcher views the world. The aim is to explain how acceptable knowledge is gained and the nature of methods and ethos of gaining acceptable knowledge. There are two contradicting views about acceptable knowledge that are the basis of two conflicting schools of thought. The positivism school of thought asserts that in order to gain acceptable knowledge in social research, methods and principles of natural sciences can be applied (Bryman and Bell 2011). On the other hand, another school of thought, namely interpretivism, asserts that methods and techniques of natural sciences cannot be applied in social research. This is because the subject matter of social phenomena is different as compared to the subject matter of natural phenomena. Therefore, in order to gain acceptable knowledge it is important that social science researchers use a separate strategy to study social phenomena (Wilson 2014).

In this study, the phenomena under consideration are corporate governance and mechanism applied in SMEs of South Africa for corporate governance. The subject matter of
this phenomenon is the orientation of mechanism within the context of shareholder-
stakeholder debate which is by nature qualitative and thus methods and techniques of natural
sciences that are used to study quantifiable phenomena were not applicable to this study.
Thus, this study assumes that in order to gain acceptable knowledge of corporate governance
mechanisms in South Africa and their orientation, methods and techniques of social sciences
were more appropriate. It indicates that a separate research strategy is required and therefore
interpretivism is more suitable epistemological position for this study.

3.3 Ontological Considerations

Ontological considerations refer to the philosophical assumptions of the study with
respect to the nature of relationship between phenomena under consideration and related
social actors. There are also two contradicting schools of thought in ontological discourse.
There is objectivism school of thought that argues that social phenomena are independent of
actions and behaviour of related social actors (Eriksson and Kovalainen 2008). This implies
that social phenomena are beyond the reach of social actors and are not affected by changes
in their actions and behaviours. On the opposite, there is constructionism school of thought
that asserts and argues that social phenomena are not independent of social actors. They are
in a constant state of change due to changes in the actions and behaviour of social actors
(Myers 2013).

The social actors of corporate governance mechanisms in South African SMEs are
managers, academics, regulatory authorities, shareholders, as well as other stakeholders. It is
obvious that the social phenomena are subject to changes in the actions and behaviours of
social actors and therefore they are in a constant state of change. There have been significant
developments in corporate governance scenario in the past two decades. Thus, the natural
ontological choice for this study is constructionism.
3.4 Research Approach

There are two different research approaches. If the study begins by collecting general information such as a theory and continues to conduct analysis to make specific conclusions; it is deductive reasoning or “top-down” approach. On the contrary, if the study begins by collecting specific observations and works forward to make general conclusions; then it is called inductive reasoning or “bottoms-up” approach (Denzin and Lincoln 2011).

This study began by collecting specific observations from research participants and continues to analyse data to identify the influence of shareholder-stakeholder debate on corporate governance mechanisms in South African SMEs. In other words, this study aimed to make general conclusions about the corporate governance mechanism and orientation of SMEs in South Africa. Thus, the research approach of this study is inductive or the bottoms-up approach.

3.5 Research Method

There are three types of research methods: qualitative, quantitative, and mixed method. Quantitative research methods possess high level of verifiability and are based on methods of natural sciences. Researchers must collect quantifiable data to conduct quantitative research. However, when it comes to experiences and opinions of people quantitative research fails to gain reliable results. Qualitative research is adopted to study experiences and opinions of people and qualitative researchers collect qualitative data. However, qualitative research has relatively low verifiability and higher level of bias. Mixed research is the one that is hybrid of both quantitative and qualitative methods. Mixed methods approach overcomes weaknesses of the other two methods as it collects and analyses both qualitative and quantitative data. Research methods are chosen in accordance with the
epistemological and ontological assumption undertaken in the research (Bell and Bryman 2011).

In this study, the epistemological and ontological choices show that methods of natural sciences are not applicable and furthermore, the actions and behaviours of social actors are important. Since quantitative research uses natural sciences methods and techniques and qualitative research is adopted to study behaviours and actions of people, therefore the most suitable research method for this study is qualitative research.

3.6 Research Design

Research design refers to the choices of data collection method and timeframe chosen in the study. There are various types of study, cross-sectional, longitudinal and sequential (Bryman 2012). Cross-sectional study is one that collects data from a sample of population at a specific point in time (Creswell 2013). This study is cross-sectional as it aimed to collect data from managers of SMEs in South Africa at one specific point in time as due budget and time available for research were limited and the researcher of this study could not conduct repeated observations as in case of a longitudinal study.

3.7 Data Collection Methods

Primary data collection and secondary data collection are the two methods of data collection. Primary data is the data that has not been collected before and is collected through observation, surveys, interviews, focus groups, etc. Each of them has its own benefits and limitations. For example, the most popular data collection methods in qualitative research design are interviews and focus groups. Focus groups are conducted by gathering a number of research participants at the same time on the same venue in order to discuss the research issue in detail. The researcher collects opinions and experiences of research participants by
Posing questions that are debated by the participants (Bryman 2012). Surveys are the most widely used method for primary data collection. They are easy to administer and cost-efficient. However, surveys are mostly used in quantitative research to collect quantifiable and measurable data. Therefore, surveys were not suitable for the purpose of this research.

Individual Interviews on the other hand are the most widely used method in qualitative research (Bryman 2004). This research collected data by conducting individual interviews because confidentiality and anonymity are major ethical considerations in qualitative research. They are beneficial in the way that they ensure high level of confidentiality and anonymity. The interviewer has much greater control on the focus of debate; therefore it is easier to collect qualitative data through interviews. However, interviews can be time consuming and relatively expensive as they require travelling (Creswell 2013). There are three types of interviews; structured, semi-structured, and unstructured interviews. This study used semi-structured interviews to collect data.

Secondary Data is the data that is already collected by other people and exists in the form of books, published research articles in journals, research reports, etc. For this study, secondary data was collected for literature review through journal articles, books and Internet sources. Additionally, the annual reports of South African SMEs were also consulted.

3.8 Sampling Technique

Sampling technique refers to identifying a sample from target population in order to conduct research because it is not possible for researcher to collect data from whole population. The sample and the data collected from the sample are assumed to represent the whole population (Seidman 2013). In this study, the target population included all the managers of all SMEs in South Africa, as such, it was impossible for the researcher to collect
data from all of them. Therefore, a sample was drawn from this population using a sampling technique.

There are several sampling techniques which are broadly classified as probability and non-probability sampling. In probability sampling, all members of a population have equal chances of participating in research while in non-probability sampling; this is not the case (Merriam 2014). This study used non-probability convenience sampling technique due to time and budget constraints. Convenience sampling refers to recruiting participants based on proximity or the convenience of the researcher to access research participants as near as possible. The final sample size was 5 managers of 5 Small and Medium Enterprises in Pretoria, a city in Gauteng Province in South Africa. The sample size was kept small because interviews generate huge amounts of data which can be difficult to code and analyse. The managers were contacted through their LinkedIn profiles. The participants were all male and had at least 3 years of experience of corporate governance.

3.9 Data Collection Procedure

The researcher obtained email addresses of managers in SMEs of South Africa from publically available information from social media website LinkedIn. An interview brief was emailed to 15 potential participants, to explain the intent of the study and the role of the participants. The interview brief contained information about the research aims and objectives, ethical considerations, and consent form. 5 of them responded and signed consent forms. An appointment was set with each of them as per their convenience and face-to-face interviews were conducted. Each interview lasted for about 30 minutes. The interview questionnaire was semi-structured (See Appendix 1). The interviews were recorded with the permission of the participants and transcribed for analysis.
3.10 Data Analysis Technique

Data analysis techniques refer to techniques that are applied on the collected data to derive meaningful information for the research. The results induced by applying data analysis techniques are actually the results of the research which are then used to draw conclusions for the research. There are several well-established data analysis techniques for qualitative data, for example, Thematic Analysis, MaxQDA (software for Qualitative Data Analysis), etc. This research used Thematic Analysis to analyse data and derive meaningful information for results of this research (Vaismoradi, Turunen, and Bondas 2013).

Thematic analysis was chosen in order to address some issues in qualitative research. Two key aspects in the process of qualitative research are the registration and systematization of information; these tasks are fulfilled in time between collection and production of information and understanding or interpretation of it (Marshall and Rossman 2014). The complexity in this type of research is that much of the information is related to perceptions, attitudes, myths, opinions, feelings, emotions, lifestyles, values, attitudes, insights from common sense, among others, collected through field notes, documents, photographs, recordings, which is of some difficulty for recovery if they are not working from the start with a particular form of organization that allows relevant and agile recovery (Thyme et al. 2013).

The work of recording and systematizing becomes difficult not only for the time required, but because of the emerging use by researchers of uniform systems for describing documents and information generated in the fieldwork and proper allocation. The files of investigations usually are designed for personal use of the Investigator, leading to future studies on related topics, from reviewing documentation should already be analysed or of collecting information that already exists again (Bryman and Bell 2015). These personal systems not only limit the exchange of information, even among members of the research
team, but can lead to loss of registration errors or omissions, hampering recovery and interpretation (Ritchie et al. 2013).

In order to organize the information collected and produced in the development of research, understanding and interpretation guide and make possible recovery, the researcher or research team requires establishing criteria and registration forms and systematization of information (Ritchie et al. 2013); this is where it makes sense to think of an alternative as raised from the thematic analysis. Any proposal for systematization should be part of the epistemological and methodological approach to research, as well as the objectives, the context in which the research is conducted, the subjects involved and the resources that the process is supported (Bryman and Bell 2015).

The epistemological and methodological framework for thematic analysis is the social phenomenology of Schutz (1932/1967). As mentioned, the social phenomenology is a comprehensive and interpretive theory of social action that explores the subjective experience in the world of everyday life for people in which raw "common sense" (Thyme et al. 2013). From this approach, it is considered that people living in the world of everyday life are able to attribute meaning to a situation; therefore, it is the subjective meaning of experience of managers of South African SMEs which is the subject of this study (Marshall and Rossman 2014).

3.11 Ethical Considerations

Ethical considerations are very important in research and particularly in qualitative research involving human participants. Ethical considerations are adopted throughout the process of research to show integrity with research community and research participants. With respect to research community, one of the ethical considerations for secondary data collection in this study was to prevent plagiarism which is one of the most serious academic
and research misconducts (Miller et al. 2012). Plagiarism was avoided by using Harvard referencing style to give proper credit to the authors.

With respect to research participants there are also various ethical considerations. Firstly, confidentiality and anonymity of participants was maintained in this study by avoiding the use of names of participants in reporting results and conclusions (Creswell 2012). This study does not use any information that can lead to the identification of interviewees. Furthermore, the name of SMEs that the participants belonged to also had to be kept confidential to comply with the request of the research participants. Another significant ethical consideration was gaining consent from participants. Proper consent forms were obtained from all participants mentioning that the participant was free to involve in the research and free to quit participation at any point during the research process, particularly data collection process, without any obligation.

3.12 **Reliability and Validity**

In qualitative research, reliability refers to the degree to which research methods and techniques applied in research are replicable and can be conducted by any other researcher at another point of time. On the other hand, validity of qualitative research refers to the degree to which methods and technique applied in research are expected to produce similar results if conducted by other researchers at other point of time (Sarantakos 2012).

This study attempted to establish reliability by presenting explanations and justifications for all the methodological choices made in this study. Other researchers can easily replicate this research and techniques applied in this study at any other point of time by using details provided in this study. Furthermore, the role of researcher in this study was important therefore the researcher remained unbiased throughout the interviews so as not to
contaminate the results of the study by influencing the responses of the participants. Therefore, it is assumed that there is reasonable degree of reliability in this study.

However, it is to be noted that this study is based on interviews focusing on opinions and experiences of managers. Opinions and experiences may change over time and therefore results derived from methods and techniques in this study may be different even if the same participants are interviewed again. However, it is assumed that experience and opinions of participants regarding corporate governance mechanisms are not expected to change to such a degree in short or medium term that there are significant differences in results and conclusions. Thus, it is assumed that there is reasonable degree of validity in the results and conclusion of this study.
CHAPTER 4: RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents findings of the primary research of this study. As explained earlier, the primary research based on individual interviews was conducted with the managers of SMEs in Pretoria, South Africa. The results are presented within the context of research questions that were formulated in the introductory chapter. This chapter begins by presenting various corporate governance mechanisms in SMEs of South Africa. The orientation of all corporate governance mechanisms is discussed in the discussion following the findings of primary research so that the overall picture of corporate governance in South African SMEs can be explored. The chapter ends with a summary of the key findings.

4.2 Corporate Governance Mechanisms in SMEs of South Africa

4.2.1 The Board

The Board is the foremost and probably the most effective corporate governance mechanism in any organisation (Bushee, Carter, and Gerakos 2013). All of the participants opined that the board of directors in their organisation is composed of owners and major shareholders. The number of members of the board is limited because in SMEs typically shareholders are limited and the boards mostly consist of executive directors as members. One of the participants reported that there are no independent directors of the board. Most of the participants admitted that the appointment of board members is made by the shareholders, particularly those who have a good number of shares in the company.

SMEs typically do not have company secretaries. One of the participants reported that the company secretary in his organisation was the CEO who was also a board member. The CEO plus director plus secretary held around 51% shares of that organisation. None of the
organisations had any board committees having formal terms of references to appoint board members. All of the participants said that the CEO of their organisation also held a board member position. 3 out of 5 participants reported that the remuneration of CEO and directors was aligned with profitability of the organisation. Only 2 of the participants said that bonus payments and remuneration of their CEOs were aligned with the profitability as well as corporate social responsibility (CSR).

4.2.2 The Internal Audit

Another effective corporate governance mechanism is the internal audit function. An internal audit function ensures that the internal control mechanisms and risk management approach of the organisation are aligned with long term survival of the company. It also affects, up to a limited degree, the risk taking behaviour of CEOs and other executives (Xinzhen and Bank 2015). A majority of the participants reported that there are no formal internal control departments. One of the participants reported that there are formal internal control processes and mechanisms, however, they are formulated and implemented as well as monitored by the CEO. Another participant reported that there have been significant accountability issues due to the lack of formal internal control and because the organisation was undergoing a development of internal control mechanism and was also seeking to appoint an internal audit manager.

One of the participants highlighted the fact that an internal audit department was lately established in the organisation and that the company was beginning to realise the benefits of an independent internal audit. One of the participants reported that there were significant issues regarding the financial health of the organisation and one of the reasons in his opinion was the lack of internal control. He also revealed that there had been various incidents of fraud and mismanagement by one of the key executives. Those incidents have
stressed on the need of internal audit function in the company. Overall, there is a lack of formal internal audit function in the SMEs.

4.2.3 Risk Management

Risk management is one of the core aspects of corporate governance as it serves a significant role in this domain, which is controlling and managing corporate decisions while ensuring longevity and sustainability of the organisation. It is important to note that profitability and organisational sustainability are key interests of shareholders while the stakeholders’ interest may not align with those of the shareholders’ (Aebi, Sabato, and Schmid 2012). All of the participants accepted that risk management is performed by the board of directors and that there are formal risk management processes and mechanisms in their organisations. Two of the participants revealed that most of the risk management processes focused on the financial risks facing the business. They focused on risks to profitability and liquidity of the company.

One of the participants reported that there is a risk manager besides the board who was accountable to the board. The risk manager coordinated with the CEO and other department heads in identifying and managing various risks by using risk registers. One of the participants reported that the board planned and implemented an annual risk management plan which was reviewed and monitored on a continuous basis. Another participant reported that there are no formal risk management processes; however, each department head was accountable to the CEO regarding risk and their management in the organisation. Overall, it can be observed that a majority of the SMEs have formal risk management procedures, but much of the risk management is focused on financial risks.
4.2.4 Compliance

Compliance refers to the degree to which various governance processes are compliant with those required or recommended by the regulatory authorities. In South Africa, the corporate governance system and mechanisms are subject to the King report. The latest report, King III, was published in 2009 and recommendations made in this report is applicable to “all entities regardless of the manner and form of incorporation or establishment and whether in the public, private or non-profit sectors” (KPMG 2009, p. 1). When participants were asked about the degree of compliance to the recommendations made in the King III report, a majority of the participants reported that there is a low degree of compliance, particularly in terms of composition of the board.

One of the participants opined that the organisation lacks sufficient resources in terms of human resource and financial resources to comply fully with the King report. Another participant simply said that the company could not afford to appoint independent non-executive directors. Similarly, a fee for the membership of remuneration committees, audit committees, risk management committees, and others, as recommended in the King III is increasing (PwC 2013), making it difficult for SMEs to comply with them. Two of the participants highlighted the fact that there is a high level of compliance with respect to the external audit and IT governance in their organisation, but there was little compliance to internal audit and board composition.

4.2.5 CSR

The very concept of CSR and related corporate activities has emerged from the concept of stakeholder management (Jo and Harjoto 2012), and thus it can be safely assumed that if a company is paying significant attention to CSR then it reflects good stakeholder
management. According to Jeppesen (2012), the awareness of CSR in South African SMEs is relatively high yet the application of effective controls and mechanisms is relatively low.

This study found similar results. One of the participants highlighted a number of CSR activities, but pointed out that these activities heavily focus on working conditions and labour practices as it was a construction company. Another participant opined that the CSR activities with respect to the environment such as carbon footprint and waste management are the focus of the organisation. This is because, according to the participant, such activities had a positive impact on the companies’ brand and profitability. One of the participants revealed that their board actively promoted the CSR activities and had a number of processes related to CSR. The focus was also the employee and the environment safety. Another participant stated that although there was a high level of awareness in the company board, there were no formal procedures to address the CSR concerns. Another participant expressed that there was no focus on the CSR activities whatsoever in his organization. Overall, it can be observed that there is a high level of awareness, but SMEs pursue the CSR activities because of their impacts on profitability. It can also be observed that there is no awareness or relationship of CSR activities in South African SMEs with the aim to enhance corporate governance.

4.2.6 Stakeholder Management

Lastly, this study asked the participants about stakeholder management of their organisations. One of the participants reported that stakeholder management is not a significant issue in the organisation and most of the stakeholder management is in the hands of the executives. Another participant identified that most significant stakeholders in his organisation were suppliers and third party contractors with whom the board members faced and managed conflicts. However, there are no formal conflict management procedures. Another participant opined that stakeholder management was not much of an issue for the
company as main stakeholders of the company are shareholders, employees, and suppliers, all of whom are satisfied. Since there are no issues, therefore there are no formal processes.

One of the participants reported that the main stakeholders of his organisation are its customers as it was a service business and there were formal and strict processes for conflict and stakeholder management. However, it was observed that customer management was mainly due to profitability reasons and the company did not focus on other stakeholders (Claessens and Yurtoglu 2013). Overall, it can be fairly opined that there are no formal stakeholder conflict management procedures in South African SMEs. Stakeholder management is not considered a part of corporate governance and neither as a mechanism for corporate governance.

4.3 Discussion

In this section, the study discusses the findings within the context of broad literature and attempts to find the orientation of existing corporate governance mechanisms in SMEs of South Africa. First, the study found that one of the most effective corporate governance mechanisms is the board and boards in South African SMEs are composed of owners and major shareholders. This implies that naturally as the board is responsible for corporate governance, therefore shareholder interests are the focus of these mechanisms (Bednar 2012). Secondly, the study also found that a majority of the SMEs lack formal internal audit functions and there is little to no awareness that internal audit is a significant mechanism for corporate governance (Bednar 2012). Those who have or are establishing internal control are doing so to cater financial needs. Thus, again, it is inferred that the orientation of internal audit is not stakeholder management but shareholder management.

In addition, the study found that risk management is a significant aspect of corporate governance (Nicolăescu 2012) and in South African SMEs the focus of risk management of
the majority of SMEs is to address the financial risks. Managing financial risks is a priority mainly to maximise profitability. This implies that shareholder interests are more focused compared to the stakeholders. Considering the compliance of an organisation with the regulatory environment as a corporate governance mechanism (Shaoul, Stafford, and Stapleton 2012), this study found that a majority of the SMEs focus on external audit and IT governance. This is done primarily to prevent financial losses in the form of fines and penalties that may be caused by non-compliance. This implies that the orientation of corporate governance mechanisms in South African SMEs is again towards shareholder interest instead of stakeholders.

The study also found that there is a high level of awareness among South African SMEs regarding the CSR concept (Hřebiček et al. 2014) and its importance particularly because it affects the financial performance of the company. Overall, it was found that there are CSR activities, but the aim is not to use them as a corporate governance strategy and rather as a tool to maximise financial performance and to manage the brand, etc. This implies that the CSR activities conducted by SMEs are to manage shareholder interests instead of stakeholders. Finally, the study found that stakeholder management is not a significant issue in South African SMEs. SMEs usually identify one or two main stakeholders and focus on them to keep them satisfied. Again, there are financial reasons to manage main stakeholders (Bushee, Carter, and Gerakos 2013). It was also found that CSR activities are not linked with the corporate governance concept. Therefore, it is inferred that the orientation of corporate governance mechanisms in SMEs is towards the shareholder, not stakeholder, interests.

This chapter concludes that there are corporate governance mechanisms in SMEs of South Africa; however, the majority of these mechanisms of corporate governance is to safeguard shareholder interests instead of the stakeholder interest. This study inferred that this orientation is mainly because of the fact that a majority of the board in SMEs is
composed of owners and shareholders and therefore they tend to safeguard their own interest as compared to other stakeholders. Major conclusions and recommendations are presented in the following chapter.
CHAPTER 5: CONCLUSION AND RECOMMENDATIONS

5.1 Conclusions

This study conducted both primary and secondary qualitative research to explore what are the corporate governance mechanisms in SMEs of South Africa. On the basis of results and findings, this research concludes the following:

- There has been a rise in awareness regarding corporate governance in South Africa since 1992. Since then, there have been significant and positive developments in corporate governance in the country. There have been three milestone reports under the title King Report (last revision was published in 2009) that explicitly deal with the principles of corporate governance and related corporate governance mechanisms that are to be adhered by all business entities in South Africa. These reports are comprehensive and show that the business environment in South Africa is highly focused on corporate governance.

- The study also concludes that there is a significant role of shareholder-stakeholder debate in the development of corporate governance framework. In South Africa, the King III adopts and promotes an inclusive approach to corporate governance for stakeholders and recommends that the legitimate interests of various stakeholders such as suppliers, employees, regulators, customers, community, and environment should be recognised and integrated instead of keeping the shareholder’s interest over and above the stakeholder interest.

- The report also concludes that there are corporate governance mechanisms in SMEs of South Africa; however, a majority of the mechanisms for corporate governance are to safeguard shareholder interests. This study inferred that this orientation is mainly because of the fact that a majority of the board in SMEs is composed of owners and
shareholders, and therefore they tend to safeguard their own interest as compared to other stakeholders. In this regard, key recommendations are presented in the following section.

5.2 Recommendations

Corporate governance and its principles have mostly been related to large and listed entities. The term in general refers to the processes and structures for controlling and directing corporate decisions and managers under the aim to manage the relationships among various role players in the organisation such as the top management, the board, shareholders, and other stakeholders (Ntim 2013). But after the publication the King III, i.e., the recognised code of corporate governance in South Africa, it can be inferred that SMEs, whether managed by owners or non-owner, must strive to adopt sound corporate governance principles and practices. This will enable them to reap benefits in the long term which include sustainability in business and maximising the confidence of stakeholders. This will in turn help SMEs to boost their grow rate to become larger and more established business organisations (Ioannou and Serafeim 2014).

Thus, it is highly recommended that SMEs and their owners and managers pursue understanding and implementation of sound corporate governance principles and practices within their business operations. This should be done right from the establishment of SMEs and should not be postponed to a point in the future where they would have turned into large organisations. Following recommendation are drawn by studying the principles presented in the King III report that can be applied by SMEs:
5.2.1 *Corporate Citizenship and Ethical Leadership*

Corporate Governance in SMEs heavily rely on the orientation of leadership and the ethical values that they undertake while conducting business. The leadership of SMEs should consider following four ethical principles: accountability, responsibility, transparency, and fairness.

5.2.2 *Strategies*

Strategic planning and thinking shows what and how the organisations will achieve their objectives. The strategic vision is important and must be grounded on sound corporate governance principles so that the organisation can apply corporate governance mechanisms from the beginning. This strategic thinking is reflected in the preparation of business plan, business strategy and tactics, structures of the business, and design of organisational processes.

5.2.3 *Structures*

The prosperity of an organisation is heavily dependent on its structure because structure contains checks and balances that are put in place in order to assess the effectiveness and efficiency of organisational operations. The division of power, authority, and responsibility affect the effectiveness of checks and controls and thereby affect the overall organisational efficiency. According to the recommendations presented in King III, the board of an organisation, including SMEs, should be composed of a majority of non-executive directors as well as the individuals who possess suitable experience, skills, and knowledge to make corporate decisions within the strategic vision.
5.2.4 Responsibilities within SME’s

It can be observed that often a single individual is responsible for various responsibilities and assumes various roles and therefore undertakes majority of the decisions. This individual is responsible to manage conflicts of interests among various players such as the shareholders and employees. It is naturally difficult for a single human to fulfil all responsibilities at the same time and it is likely that he/she would be overwhelmed and take ineffective or biased decisions. King III recommends that SMEs identify and distinguish different roles and develop documents explaining roles, responsibilities and duties. Assign roles to different people and divide the workload and authority to prevent concentration of power issues.

5.3 Future Research Opportunities

This research presents conclusions regarding the corporate governance mechanisms for SMEs in South Africa. Based on these findings, future researchers may conduct studies to identify strategies that can be used to overcome weaknesses in corporate governance systems. Future researchers may also conduct research to identify potential factors that hinder implementation of corporate governance mechanisms recommended in the King III report. In addition, future researchers may conduct studies focusing on the directors in SMEs to explore the level of awareness, their interests, and plans to adopt corporate governance mechanisms particularly after the publication of King III.
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APPENDIX 1: Interview Questionnaire
1) How does the corporate governance work at your organisation?

2) Tell me about the Board of Directors (size, composition, remuneration)

3) Tell me about the Audit Committee (External auditors, independent internal audit function, rotation of external auditors, internal audit reports, internal audit plans and reviews, control, etc.)

4) Tells me about the formal risks management processes and mechanisms.

5) What legislation or regulation does your organisation comply to?

6) Who are the key stakeholders of your organisation and how do you ensure to take into account all the stakeholders of the company?

7) What do you think about Corporate Responsibility?