

**SERVICE QUALITY MEASUREMENT FOR NON-EXECUTIVE DIRECTORS**

**IN PUBLIC ENTITIES**

by

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**A THESIS**

submitted in fulfilment of the  
requirements of the degree



**BUSINESS MANAGEMENT**

at the

**FACULTY OF ECONOMIC AND BUSINESS SCIENCES**

at the

**RAND AFRIKAANS UNIVERSITY**

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**JOHANNESBURG**

**MARCH 1998**

## ABSTRACT

In commercial corporations shareholders, at least in theory, evaluate the performance of the boards they have appointed. Such evaluation is mainly based on the financial performance of the entity. Public (state funded) entities have only the state as shareholder and the performance of their boards is not evaluated by the taxpayers who ultimately pay the directors' fees.

The term "public entity" refers to 20 corporations with an annual turnover in excess of R 55 billion which are substantially tax-funded or are awarded a market monopoly in terms of legislation by parliament. Although these public entities are regularly criticised by the press, the academic literature reports neither an assessment of the quality of governance by their non-executive directors' nor any instrument to use in such an assessment.

The aim of this study was to measure the expectations and perceptions of executives in public entities about their non-executive boards' corporate governance service. This began with a literature analysis, firstly to define what "proper" corporate governance and secondly to find a recognised methodology to use in the development of an assessment instrument.

It was found that two main corporate governance models were generally recognised, namely the United Kingdom model and the German model. The United Kingdom model advocates a single board comprising both executive and non-executive directors while the German model has a supervisory board of non-executive directors overseeing the activities of an executive management board. It was further found that, contrary to King's (1994) recommendation to use unitary boards, the 20 listed public entities all had supervisory boards as advocated in the German model.

A procedure advocated by Churchill (1979:65-72), in his paradigm for developing measures of marketing constructs, proved to be very successful in the development in the United States of America of an instrument named SERVQUAL which was applied in the general service arena where a paying client evaluated a service. Churchill's method was therefore used in this study to develop an instrument called ECGSI to measure the quality of governance of listed public entities' non-executive boards. The opinions of executives attending board meetings, e.g. to make presentations, were used both to develop ECGSI and to measure the quality of the non-executive directors' service.

In accordance with Churchill's (1979:65-72) recommendations, a list of good governance criteria was drawn up and verified against expert opinion. A representative group of executives was then asked to assess the desired, minimum acceptable and actual service levels according to the corporate governance criteria. Corrected item-to-total correlations and factor analysis were used to evaluate the items. By examining the dimensionality of the items using oblique rotation, in accordance with the OBLIMIN procedure in SPSS through a factor-loading matrix, items loading on an inappropriate dimension were eliminated. By reassigning and repeating the deletion of items several times the number of items was reduced from 55 to 31, representing four distinct dimensions.

In the final ECGSI, the alpha values ranged between 0,84 and 0,95 on the four dimensions. The average pairwise correlation among the four factors following oblique rotation was 0,29 and ECGSI was accepted with its four dimensions as a reliable instrument. The concise definitions of the dimensions are: directing and monitoring: giving direction to and monitoring the entity; board capacity: having the capacity to execute the corporate governance; responsiveness and reliability: having the willingness and dependability to act; and assurance: caring for the stakeholders. Strong association with measures of other related variables and of overall quality

was found and ECGSI was accepted as having convergent, content and also face validity.

The measurement revealed that respondents' expectations were no higher than those held by the clients of libraries and several other companies in the United States of America. This was true for both levels of expectation, namely about the service level desired, as well as the lowest service level regarded as acceptable. Contrary to the findings in the United States, respondents in this assessment expressed the opinion that the service rendered was below expectation. The overall mean score, on a seven-point scale, was 1,9 points below the desired service level and 0,9 points below the lowest acceptable service level. On all four dimensions and even on all the evaluation items the service was assessed as below both the desired and lowest acceptable service levels. This is out of line with the assessments done in the United States where, for example, library, computer and banking services were assessed as generally above lowest acceptable level and substantially better than the corporate governance service at the desired service level. Three items recorded the third-most negative score of -1,1, namely "disallowing each other private, hidden agendas", "promptness in taking governance action" and "governing continually and not only when convenient". Two items recorded the second-most negative mean score of -1,2, namely "having the confidence of stakeholders" and "being always properly prepared for meetings". The item "having the knowledge to optimally govern" recorded the most negative mean score, namely -1,5.

As a result of the number of the respondents it was concluded with 99,5% probability that the sample mean did not differ from the population mean by more than 0,2 on a seven-point scale and that the corporate governance service rendered by non-executive directors was validly and reliably assessed not only as being lower than desired but also below acceptable. The worst-assessed issues can be summarised as a lack of professionalism and entails the non-executive directors' lack of knowledge to govern, being not always properly prepared for meetings, their allowance of each other's

private agendas, not having the confidence of stakeholders, their lack of promptness in taking governance action and not governing continually but only when convenient.

To improve the non-executive directors' level of service, it is recommended that the occupation of holding non-executive directorships in public entities be dealt with as a profession. This will ensure that non-executive directors will be appointed from a pool of professionally trained and constantly evaluated people. It also entails locating the functions of recruiting, training, admission, performance and workload monitoring, quality control, discipline and expulsion with an independent body. Corporate governance meets the requirements of both generally accepted approaches (De Beer and Roux, 1994:42) for recognition as a profession, namely the Trait Approach and the Functional Approach. The Trait Approach identifies esoteric knowledge, advanced education and a professional code of ethics as of critical importance while the Functional Approach highlights the relevance to society as critical. The knowledge, education and ethical requirements for non-executive directors as well as public entities' national character, R 55 billion annual turnover and monopolistic nature prove that the holding of non-executive directorships deserves treatment as a profession.

It is therefore recommended that an independent professional statutory body be established to regulate non-executive directors in public entities and that only members of this profession be allowed to accept non-executive directorships on public entity boards. This body can be empowered through full and associate membership systems to recruit, screen and examine, admit, train, advise on workload, discipline and suspend non-executive directors. It is also recommended that this new body be responsible for ensuring that international best practices or at least generally accepted corporate governance practices are adhered to by all its members.

## OPSOMMING

Aandeelhouers in kommersiële organisasies evalueer die prestasie van direksies wat deur hulle aangestel word – ten minste in teorie. Sulke evaluasies word hoofsaaklik op grond van die finansiële prestasie van die betrokke entiteit gedoen. Openbare entiteite (staatsgefinansierde entiteite) het slegs die staat as aandeelhouer, en die prestasie van hulle direksies word nie deur die belastingbetalers, as uiteindelijke betalers van die direkteursfooie, geëvalueer nie.

Die term “openbare entiteit” verwys na twintig organisasies met ’n jaarlikse omset van meer as R55 miljard. Hulle word almal weselik met belasting gefinansier, of geniet markmonopolie in terme van Parlementêre wetgewing. Alhoewel hierdie openbare entiteite gereeld in die pers gekritiseer word, rapporteer die literatuur geen evaluering van die kwaliteit van die entiteite se nie-uitvoerende direkteure se korporatiewe bestuur nie, en geen melding word gemaak van enige instrument om so ’n evaluering mee te doen nie.

Hierdie studie is gedoen om die verwagting en persepsies in verband met nie-uitvoerende direksies se korporatiewe bestuur te meet. Om dit te doen, is die literatuur ontleed, eerstens om te bepaal wat goeie korporatiewe bestuur is, en tweedens om ’n erkende metodologie vir gebruik in die ontwikkeling van ’n evalueringinstrument te vind.

Met betrekking tot wat behoorlike korporatiewe bestuur is, is bevind dat twee belangrike korporatiewe bestuursmodelle algemeen erken word, naamlik die Verenigde Koninkryk model en die Duitse model. Die Verenigde Koninkryk model hou ’n unitêre direksie voor, bestaande uit uitvoerende sowel as nie-uitvoerende direkteure. Die Duitse model gee voorkeur aan ’n toesighoudende direksie, bestaande uit nie-uitvoerende direkteure wat die aktiwiteite van ’n uitvoerende bestuursraad beheer. Daar is verder bevind dat, in stryd met Kling (1994) se aanbeveling dat unitêre direksies gebruik

moet word, al twintig openbare entiteite toesighoudende rade volgens die Duitse model het.

Die prosedure verkondig deur Churchill (1997: 56-72) in sy paradigma vir die ontwikkeling van beter meetinstrumente het geblyk baie suksesvol te wees in die ontwikkeling van 'n instrument genaamd SERVQUAL, waar betalende kliënte dienste evalueer. Churchill se metode is vervolgens gebruik om 'n instrument genaamd ECGSI te ontwikkel om die kwaliteit van korporatiewe bestuursdiens in gelyste openbare entiteite se direksies te meet.

In ooreenstemming met Churchill (1997: 56-72) se aanbevelings is 'n lys van goeie bestuurskriteria ontwikkel en met die hulp van deskundige menings bevestig. 'n Verteenwoordigende groep uitvoerende amptenare is hierna gevra om die verwagte minimum aanvaarbare en werklike diensvlakke volgens die korporatiewe bestuurskriteria te beoordeel. Gekorrigeerde item-tot-totaal-korrelasies en faktoranalises is gebruik om die items te evalueer. Die dimensionaliteit van die items is ondersoek deur middel van skuinsrotasie op 'n faktormatrys, in ooreenstemming met die OBLIMIN prosedure in SPSS, ten einde items te elimineer wat in in toepaslike dimensies sorteer. Deur hertoewysing en die skrapping van items verskeie kere te herhaal, is die getal items verminder van 55 tot 31, wat vier duidelik onderskeibare dimensies verteenwoordig. Die alphawaardes in die finale ECGSI op die vier dimensies het tussen 0,84 en 0,95 gewissel. Die mediaan paargewyse korrelasie tussen die vier faktore na skuinsrotasie van 0,29, en die ECGSI met sy vier dimensies is as 'n betroubare instrument aanvaar. Die verkorte definisies van die dimensies is: rigtinggewing en monitering: gee van rigting aan en monitering van die entiteit; direksiekapasiteit: om die kapasiteit te kan hê om korporatiewe bestuur te verskaf; reagerend en betroubaarheid: om die gewilligheid en betroubaarheid te hê om op te tree; en versekering: omgee vir belanghebbers. Sterk assosiasie met maatstawwe van ander verwante veranderlikes en met maatstawwe van oorkoepelende kwaliteit is gevind, en daar is bewys dat die ECGSI konvergerende, inhoudelike en, as gevolg van die metodologie gebruik, ook gesigsgeldigheid het.

Die meting het aangetoon dat respondente nie hoër verwagtings huldig as kliënte van biblioteke en ander maatskappye in die Verenigde State van Amerika nie. Dit was waar vir beide vlakke van verwagting, naamlik van die diens se verlangde sowel as van die laagste aanvaarbare diensvlak. Anders as in die Verenigde State van Amerika se bevindings, het respondente in hierdie evaluasie die mening uitgespreek dat die diens benede verwagting is. Die oorhoofse mediaantelling op 'n 7-puntskaal was 1,9 punte onder die verlangde diensvlak, en 0,9 punte onder die laagste aanvaarbare diensvlak. Op al vier dimensies en selfs op al die evaluasie-items is die diens geëvalueer as onder beide die verlangde en die laagste aanvaarbare diensvlak. Dit is in stryd met evaluasies gedoen in die Verenigde State van Amerika, waar biblioteek-, rekenaar- en bankdienste byvoorbeeld geëvalueer is as oor die algemeen bo die laagste aanvaarbare vlak, en aansienlik beter as die korporatiewe bestuursdiens op die verlangde diensvlak. Drie items het die posisie gedeel om die derde negatiefste telling van  $-1,1$  aan te teken, naamlik die nie-toelating van privaat verborge agendas, spoedigheid in die doen van korporatiewe bestuurstappe, en deurlopende bestuur en nie net wanneer dit gerieflik is nie. Twee items het saam die tweede negatiefste telling van  $-1,2$  aangeteken, naamlik die besit van die vertroue van belanghebbers, en om altyd behoorlik voorbereid te wees vir vergaderings. Die item om voldoende kennis te besit om optimaal te bestuur het die negatiefste mediaantelling van  $-1,5$  aangeteken. Danksy die getal respondente kon daar met 'n waarskynlikheid van 99,5% besluit word dat die steekproefmediaan nie met meer as 0,2 op 'n 7-puntskaal van die populasiemediaan verskil nie. Daar is dus bevestig dat die korporatiewe bestuursdiens soos gelewer deur nie-uitvoerende direksies geldig en betroubaar geëvalueer is, nie net as laer as die verlangde diensvlak nie, maar ook as laer as die minimum aanvaarbare vlak. Die dienselement wat as die swakste geëvalueer is, kan opgesom word as die gebrek aan professionalisme. Dit behels die nie-uitvoerende direkteure se gebrek aan kennis om te bestuur, dat hulle nie altyd behoorlik voorbereid is vir vergaderings nie, dat hulle mekaar se private agendas akkommodeer, nie die



vertroue van belanghebbers het nie, hulle gebrek aan spoedigheid in die doen van bestuurstappe, en dat hulle nie deurlopend bestuur nie, maar slegs wanneer dit gerieflik is.

Om nie-uitvoerende direkteure se professionalisme te bevorder, word daar aanbeveel dat die beroep van nie-uitvoerende direkteur in openbare entiteite as 'n professie behandel word. Dit behels dat die aanstelling van nie-uitvoerende direkteure gemaak word vanuit 'n poel professioneel opgeleide en konstant geëvalueerde mense. Kortom beteken dit die plasing van die verantwoordelikheid vir werwing, opleiding, toelating, prestasie en werkklasmonitering, kwaliteitbeheer, dissiplinering en skorsing by 'n onafhanklike liggaam. Dit blyk dat korporatiewe bestuur voldoen aan die vereistes van albei algemeen aanvaarde benaderings (De Beer & Roux, 1994: 42) vir erkenning as 'n professie, naamlik die kenmerkbenadering en die funksionele benadering. Met betrekking tot die kenmerkbenadering is die vereiste, naamlik esoteriese kennis, gevorderde opvoeding en 'n professionele etiese kode, reeds geïdentifiseer as kritiek in hierdie beroep. Met betrekking tot die funksionele benadering is die nasionale karakter, omset van R55 miljard en die monopolistiese aard van die openbare entiteite as voldoende aanvaar, en dit laat geen twyfel oor hulle relevansie vir die groter gemeenskap nie.

Daar word dus aanbeveel dat 'n onafhanklike professionele statutêre liggaam ingestel word om nie-uitvoerende direkteure in openbare entiteite te reguleer, en dat slegs lede van hierdie professie toegelaat word om nie-uitvoerende direkteurskappe op openbare entiteite se direksies te aanvaar. Hierdie liggaam kan bemaagtig word om deur volle en assosiaatlidmaatskapstelsels die werwing, sifting en eksaminering, toelating, opleiding, advies oor werkklas, dissipline en skorsing van sulke nie-uitvoerende direkteure te behartig. Daar word ook aanbeveel dat die nuwe liggaam die verantwoordelikheid kry om te verseker dat die beste internasionale korporatiewe bestuurspraktyke, of ten minste algemeen aanvaarde korporatiewe bestuurspraktyke, deur alle lede nagevolg word.

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## CHAPTER ONE: INTRODUCTORY PERSPECTIVES

### 1.1 Introduction: Definitions relating to corporate governance as a service

Corporate governance is part of the larger and more comprehensive concept “governance” and can be clarified by examining the basic concept of governance. In the eyes of most people governance is equal to political governance. Sinclair and Hanks (1995:339) define the term “govern” as “to have control or influence over something”. Although politicians have control over and rule the country, they are elected, put into power and can be replaced by the people. Politicians serve the people, who, if they are not satisfied with their service, can elect others to take their place.

In the commercial world, shareholders elect and appoint boards comprising non-executive (part-time) and executive (full-time) directors to guide and control corporations. The board renders a service to the shareholders and if the shareholders are dissatisfied with their service, they can replace the directors. In short, the shareholder pays and the board serves.

The term “public entity” means, in South Africa, an organisation listed by the Minister of Finance as such under the Reporting by Public Entities Act (Act 93 of 1992). In public entities, which are funded by substantial taxpayer contributions, directors are appointed as follows: Voters (taxpayers and non-taxpayers) elect politicians, who appoint public entity boards (almost exclusively non-executive) that serve the people at taxpayers’ cost. Although taxpayers are more distant from public entity directors than shareholders are from commercial company directors, public entity directors clearly render a service to the community paid for by the taxpayer.

## 1.2 Background: The condition of corporate governance service

Poor corporate governance, resulting in financial losses, failure to reach objectives or gross inefficiency, is continually being reported locally and internationally. More often than not such reports carry headings such as "bankruptcy", "fraud", "corruption" or "economic crime".

These negative reports indicate that some stakeholders are not satisfied with the quality of corporate governance service. King (1994:40) feels that a general collapse in corporate governance standards is central to the problem.

### 1.2.1 Corporate governance in commercial business

Directors of commercial companies run the risk of creditors holding them personally liable should the company they govern fail. A test of non-executive director liability in South Africa came up in the case of Trust Bank founder, Dr Jan Marais, who was sued in his personal capacity for debts of the Funds Trust Limited. Marais acted as non-executive chairman of this liquidated company and charges against him included several counts of fraud, corruption and contravention of the Banks Act. Marais was acquitted later by the Cape Supreme Court on charges of fraud, but was found guilty of reckless trading for 12 days for "failing to stop the rot". The court also found Marais guilty of failing to ensure that annual financial statements were prepared and issued in time. (West, 1995:1).

### 1.2.2 Corporate governance in civil service

*The Star* reporter (8 September 1994:8) reported that, according to the Auditor-General, there were unreconciled differences of millions of rands in



some accounts of the then-defunct House of Delegates' Housing Development Fund. At about the same time two senior officials of the defunct Development Aid Department were found guilty of defrauding the state and accepting bribes (*Business Day* reporter, 11 August 1994).

Reporting on the Independent Electoral Commission (IEC), *The Star* reporter (20 September 1994:6) said that the IEC was granted a final Rand Supreme Court order the previous day to freeze the bank account of a man alleged to have been part of a syndicate that had stolen R2,8 million from the IEC.

Cohen (1995:1) revealed a report to parliament in which the Auditor-General, Mr Henri Kluever, issued an indictment of the IEC, saying he had been unable to provide an audit opinion because of the extent of its internal control deficiencies. In Kluever's opinion, so serious were the effects of the shortcomings that, given a different course of events, they very well might have plunged South Africa into civil war. Taxpayers had lost millions of rands.

Elaborating on the Auditor-General's inability to express an opinion on the correctness and reasonableness of expenses incurred during multiparty negotiations at the World Trade Centre, Waugh wrote (1995:6) that R66,2 million had been spent on leasing the building and paying for catering. Unintelligible descriptions had been used on invoices for which no one had been able to supply acceptable explanations. Kluever found that "owing to the non-availability of certain documentation at the department and in the absence of written agreements and the inability of the supplier and the department to furnish satisfactory explanations and/or alternative audit vouchers, it is not possible for this office to determine the extent of the losses".

To summarise the severity of the financial situation, it was reported on 7 December 1994 (South Africa (republic), 1994) that, in defraying unauthorised expenditure, the State Revenue Account had been charged

with R316 905 703,20. Writing off such amounts occurs annually and only one conclusion is possible, namely that tax money is not governed optimally.

### 1.2.3 Corporate governance in public entities

On 29 November 1994 (the date of publication of the *King Committee Report on Corporate Governance*) 20 organisations were listed by the Minister of Finance as public entities in terms of the Reporting by Public Entities Act, 1992. These 20 public entities in 1996 had a combined turnover in excess of 55 billion Rand.

The objectives of public entities include non-financial objectives and, should the governance of such entities be deficient, neither their inefficient governance nor their under-achievements are likely to be noticed by the taxpayers.

Press reports make interesting reading to irritated taxpayers. Scandals in the management and governance of tax money are published regularly. Apart from low productivity, the number of tax money scandals and amounts involved are staggering. The following are examples of headlines reported during August 1994 by *Business Day*: "Johannesburg Municipality man facing corruption probe" (Bothma, 1994:1), "SABC acts to halt fraud" (Russel, 17 August 1994:3) and "Eskom judgement reserved", (Russel, 4 August 1994).

In discussing the Auditor-General's performance audit report on the 1992-1993 fiscal year, Friedland (1994:39) said that some public entities had been hoarding cash and investments that had not been taken into account when establishing subsidy levels for subsequent years. Thus, at 31 March 1992, the CSIR held R217 million and the South African Bureau of Standards R95 million. This performance audit had uncovered serious financial control deficiencies and complex schemes instituted for unlimited periods to, without any cap on the amount of assistance, claim subsidies.

Annual financial statements are produced annually for all public entities in accordance with generally accepted accounting practices. These annual financial statements include a directors' report that deals with several issues, including the achievement of the objectives of the entity. However, achievements claimed in the audited directors' report are moderate compared to the claims made in unaudited chairman's reviews and managing director's reports. The unaudited performance claims sometimes largely overshadow the audited directors' report (see *Transnet 1995 Annual Report*, in which unaudited reviews cover 78 pages and the audited directors' report only eight pages). Should only the audited achievements be compared with the taxpayer's investment, one can question the quality of the non-executive directors' service.

Contrary to the situation in commercial business, directors of public entities have almost no personal risk should they be negligent in governing. Should financial losses be suffered, the most likely occurrence is for tariffs or taxes to be increased. The possibility of a public entity going insolvent is very remote and only in such a case is there a chance of a director being at personal risk.

Boards of directors of public entities render a governing service and directors are remunerated for their services. If, as Magnet (1992:90) suggests, a shareholder with a one per cent share in a company is disempowered, the taxpayers who ultimately pays for the public entity director's service are even more disempowered by their distance from the politically appointed non-executive director. Neither the non-executive director nor the taxpayer is likely to be informed about the quality of the non-executive governance service. No scientific evaluation of the quality of this service has been done and no instrument exists to do such an evaluation.

The details of public entity directors are usually listed in annual financial statements, their names are generally printed in bold, sometimes accompanied by their pictures. They are generally represented as proud of

their governance of the entity and the service they render to the taxpayer in supervising the executive management of the entity. However, in light of the regular negative publicity described earlier, it does not appear as if all stakeholders are satisfied with the non-executive directors' governance.

#### 1.2.4 Remedial action in corporate governance

Remedial steps to improve corporate governance are taken all over the world. In public entity organisations more often than not such remedial action is in the form of legislation [e.g. the *Reporting by Public Entities Act*, 1992] enforcing improved corporate governance through prescribed governance structures. This is necessary as taxpayers funding the public entities have no exit option (selling shares) like commercial shareholders - paying taxes is compulsory.

The first country to recently (1987) address corporate governance issues was the United States of America. There the National Commission on Fraudulent Reporting (also called the Treadway Commission) had a limited scope, namely to investigate reporting issues. During 1992 the United Kingdom's Cadbury Committee addressed corporate governance fairly comprehensively in an endeavour to improve disconcerted structures.

In South Africa the King Committee issued the *King Report On Corporate Governance* on 29 November 1994 recommending sound corporate governance practices for both commercial companies and public entities. As discussed earlier, bad corporate governance in public entities is equally serious as in commercial companies. Due to world-wide public outcry about bad corporate governance in organisations using tax money, several remedial steps, such as those recommended by King, were taken during the last decade. Among other things, auditing was embraced as a partial solution and alternative auditing disciplines such as value for money auditing, performance auditing and comprehensive auditing were designed

and implemented. The South African Institute of Chartered Accountants also issued guidelines advising public auditors on performance auditing issues.

The *Reporting by Public Entities Act*, the King Report and the above guidelines go a long way towards addressing corporate governance issues in South Africa. However, judging by the ongoing criticism of South African and international corporate governance, it is clear that public entities are still not governed optimally and that the corporate governance rendered by their boards of directors can be improved significantly. Taylor *et al.* (1996:36) conclude that effective governance by the board of a non-profit organisation is a "rare and unnatural act".

#### 1.2.5 Differences between the governance service and other services

Services are generally rendered by a service provider and utilised by a service user. The user usually pays for the service and feels entitled to evaluate it and contract an alternative supplier if considered necessary. Shareholders do that: if they are not satisfied with a director's performance, another director is appointed.

Since politicians appoint non-executive directors to serve on public entity boards and taxpayers pay the bill, the situation is somewhat different. Clearly the supplier / client relationship between a non-executive director as supplier of the corporate governance service and, for example, an executive manager representing the taxpayer as client, is substantially weaker and less direct.

#### 1.2.6 An important difference between public entity boards and other boards

Public entity boards and commercial company boards differ in their composition. Commercial company boards are unitary boards where non-

executive and executive directors are both present on a single board (Gerson, 1991:75). Such commercial companies generally have more executive directors than non-executive directors or approximately equal numbers - executive directors are seldom a minority. Public entity boards on the other hand are supervisory boards (although not called that) and have separate management boards. The supervisory board has no executive role but can appoint and remove the management board (Macdonald and Beattie, 1993:305).

Public entities seldom have more than one or two executive directors on the board and non-executive directors are always the majority. Of the 20 South African public entities the only executives reported in annual financial statements as serving on the boards, are the chief executive officers. One can conclude that with regard to public entities, non-executive directors are the governors in a supervisory board system. This is surprising, especially in view of affirmative action programmes and the benefits for new non-executive board members of interaction with experienced executives. King (1994:26) for this reason recommends unitary boards with a balance of executive and non-executive directors.

### 1.3 Problem statement

Taxpayers funding a public entity and thus also the fees paid to its non-executive directors are not in a position to scientifically measure whether they are getting value for their money from the non-executive board of directors' corporate governance service. No instrument exists to reliably measure such service and Mary Keegan (1993:79) concluded that the real issue in corporate governance is not how to report it, but how to measure it.

In the absence of an independent scientific evaluation of their governance service, non-executive boards of public entities can be complacent and may be generally satisfied with themselves while taxpayers might be generally

dissatisfied. Alternatively, non-executive boards may think that taxpayers are generally dissatisfied when taxpayers are quite satisfied. It is not known if payers for and providers of the non-executive governance service hold similar or opposing views about the service.

If such scientific research findings existed, such taxpayers would be marginally less disempowered than currently. At least they could tell the non-executive board what they collectively think of the service and use political influence to pressure non-executive boards to improve their service.

#### 1.4 Research objectives

There is a strong possibility that measuring and reporting the quality of non-executive boards' corporate governance service will lead to improved service. Keegan (1993:79) states that it is a scientific principle that by measuring something, one inherently changes it. She feels this applies particularly to those behavioural processes involved in corporate governance.

##### 1.4.1 Principal objective: To measure the quality of non-executive boards of directors' corporate governance service

The principal objective of this study is to measure the quality of non-executive boards of directors' corporate governance service in public entities in South Africa. This measurement is done by comparing the expectations and perceptions of one stakeholder group about this service. For this purpose a measurement instrument has been developed as explained in the supplementary objectives.

1.4.2 First supplementary objective: To determine what good corporate governance entails

The first supplementary objective is to find out what proper corporate governance is and what can be expected of professional non-executive corporate governors, using a literature study.

1.4.3 Second supplementary objective: To develop an instrument to measure non-executive boards' service

The second supplementary objective is to develop an instrument, using a recognised methodology, to measure the stakeholders' expectations and perceptions about the non-executive boards' corporate governance service.

1.4.4 Third supplementary objective: To measure any expectation/perception gap

The third supplementary objective is to calculate or measure any differences between expectations and perceptions

1.5 Research methodology

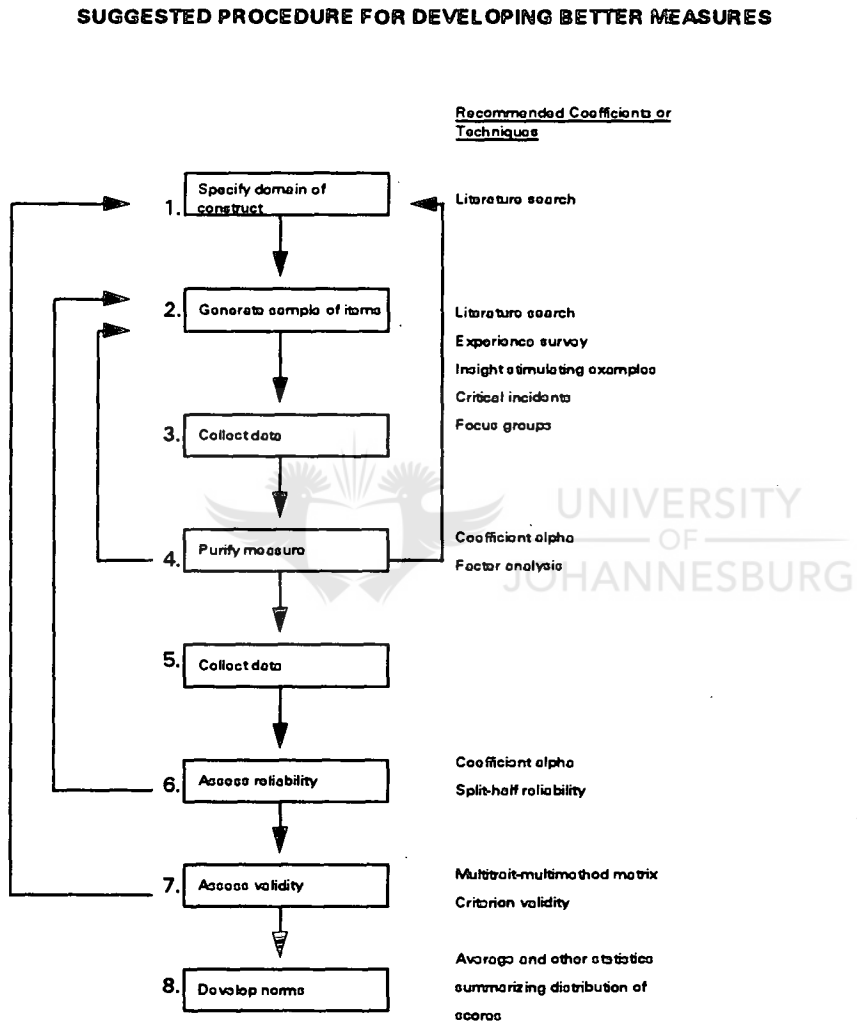
1.5.1 Development of an instrument to measure the quality of a board's governance service

The same methodology that successful developed (Pitt *et al.*, 1995:173) a service quality measurement instrument called SERVQUAL, is used to develop an instrument to evaluate the quality of non-executive boards' corporate governance service. The process used to develop the SERVQUAL instrument was based on a widely recognised technique,



namely Churchill's paradigm for developing better measures of marketing constructs. (Parasuraman *et al.*, 1988:13).

The procedure advocated by Churchill (1979:64-72) in his paradigm for developing measures of marketing constructs contains a sequence of steps for developing measurement instruments. Churchill's procedure (1979:66) is represented best through his own diagram, as set out below.



**FIGURE 1.1 PROCEDURE FOR DEVELOPING BETTER MEASURES**

The first step in Churchill's (1979:67) process is to specify the domain of the construct - in this case evaluating the quality of public entity non-executive boards' corporate governance service. The second step is to generate items that capture the activity of interest - non-executive corporate governance.

Churchill (1979:67) refers to literature searches, experience surveys and insight-simulating examples as the most productive techniques to use during this phase.

#### 1.5.2 Testing the instrument to measure the quality of a board's governance service

The instrument is tested and refined in accordance with Churchill's (1979:67) recommendations for measure purification. This entails data collection, reliability and validity assessment and item revision.

Parasuraman *et al.* (1988:18) purified SERVQUAL in this way, by applying it in the research population till acceptable validity and reliability were apparent.

#### 1.5.3 The research population

Parasuraman *et al.* (1988: 13-40) conclude that meaningful responses require respondents to have some knowledge of and experience with the service being evaluated. This rules out the average taxpayer and man in the street as part of the research population.

The population is defined as executive managers who have been exposed to public entity boards. It is estimated that 140 people are available in this capacity to give their opinion about non-executive boards' corporate governance service. The contact details of some serving executive managers are available from published annual financial statements. They can be approached with the battery of items to evaluate the quality of non-executive boards' corporate governance service. Such evaluation can initially purify the instrument and the data obtained used to finally assess the service.

#### 1.5.4 Sample selection and sample size

An alphabetic list of public entities is used and, starting alphabetically with the entities, the first approximately 100 managers who have been exposed to corporate governance are then asked to participate. In entities not listing their managers, the company secretary is approached for details.

#### 1.5.5 Application of the instrument

After the instrument is developed, it is applied to the data obtained through the survey.

#### 1.6 Constraints under which the research was done

Since only 20 organisations are listed as public entities only one round of scale purification and assessment was possible. Only people with knowledge of the governance service rendered by the non-executive directors could meaningfully evaluate the service quality. In addition they had to be people who could see themselves to some extent as taxpayers subsidising the non-executive boards' governance service. Finally, they had to see the non-executive directors as the providers of the service and not regard themselves as part suppliers of the service, as a self-evaluation could possibly spoil the outcome.

#### 1.7 Demarcation of the research

This report comprises seven chapters. Chapter one contains a general introduction and an analysis of the problem and sets the research

objectives. In addition it explains the research methodology as well as the constraints under which the research is done.

Chapter two records a literature review on corporate governance.

Chapter three records a literature review on service quality measurement instruments. With a view to finding a reliable methodology to develop service quality evaluation instruments, special attention is paid to the development of the SERVQUAL instrument which used the procedure advocated by Churchill (1979:65-72) in his paradigm for developing measures of marketing constructs.

Chapter four describes the development of a new instrument to evaluate the quality of public entity non-executive boards' corporate governance service, as rendered by non-executive directors.

Chapter five reports the assessment of the quality of public entity non-executive boards' corporate governance service, as rendered by non-executive directors, with the new instrument.

Chapter six describes the conclusions reached through the study.

Chapter seven makes recommendations for the future.

## CHAPTER TWO: LITERATURE ON CORPORATE GOVERNANCE SERVICE CRITERIA

### 2.1 Introduction

The problem addressed by this research, as defined in Chapter one is that no reliable instrument exists to measure the quality of corporate governance service in South Africa public entities. The first supplementary objective is to determine what good corporate governance entails and what issues are regarded as important in evaluating corporate governance service. This is covered in this chapter. A situation analysis was used to identify service criteria regarded by experts as important corporate governance elements that should be build into the measuring instrument.



### 2.2 Definitions

#### 2.2.1 Corporate governance

Clarke (1993:8) says that corporate governance has become a subject of increasing fascination and that all are asking questions such as: "what is the role of the directors?". Although final consensus on who must do what will probably never be reached, substantial congruence of opinion is emerging from the definitions below. If agreement on the role of the directors can be reached the gross oversight of governors becoming involved in managing or managers taking exception to governors' legitimate actions, can be avoided.

Literature offers several similar definitions of corporate governance:

Clarke (1993:8) suggests that while management is about running the business efficiently, governance is about setting overall direction, monitoring performance and ensuring accountability.

Tricker, as quoted by Keasey and Wright (1993:292), states that the important elements of governance are supervising or monitoring management performance and ensuring management accountability to shareholders and other stakeholders.

Macdonald and Beattie (1993:304) believe that management is about running the business, and governance is about seeing that it is run properly.

The only slightly different emphasis in definitions of corporate governance is found where the interest of stakeholders is given prominence in the overseeing function. Demb and Neubauer (1992:9) conclude that corporate governance is the process by which corporations are made to react to the rights and wishes of stakeholders.

However worded, it is clear from the above definitions that corporate governance is the directing and supervising service rendered by governors to shareholders with shareholders paying directly or indirectly and benefiting directly or indirectly. Davis (1993:58) reported on the reasons for unnecessary insolvencies and found lack of direction to be an important one. The title "director" implies someone who directs and the quality of directing by non-executive directors has to be one of the most important criteria in evaluating the corporate governance service. Davis (1993:58) found with regard to supervising and control that inadequate systems of financial control contributed substantially to insolvencies. A board's responsibility to supervise and ensure that sound financial controls are in place has to be another important criterion in evaluating corporate governance service.

Hertzlinger (1994:53) points out that if boards of non-profit organisations are to be effective, they must assume the roles that owners and the market play in business. This view is supported and accepted as a criterion in evaluating corporate governance service.

In summarising, studying the above definitions of corporate governance resulted in the identification of service criteria emphasising overseeing of corporate direction and overseeing of corporate control. These criteria relate to the service rendered by governors on behalf of persons (mainly taxpayers) who indirectly contribute towards payment for that service and who can hold an opinion about the quality and value for money delivered through that service.

### 2.2.2 Quality service

Parasuraman *et al.* (1988:13) note that, unlike quality in goods that can be measured objectively by indicators such as durability and number of defects, service quality is an abstract and elusive construct. They attribute this to the three features unique to service, namely intangibility, heterogeneity, and inseparability of production and consumption. Service is thus a form of product with no physical appearance. It is not possible to evaluate a service by touch and a more sophisticated instrument must be developed for this purpose.

Van Halm (1995:131) believes that quality is ultimately customer driven and that customers must be asked what they require. He argues that in managing quality the customer's point of view is central and not management's perception of quality issues. According to this view, no one has a better right than the person paying for the service to query the quality of service.

The above viewpoints are agreed with and the development of an instrument to assess governance service was done utilising the opinions of informed taxpayers.

## 2.3 Historical developments

### 2.3.1 International corporate governance

Keasey and Wright (1993:291) submit that problems pertaining to corporate governance go back at least as far as the separation of ownership from control within business organisations. The concept of corporate governance came into existence when ownership was separated from control as a result of introducing professional managers in large organisations not controlled by executive shareholders.

Two main corporate governance models in Europe are described, namely the United Kingdom model and the German model. The essence of these two models is indicated by the following:

Regarding the United Kingdom model, Macdonald and Beattie (1993:305) point out that the board oversees the running of the company and reports regularly to the members on the stewardship of their investment, while independent auditors, appointed by members, report on whether the financial statements show a true and fair view. The board is a single unit comprising both executive and non-executive directors, with a shared commitment towards shareholders.

In the German model, a supervisory board of non-executive directors oversees the activities of an executive management board (Macdonald and Beattie, 1993:305). The supervisory board,



having no executive power over direction or over the execution of action, exercises its authority by the right to appoint, approve or remove members of the management board. In this model, role clarity is of critical importance and Demb and Neubauer (1992:13) report that only five tasks were named by 200 directors as important in corporate governance. Testing a board's clarity on what they must do and what not is considered very important and is thus included as a criterion of good governance. Carver (1992:21) believes that the supervisory board has no role in staff's decisions and that staff should not "steer or manipulate" board decisions. Refraining from becoming involved in management is therefore rated as an important criterion in evaluating the service of a board.

On the other side of the world the Japanese model, although it looks similar to the United Kingdom model in that it has a one-tier board system, is perhaps more closely aligned in practice to the German model because of the influence of banks in corporate governance (Macdonald and Beattie, 1993:306).



### 2.3.2 South African corporate governance

Gerson (1991:75) feels that the Johannesburg Stock Exchange's long-standing tolerance of pyramids was fortunate. In his view it enabled South Africa's system of corporate governance to evolve along Continental European lines. He describes it as a system in which commercial companies, especially listed companies, in South Africa are mostly governed under a unitary board with both executive and non-executive representation.

Legislation regulating public entities in South Africa makes it clear that public entities are generally governed along the German model. Non-executive directors, in supervisory board capacity, are politically appointed to oversee management boards. The terms "supervisory board" and

“management board” are, however, seldom used and an analysis of the annual financial statements of public entities reveals that the chief executive officer is almost without exception the only executive on the board.

### 2.3.3 Service evaluation

English (1994:10) points out that increasingly shareholders and creditors are holding governors accountable for their actions or lack thereof. King (1994:19) recognises this and points out that bad governance will not be tolerated by stating that there should be “no assistance” for directors not governing professionally. Based on the lack of shareholder interest in annual general meetings when things are going well, it unfortunately appears that the quality of the governance service is only evaluated when governance fails and financial losses are incurred. In such circumstances any evaluation of service quality is highly subjective and tainted by the impact of the losses.

Literature reports no scientific evaluation of corporate governance service in South Africa. However, it appears from concepts such as total quality management as if the South African service sector is starting to realise that the client's evaluation of the service is an important factor in supplier loyalty. Unfortunately this reality still seems absent in reports about corporate governance service as the payer for the governance is very seldom mentioned in the corporate governance debate.

## 2.4 Situation analysis

Authors (e.g. Stiles, 1993:119-124) on corporate governance generally all have problems with governance and propose their own solutions. The issues most frequently raised by these authors are discussed briefly below.

The purpose of extracting these key elements of the governance service is to use them as service criteria in an instrument to be developed.

#### 2.4.1 Corporate governance as a service

Some writers feel that governors are not serious about the task of governing. Any task not taken seriously is at risk of being executed poorly and taking accountability seriously is considered an important criterion in evaluating a board. Carver (1992:22) describes it as a game that boards and executives play with each other: "Let's bring in our dog-and-pony show as a staff and tell the board what good things we've been doing. Let's bring them a budget so they can ratify it. The board manipulates around the edges to look like it's not rubber-stamping, so it can then rubber-stamp it". An assessment of governance service has to check whether boards are doing their job thoroughly or merely rubber-stamping management's proposals.

Overwhelming evidence of corporate governance failures in South Africa is available and supports the views of those critics of governors. A few examples of bad corporate governance service are:

"Out of 71 parastatal bodies audited, Auditor-General Henri Kluever was unable to give full approval of 18 sets of accounts." (Cranston, 1994:15)

Wilmot (1994:4) points out that the increase in fraud in South Africa during the five years ending in 1991, has been quite staggering. He reports that in 1986 there were some 33 000 cases of reported fraud, whereas in 1991 there were 55 300 cases. This represents a 67 percent increase over the five-year period. All serious crimes have increased by 45 percent over the same time.

Even in organisations that consult and advise others in corporate governance, things sometimes go wrong. A senior executive director of Ernst and Young, Lieb Johannes van Jaarsveld, appeared in the Johannesburg Magistrate's Court in 1994 in connection with allegations of fraud of R1,5 million. He was charged with and found guilty on several counts of fraud and one of theft. Van Jaarsveld authorised cheques of nearly R1,5 million, which were later deposited into his own accounts, while he was curator of Alpha Bank. (*The Star* reporter, 1994:7)

Magnet, (1992:90) remains optimistic about governance service and feels that the corporate governance system doesn't need rebuilding from the ground up. In his opinion the existing machinery simply needs to be switched on. He concludes that "getting boards to stop snoozing, and even, if needed, to turn activist, isn't easy". It appears that vigilance is critical for good governance and the vigilance of directors during meetings is therefore used as a criterion in evaluating a board's service.

Magnet (1992:90) quotes Harvard Business School professor Michael Jensen as saying that directors are highly intelligent, highly professional, well-intentioned people but they don't have proper incentives to take hard actions. The willingness of boards to make unpopular decisions is important and is therefore regarded as an appropriate criterion in service evaluation. Regarding director commitment, Magnet reports that Jensen feels that a director is supposed to serve the shareholders, but when a shareholder rarely owns even one percent of the stock, such a shareholder becomes little more than an abstract concept. A chief executive officer and his executive team, on the other hand, seem solid and material and much more important to get along with.

Clarke, (1993:8) believes that existing mechanisms for governing corporations are no longer adequate. He feels that the scale, complexity, importance and risk of corporate activity have overrun our institutions and that directors with adequate specialist knowledge are of paramount

importance. English (1994:13) quotes Harding, saying that it is no longer possible for non-executive directors to be excused for an ignorance of financial matters on the grounds that they were appointed because of different expertise. Expert financial knowledge is therefore regarded as an important criterion in evaluating corporate governance service.

Keasey and Wright (1993:302) believe that the Cadbury Committee Report accepts that existing governance is largely adequate. It is therefore concluded that if the governance is adequate only the quality of service has to be assessed.

It appears that opinions about corporate governance service diverge into two camps. One group feels that governance is fundamentally sound and just needs to be "switched on". The other group feels that current mechanisms are no longer adequate. It is not clear whether writers supporting shareholders and creditors are in one camp and those supporting directors in the other.



## 2.4.2 Appointment of non-executive directors

### 2.4.2.1 Independence

Forbes and Watson (1993:336) recommend that in order for non-executive directors to monitor and control executives they need to be independent. They believe that non-executive directors of commercial companies are in practice effectively nominated by the chief executive officer, that they must rely on the executives for most of the information they receive, and that they need good relationships with the officers if they are to function well in guiding corporate policy. In addition, directors often share similar backgrounds and interests with the firm's executives, and frequently they themselves are senior executives in other firms. Moreover, outside directors

who are not chief executive officers of other firms may well derive a significant portion of their incomes from their directorships. Forbes and Watson (1993:336) also agree with the growing feeling that the notion of outside directors with little or no equity stake in the company effectively monitoring and disciplining the managers who selected them has proven hollow at best.

King (1994:33) recommends that the most widely used technique to counter executive influence over non-executive appointments, namely nomination committees, is inadequate, should not be used and that the appointment of directors is a matter for the whole board. The criticism about the independence of non-executive directors, namely that they are not in a position to be independent from executives, are unfortunately also true to some extent for public entities. The appointment of non-executive directors is, without exception, to represent a stakeholder community, and undue emphasis on the interests of that stakeholder group creates the risk of non-executive directors being biased instead of independent. Non-executive directors can advance their stakeholder group's interest at the expense of the public entity. The prevention of private agendas is therefore regarded as an important criterion in board service.

Public entity executives have no influence over the nomination and appointment of non-executive directors. Without exception legislation pertaining to public entities makes it clear that the appointment process used to appoint non-executive directors is under political control and the quality of non-executive directors appointed by using this means can perhaps form the subject of a different study.

#### 2.4.2.2 Composition of boards

The composition of boards is criticised regularly (e.g. Stiles, 1993:121; Demb and Neubauer, 1992:18) for contributing to non-optimal board

performance. Two issues are considered important, namely the executive : non-executive ratio and the discipline mix on the board.

Main and Johnston (1993:357) report from the United Kingdom that typically one-third of the board members in their sample companies were non-executive. In South Africa, King (1994:32) took a less stringent stance than the rest of the world (where a 50/50 split between non-executive directors and executive directors is becoming the objective), by recommending that at least two directors should be non-executives. Although King wants them to be of senior standing and of "such a calibre that their views will carry significant weight in board decisions" it seems that this standard is set too low and that non-executives will continue to be outnumbered by executives.

In addition, boards should be balanced in terms of disciplines and backgrounds. Davis (1993:58) found unbalanced boards in terms of skills, to be one of the reasons for insolvencies. This argument carries weight, as multidisciplinary input seems critical. A proper skills mix is therefore an important criterion in evaluating a board.

#### 2.4.2.3 Availability of non-executive directors

Again in Britain, Ira Millstein, when interviewed by Vogel (1993:27), remarks that he finds that institutional investors "have trouble locating people to recommend as non-executive directors". Stiles (1993:121) recommends that, as it is a difficult job and not one for amateurs or for ex-employees of the firm, cadres of people, trained and professional, should be established, and they should be rewarded substantially. Non-executive directors should be selected by the shareholders and not by the executives, thus addressing the need for greater shareholder action and vigilance regarded as essential in bringing about better corporate governance. As this study only revolves around the service rendered by boards of directors the availability of quality directors is beyond its scope and can form the subject of future research.

Stiles (1993:121) further agrees that the ideal of a majority of non-executive directors is laudable. He quotes Sir Peter Thompson who confirms that high quality independent non-executives are very hard to find. Thompson attributes this to three factors, namely the time required, the difficulty of the task and low pay. These three issues are addressed in later sections of this document.

Demb and Neubauer (1992:15) quote directors they surveyed, who stated that boards had to meet monthly - four times a year was regarded as inadequate for supervisory board meetings. Thompson, as quoted by Stiles (1993:121), considers it difficult to justify absence from the company at which someone holds an executive position, if that person is spending an average of 18 full days on a board. The current South African standard (King, 1994:33) is that a board must meet "regularly" - meaning at least quarterly with regularity determined by the board with regard to the company's situation. Davis reports infrequent board meetings as a reason for insolvencies. It is agreed that good governance depends on regular board meetings and an adequate number of meetings and regular attendance is therefore an important criterion in evaluating corporate governance service.

Stiles (1993:121) reports that intervention takes a lot of time if a director wants to be properly prepared and that, if the company on whose board a person sits as a non-executive director hits hard times, the time spent with them can rise alarmingly. Demb and Neubauer (1992:15) report a Swiss executive stating that to properly prepare for a meeting a director needs two full days preparation time. Apart from ability, time is the only input into governance and proper preparation for meetings is regarded as an important criterion in evaluating the quality of governance service.

Stiles (1993:121) feels that the task of a non-executive director is a difficult one. Asking searching questions of executive directors usually means becoming unpopular but it has to be done. It appears that the non-executive



board's ability and willingness to ask penetrating questions is important and the criterion of "questioning" is accepted.

To compensate for a perceived unavailability of quality non-executive directors, King (1994:33) recommends that all directors should have access to the advice and service of the company secretary. Assuming that some conditions and circumstances are met, non-executive directors should be entitled to seek independent professional advice about company affairs at the company's expense. It appears that the best way to compensate for a lack of experienced is to seek advice and the extent to which non-executive directors utilise expert advice is therefore another criterion of quality of service.

Keasey and Wright (1993:295) point out that non-executive directors are a means of strengthening shareholder voice and while non-executive directors do have an important role to play, there remain doubts about their ability to exercise sufficient supervision over executive management. Singleton-Green (1993:45) concedes that directors with little or no stake in the company cannot effectively monitor and discipline the chief executive officer and his managers. These arguments are accepted and as the monitoring function is of critical importance the quality of monitoring is regarded as an important criterion to be measured.

#### 2.3.2.4 Independence of non-executive directors

Sheridan and Kendall (1992:71) make it clear that directors have to put their own interests apart when dealing with corporate affairs. They report that directors by law have to act in the best interest of the company and that they can be sued if they fail in their duty to do so. This is increasingly true in South Africa and consequently the avoidance of conflict of interest is regarded as an important criterion to include in an instrument to evaluate corporate governance service.

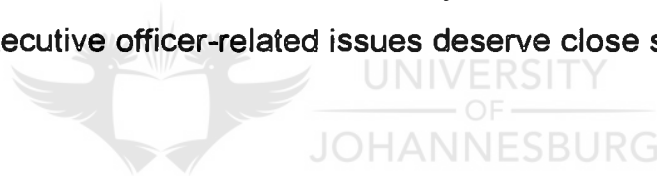
An unduly long relationship with the public entity can negatively impact on the independence of non-executive directors and their ability to render a professional corporate governance service. There is mounting pressure for non-executive directors not to be appointed for an indefinite period. "Directors should not be appointed for more than three years without shareholders' approval" (Keasey and Wright, 1993:291). King (1994:33) recommends that the service contract of an executive director should not exceed five years but does not address the equally pressing question of term appointments for non-executive directors. Directors of public entities are, without exception and in terms of legislation appointed on fixed terms and not on an open-ended basis. The term of appointment of non-executive directors in South African public entities is regulated through the applicable entity's legislation. The directors themselves cannot do anything about this and their service cannot be evaluated in terms thereof. It is recommended that this becomes the subject of future research, namely to determine if the term in office of non-executive directors has any influence on the quality of their service.

King (1994:32) provides a South African interpretation of independence. The basis of his definition is in line with international thinking: "Those who are independent of management and do not have any benefits from the company other than their fees". In the rest of the definition King deviates from international thinking and classifies several clearly dependent groups of people as independent. A few examples of his "independent" directors are shareholders, persons having a contractual nexus with the company, former executive directors, holding company directors and even directors of a listed subsidiary.

### 2.4.3 Issues relating to the chief executive officer

In any organisation, the chief executive officer is the person whose example is followed by all but the exceptionally brave and the stupid. King (1993) remarks that when a dominant management member in a corporation overrides controls, an opportunity for corruption is created. He believes that if a senior manager abuses his expense account it soon becomes known throughout an organisation. Other staff then feel that if the boss can abuse his power and enrich himself they can do the same. Davis (1993:58) reports an over-dominant and over-ambitious chief executive or executive team as a reason for insolvencies. It is therefore in an organisation's interest to counterbalance dominant people and including this as a criterion for evaluation is considered prudent.

Since the chief executive officer is the one person who is almost without exception both the leader of the entity and a member of the board, several chief executive officer-related issues deserve close scrutiny.



#### 2.4.3.1 Duality


Serious concern exists in some quarters about chief executive officers also serving as chairpersons of their boards. Dobrzynski (1991:55) regards it as unsound if the chief executive officer controls, as chairperson, the meetings of non-executive directors, who are theoretically monitoring his performance on behalf of shareholders. She quotes Harvard Business School professor Jay W. Lorsch, who calls a split the most important thing to do in this regard, and states that a chief executive officer can hardly be blamed for refusing to recognise the need for new talent at the top.

Millstein, as reported by Vogel (1993:25), finds it hard to understand how the chairman of a board, who is supposed to monitor and review the

performance of the chief executive officer, can be the same person as the chief executive officer.

Forker (1992:111) feels that support for the drive to split the roles of chief executive officer and chairperson is not limited to a few individuals. He reports that the British Institutional Shareholders Committee also acknowledges the potential threat posed by dominant personalities and has condemned the practice of combining the roles of chairman and chief executive as undesirable. In summarising his findings Forker concludes that the evidence also supports the view that a threat to monitoring quality exists where the roles of chief executive and chairperson are combined. King (1994:32) takes a softer stance and asks for a split "unless it is considered by the board not to be in the company's interest".

Main and Johnston (1993:357) found in their research that in around one-quarter of the British companies the chief executive officer was also the chairman.



As public entities generally operate with both a supervisory and a management board and the chief executive officer seldom serves as chairperson of the supervisory board, duality is not a problem. Demb and Neubauer (1992:17) conclude that while the two-tier structures address the split of chairman and chief executive officer roles, they also pose a different problem pertinent to resolving this paradox. The separation of the two boards means that management can form an insider's club that relegates the external non-executive directors to a secondary role. In addition, in their view, the chairperson of a board is not necessarily the leader of the board: the chief executive officer's superior information makes him a more logical person to be the natural leader. To enhance greater interaction between executive directors and non-executive directors and the positive effects thereof on affirmative action non-executive directors, King (1994:32) recommends the unitary board structure for South Africa. The structure of public entity boards is enacted and beyond the control of the boards. The

quality of corporate governance service of unitary versus dual boards is not part of this study and can be the subject of future research.

Dobrzynski (1991:55) says that external non-executive directors admit privately that they often don't have the necessary information to ask the right question, raise the right issues or make the right judgements. Davis (1993:58) reports that inadequate or biased information given to the board is a major reason for insolvencies. It is clear that knowledge of the important issues, information about those issues and good judgement are critical for good governance and all three these issues are regarded as important criteria in evaluating corporate governance service.

#### 2.4.3.2 Chief executive officer remuneration

Remuneration in any organisation is an important issue. Mangel and Singh (1993:349) found that great pay differentials between top management and lower-level employees led to significantly lower product quality.

Most people support the principle that, as executive directors and especially chief executive officers are charged with maximising shareholders' wealth, executive remuneration should be linked to the organisation's performance. As shareholders are never directly involved in managing a company, this task is, but for a few formalities, left to the board. Boards in turn have difficulty to find the time and energy to do this properly and either do it haphazardly or not at all. Keasey and Wright (1993:293) summarise the situation by saying that executive remuneration may be one means of motivating good behaviour. However, in their view, considerable problems arise in devising appropriate remuneration contracts that are in the best interests of shareholders.

This matter is further complicated by the desire to make remuneration packages as tax efficient as possible. "For reasons which are probably

accidental, the most tax effective methods and options are in fact subject to the least disclosure." (Egginton *et al.*, 1993:363)

Forbes and Watson (1993:333) have found that for performance-related pay systems to be beneficial, shareholders must have the opportunities and incentives to design, implement and monitor appropriately structured executive remuneration packages. If, however, these processes are largely under the control of the executives themselves then, because it is assumed that executives are self-interested people, it follows that only incentive contracts that serve these interests will actually be implemented by executives. Any lack of transparency in respect of performance-related pay schemes can be exploited by executives. Forbes and Watson also argue that in some situations, it may be difficult for the principal to specify a quantitative target or satisfactorily monitor performance because of management's information advantage.

Main and Johnston (1993:357) found that in Britain the composition of the remuneration committee, where one existed, did not always consist entirely of non-executives and that it was not uncommon (in around two-fifths of the cases) to find the highest-paid director serving on his own remuneration committee.

Forbes and Watson (1993:331) report that empirical evidence relating to the role of non-executive directors and remuneration committees, as advocated by the Cadbury report, also suggests that the remuneration process is largely under the control of the executive directors themselves.

King (1994:33) feels that in South Africa directors' remuneration, including that of the chairperson and other non-executive directors, should be evaluated by a knowledgeable board committee with the final decision by the board. The remuneration committee should be chaired by a non-executive director with executive directors a minority. This ruling permits the most highly paid executive directors, including the chief executive officer, to serve on the remuneration committee and, with their full time, energy and personal

interest, to materially influence their own remuneration. Only the total of executive and non-executive directors' remuneration has to be disclosed separately.

Certainly an appropriate action for stakeholders is to insist on improved disclosure. To what extent this additional disclosure must include executive remuneration remains open for debate. Egginton *et al.* (1993:371) proposed something more wide-ranging than King by saying that the requirements for disclosure can only be satisfied by a disclosure table similar to that adopted for movements in fixed assets.

Control over directors' pay is a sensitive and complicated minefield where both motivational sciences and financial realities meet. To some extent increase in directors' pay seems uncontrolled. Whittington (1993:312) feels that this concern is reinforced by the very large pay increases that were granted to senior managers and directors when former state-owned corporations were privatised in Britain.

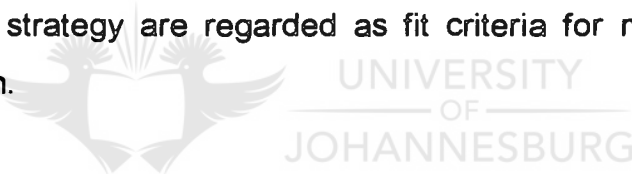
Strong support exists for setting up non-executive controlled remuneration committees to advise boards on executive remuneration. Not all, however, see this as the final solution. Main and Johnston (1993:359) conclude that setting up a remuneration committee does not offer a quick solution.

Ingham and Thompson (1993:374) state that, in a weak competitive environment, performance does not affect chief executive officer remuneration. In the public entity environment of South Africa, where competition is not allowed and mandates demarcated through legislation, the above finding emphasises the need for alternative measures such as reviews of the service of the non-executive directors in overseeing executive remuneration.

With public entities operating under supervisory board systems, executive remuneration is firmly under the control of non-executive directors, making it an unimportant criterion in the public entity arena.

#### 2.4.4 Board dynamics

Corporate governance succeeds or fails in the boardroom. *The Economist* reporter (1992:13) reports that the root of poor corporate performance is usually failed strategy, incompetent management, or both and that remedying these ills leads back to the boardroom. The quality of a board's strategic guidance and its monitoring of the chief executive officer are critical and deserve inclusion as corporate governance service criteria. *The Economist's* view is that neither Cadbury nor most other thinkers on the subject have tackled the crucial issue, namely how, and whether, to put share-voting muscle behind board members. Macdonald and Beattie (1993:308) agree that the directors must maintain a continuous control over financial management processes. Both the monitoring of executives and providing strategy are regarded as fit criteria for measurement in service evaluation.



Apart from guidance and supervision, insistence on ethical conduct is one area where a board has an important role to play. King (1994:34) recommends that as part of the corporate governance of a corporation, a democratically developed Code of Ethics should commit the entity to the highest standard of ethical behaviour as a clear guide to all employees. This Code of Ethics must have the total commitment of the board and chief executive officer of the entity. In King's view, if the bosses set the unethical example, the rest ask why they can not do the same. It is equally true that executive will follow the integrity example set by a non-executive board and the level of integrity and avoiding conflict of interest are regarded as high enough on the board's agenda to make them evaluation criteria.



#### 2.4.4.1 Small group problems

Carver (1992:18) feels that the average non-executive director is a very capable person and that the vast majority of non-executive directors are recognised leaders. He feels that they are generally properly qualified, are frequently chief executive officers in their own companies, or senior partners in professional firms, or political figures of standing and that little doubt can exist that they are extremely competent people, successful in their own lives. However, in his view, if you put a board together, all of a sudden you've got an incompetent group of competent and successful people.

In the United Kingdom, Coopers and Lybrand's insolvency team analysed the reasons for the many unnecessary corporate failures it had dealt with and in their view found few surprises. One of the problems that they encountered relating to board control included inadequate recording of board discussions (Davis, 1993:58). Records of important proceedings are always necessary and maintenance of good records of their governance is therefore a service criterion.

Demb and Neubauer (1992:16) agree that the problem lies with the utilisation of the non-executive directors and not with the directors themselves and conclude that: "Boards suffer the hazards of all small groups. These include the potential for "group think", for a few individuals (possibly the chief executive officer) to dominate discussions and decision making, and for avoiding conflict." The ability of a board to manage dominance and extract the optimal input from every director is therefore seen as an important criterion of corporate governance service.

#### 2.4.4.2 Board performance

Carver (1992:20, 21) portrays a grim picture of the service rendered by boards. He feels that even if you put good managers on boards they don't perform and that it's not the people but the process that does not work well.

Ira Millstein, as interviewed by Vogel (1993:23-27) makes several valuable remarks regarding corporate governance service levels. Regarding evaluation of board service levels, he concludes that it is practical for a board to evaluate its own performance. King (1994:33), in his section on stakeholder communications, recommends that reports be balanced and easy to understand with increased transparency, contain a statement similar to the auditors' responsibility statement and present a balance between the positive and negative aspects. Millstein's view is accepted, namely that a board has to evaluate and report on its own governance. This is accepted as a criterion of excellence in corporate governance.

Another area of criticism is the level of preparation displayed at board meetings. This is accepted as an obvious criterion of corporate governance quality. A further performance indicator proposed by Ira Millstein (Vogel, 1993:23-27) is the alertness of directors during board meetings. This is obvious but cannot be ignored and is accepted as a criterion of corporate governance quality. In Millstein's view the same persons fall asleep time and time again within 15 minutes after the board meeting begins, without anybody asking why he is on the board.

In South Africa, King (1994:32) makes it the duty of the chair, with the support of other board members, to see that a non-executive who is not contributing is removed.

## 2.4.5 Reporting issues

### 2.4.5.1 Creative accounting and expectation gap

Whittington (1993:311) records that the increase in the use and variety of creative accounting methods in the 1980s reinforced anxieties about the ability of shareholders and the stock market to manage corporate output

without proper reporting by a board. This is so because management teams were going to considerable expense to represent performance as measured by the accounts in an unduly favourable light. Whittington's conclusion that there seems to be some failure in the shareholders' capacity to monitor directors is accepted and the quality of a board's reporting of statutory required information to stakeholders therefore has to be a criterion to evaluate its service.

In listing reasons for the Cadbury commission's investigation into corporate governance in the United Kingdom, Clark (1993:8) writes that sponsors of Cadbury (including the Financial Reporting Council, London Stock Exchange and the accounting profession) were concerned at the low level of confidence in financial reporting, and the inability of auditors to provide the safeguards that the users of company reports required. Clark records that there was mounting survey evidence that investors did not believe what they read in annual company reports about organisations meeting their objectives. All definitions of corporate governance include an element of board responsibility to monitor that objectives are attained. Ensuring that executives succeed in meeting corporate objectives has to be one of the criteria for evaluating corporate governance service.

#### 2.4.5.2 Audit committee

Financial matters discussed by boards are sometimes quite technical. Notwithstanding the modern thinking (English, 1994:13) that persons sitting on boards have an obligation to become acquainted with the financial technicalities or resign in their own interest, the practice of using an audit committee to advise a board on financial and audit matters is becoming generally accepted. Collier (1993:428) found statistically significant differences between companies with and without an audit committee. Among others, successful companies have more non-executive directors and a lower proportion of their share capital is owned by directors. In

addition, Collier found evidence to suggest that dominant personalities might block the formation of audit committees.

An audit committee is considered to be a valuable tool for increasing the quality of an audit and decreasing the audit expectation gap. It also appears as if the existence of an audit committee is a power-balancing factor against chief executive officer dominance. Contrary to the emerging international norm of audit committees with a majority of non-executive directors, King (1994:34) recommends establishing an audit committee with at least two non-executive directors, one of whom should act as chairperson. An internal audit function with unrestricted access to the chairperson of the audit committee is also recommended.

Public entities are under the *Reporting by Public Entities Act* obliged to have audit committees with a non-executive chairman and a majority of non-executive members present at every meeting. Having an audit committee is no longer a criterion for evaluating corporate governance in public entities. The measure of success achieved through this mechanism could be the subject of future research.

#### 2.4.5.3 Reporting non-financial output

Reporting in public entities has to be seen in a wider context than reporting in commercial companies. Commercial companies mainly pursue shareholder wealth while public entities serve a greater purpose. Shareholders in commercial companies are clearly the group most interested in corporate progress, while public entities have a wide range of stakeholders. The non-executive directors of a public entity therefore have to pay specific attention to the comprehensiveness of reporting.

The purpose of a public entity is never exclusively financial. The annual financial statements of public entities make it clear that they exist to pursue

socially desirable objectives at affordable cost to the taxpayer. Generally accepted reporting formats, mainly developed in the private sector and formalised in the form of annual financial statements, do not cater for audited reporting of progress towards non-financial missions. Keegan (1993:79) feels that directors are asked to report on the "vaguest of terms" in the absence of a framework or of guidelines against which they can measure company performance.

The *Reporting by Public Entities Act*, states that the directors' report shall set out the functions and objectives of the entity and shall state the extent to which the entity has achieved its set objectives for the financial year concerned. In view of this legislation the directors' success in measuring public entity output is critical and accepted as a criterion in evaluating corporate governance service.

Keegan (1993:79) feels that it will take well into the 21st century before agreement will be reached on how to measure and report the behavioural aspects of corporate governance. Demb and Neubauer (1992:18) on the other hand are adamant that boards have to review their own governance. King (1994:26) makes it clear that public entities have to report on their governance by requiring them to include in their financial statements a statement that they comply with the King code and report any departures together with reasons. Ira Millstein (Vogel, 1993:23-27) feels that it is practical for a board to evaluate its own performance and this self-assessment by boards is regarded as an important criterion in evaluating corporate governance service.

## 2.5 Summary on literature

If we look at Magnet, (1992:90) who feels that the corporate governance system doesn't need rebuilding from the ground up and at Clark, (1993:8) who believes that existing mechanisms for governing corporations are no longer adequate, it is clear that the only consensus in the international

literature is that corporate governance is not working as well as it should. Clark and others regard the problems as serious and ask for a complete overhaul of the whole system. Magnet and others feel the system is fundamentally sound and needs only minor modification. Most writers do not express a comprehensive opinion of the status of corporate governance. However, they all recommend change and it can therefore be concluded that they feel the system can be improved.

In South Africa a situation similar to the international one exists.

"At the core of the problem lies a general collapse in corporate governance standards. Corporate governance relates to the fundamental processes whereby ultimate corporate authority and responsibility is shared and exercised by shareholders, non-executive directors and management. At the centre of the governance process lies the board of directors. In the traditional position, directors discharged their responsibility through a small number of critical decisions relating to the selection of senior management and the approval of major corporate decisions." (King, 1994:40)

In this chapter several standards of and criteria for good corporate governance were identified through the literature study. Those standards and criteria can be summarised under the following six headings:

### 2.5.1 Directing

The term "directors" says it all: the directors must provide direction. This is the board of directors' most important function. The literature confirms that companies without quality strategic direction run into trouble.

As part of providing sound strategic direction, a board of directors has to elicit inputs from some soft-spoken people and restrain unduly dominant people.

### 2.5.2 Accountability

Apart from directing, the responsibility assigned to directors in almost all definitions of corporate governance is that of providing accountability. Directors must see that controls (especially financial controls) are in place and that corporate objectives are met. To achieve that a board of directors must see that accountability is taken seriously. They must ensure that they are not misled.

Once a board of directors has the necessary information at its disposal the directors must be willing to make the necessary decisions even if such decisions are sometimes unpopular. Accountability also has an element of follow-through and a board of directors must monitor executives implementing the board's direction. In the final instance a board has to report comprehensively, both on their own governance as well as on progress towards the strategy objectives.

### 2.5.3 Quality of input

Of all the constraints discussed in the literature, the quality of the directors' input is perhaps the most critical. Given a sound basic predisposition and adequate time, most inadequacies in a director's makeup can be addressed. Quality of inputs, however, also provides good indicators about the inclination of directors.

Directors must be punctual both in attending meetings and in taking governance action. This can only be done by attending meetings diligently,

by studying the public entity and knowing its objectives, by being properly prepared and by being optimally alert during meetings and in general.

Considering the substantial time needed to properly prepare for board meetings and the numerous governance standards that have a time requirement, it seems from the literature (e.g. Demb and Neubauer, 1992:15) that directors should make the time available and govern as if personally financing the entity.

#### 2.5.4 Ethical

Directors are in extremely powerful positions. It is well known that people generally follow the example set by people in power. For directors not to corrupt the organisations they serve, they must be honest and avoid conflicting interests and private agendas. For directors to be seen as worth following they have to be consistent in decisions and in their control of the organisation. Directors must refrain from intruding on executives' fields and must instead add value through their governance and contacts.

#### 2.5.5 Composition

It is clear from the literature that the composition of a board of directors is critical for a board's optimal functioning. The directors serving on a board must be balanced in background and expertise, they must be knowledgeable both in issues relating to the stakeholder group they represent and on financial matters. In view of the specialist knowledge vesting in the executives sitting on the other side of the table, non-executives should never be hesitant to admit that they do not have the specialist knowledge required and then to seek the best advice.



## 2.5.6 Delivery

Governance exists to benefit the organisation involved in pursuing its mission and goals. Since directors are the ultimate authority, they have to be involved in the organisation's delivery process.

Directors must ask the right questions, know what information they need and get it, measure and report corporate and governance output and display due care and skill.



## CHAPTER THREE: LITERATURE ON SERVICE MEASUREMENT INSTRUMENTS

### 3.1 Introduction

In Chapter one the research problem was defined as the absence of an instrument to reliably measure the quality of corporate governance service in South African public entities. This chapter addresses this problem, specifically the second supplementary objective described in Chapter one, namely to study the literature applicable to developing service measurement instruments. The objective with this chapter is to find and describe a methodology that has proven itself in developing service quality measurement instruments. Such a methodology will be used to develop a new instrument to measure the quality of corporate governance service in South African public entities.

### 3.2 The background to service quality measurement

#### 3.2.1 Definitions

##### 3.2.1.1 Quality

Quality has to do with “being good”. The Oxford Dictionary (Fowler and Fowler, 1953:984) defines quality as the degree of excellence.

### 3.2.1.2 Service

Service is described (Oxford, 1953:1139) as the "giving of expert assistance to customers".

Parasuraman *et al.* (1988:13) conclude that service quality is an abstract and elusive construct. They ascribe this to three features unique to service, namely intangibility, heterogeneity, and the inseparability of production and consumption.

### 3.2.2 Service measurement instruments

A literature review of service measurement instruments revealed no instrument designed and used to evaluate the quality of corporate governance service, whether in commercial companies or in public entities. Two instruments being used to measure service quality in general were found, namely SERVQUAL and the relatively unknown SERVPREF. Their possible utilisation in the corporate governance arena is considered in this chapter. If they prove unsuitable for application, the methodology used in developing the most successful instrument of the two will be considered as a methodology for developing purpose-made instrument.

SERVQUAL was reported by Parasuraman *et al.* in 1988 (13-40) and is by far the most widely discussed instrument in this category. Fourteen publications reporting on SERVQUAL were found: (Babakus and Boller, 1992: 253-268; Carman, 1990: 33-55; Chaston, 1995: 333-349; Cronin and Taylor, 1994: 125-131; Hebert, 1994: 3-21; Kettinger and Lee, 1994: 737-767; Parasuraman *et al.*, 1988: 13-40; Parasuraman *et al.*, 1991: 420-450; Parasuraman *et al.*, 1993: 140-147; Parasuraman *et al.*, 1994: 111-124; Parasuraman *et al.*, 1994: 201-230; Pitt *et al.*, 1995: 173-187; Teas, 1994: 132-139; White and Abels, 1995: 36-45).

SERVQUAL has been widely used to evaluate service quality. In their published article "Refinement and reassessment of SERVQUAL", Parasuraman *et al.* (1991:420) list eight published articles reporting successful use of SERVQUAL. During 1994 and 1995 four further reports of successful service quality measurements utilising SERVQUAL were published. In view of this testimony SERVQUAL will be considered later in this chapter.

SERVPREF as a second service quality measurement instrument was reported in 1992 by Cronin and Taylor (1992: 55-68). SERVPREF differs from SERVQUAL in that it uses performance indicators only, while SERVQUAL uses expectation indicators as well. Further reference to SERVPREF was found only where SERVQUAL was the main subject and SERVPREF was used as comparison. No reports of utilisation comparable to that of SERVQUAL or scientific appraisals of SERVPREF were found and it is concluded that SERVPREF's recognition is very limited. SERVPREF is therefore ruled out as an instrument to evaluate corporate governance service or to be used as a role model to develop a new instrument.

### 3.3 The development of SERVQUAL

Parasuraman *et al.* (1988:13) observed that service quality was generally regarded as a possible competitive advantage and sometimes also as a prerequisite for business success or survival. Product quality was perceived to be measured by objective measurement of attributes of design while service, being intangible, was not measurable in this way. They felt that in the absence of objective measures, an appropriate approach for assessing the quality of a service was to measure consumers' perceptions of quality and for this reason they developed an instrument called SERVQUAL.

Parasuraman *et al.* (1988:13) reasoned that as no objective quantifiable yardstick was available to measure customer perceptions of service quality, subjective mechanisms had to be used. They reported that perceived quality, namely the consumers' judgements about an entity's overall excellence or superiority was not the same as objective quality and concurred with other researchers that objective quality was mechanistic and perceived quality humanistic. Naturally, this also applies to corporate governance service.

### 3.3.1 SERVQUAL's service quality dimensions and generation of scale items

Parasuraman *et al.* (1988:15) conducted 12 focus group interviews with informed customers of four service providers - retail banking, credit card, securities brokerage, and product repair and maintenance - to determine the meaning of quality, the characteristics to build into a service, and the criteria customers use to evaluate service quality. The purpose with this research was to develop a concise instrument reliable and meaningful in assessing quality across a broad spectrum of service sectors. "In other words, the purpose was to produce a scale with general applicability." Comparisons of the results showed that, regardless of the type of service, customers used basically the same general criteria to arrive at an evaluative judgement about service quality.

Parasuraman *et al.* (1988:17) found unambiguous support for the theory that service quality, as perceived by consumers, stemmed from a comparison of what they felt a firm should offer and their perceptions of what the firm actually offered. The researchers therefore viewed perceived service quality as the degree and direction of discrepancy between consumers' perceptions and expectations and fitted the evaluative criteria found to be in general use into ten dimensions. These ten dimensions (tangibles, reliability, responsiveness, communication, credibility, security, competence, courtesy, understanding/knowing the customer, and access) then served as the point

of departure to develop an initial SERVQUAL instrument with 97 items. These 97 items were each cast into two statements, one to measure general expectation and the other to measure for specific perceptions. Half the questions were positively worded and half negatively worded and reaction was asked on a seven-point scale.

### 3.3.2 Data collection for and scale purification of SERVQUAL

Parasuraman *et al.* (1988:18) used five different service categories - appliance repair and maintenance, retail banking, long-distance telephone, securities brokerage and credit cards - to condense their 97 items to 22 items, through two stages, and to evaluate the instrument's reliability. This resulted in the SERVQUAL instrument with the following 22 items spread among five dimensions:

**Tangibles:** Physical facilities, equipment, and appearance of personnel

**Reliability:** Ability to perform the service dependably and accurately

**Responsiveness:** Willingness to help customers and provide prompt service

**Assurance:** Knowledge and courtesy of employees and their ability to inspire trust and confidence

**Empathy:** Caring, individualised attention the firm provides its customers

### 3.3.3 Reliability and validity of SERVQUAL

As part of the development of SERVQUAL, both the reliability and validity of the instrument were evaluated. Parasuraman *et al.* (1988:24) report a total-scale reliability of approximately .9 in each of the four companies tested. Fairly low average pair-wise correlations between factors following oblique rotation of .26 and below were reported, further supporting the notion that the five factors are distinct.

The initial 10 dimensions and the generation of the 97 items were so comprehensive that content validity could be accepted as a given. Parasuraman *et al.* (1988:28) concluded that their scale could be considered as having content validity. It can therefore be accepted that it measures what it is intended to measure.

In addition to the qualitative evaluation of validity, SERVQUAL was also subjected to empirical assessment of its convergent validity. This was done by investigating the SERVQUAL scores in comparison with an overall rating of service quality obtained through a separate question by using a one-way ANOVA. Parasuraman *et al.* (1988:30) reasoned that the strength and persistence of the linkage between the Overall Quality categories and the SERVQUAL scores across four independent samples were such that strong support existed for SERVQUAL'S convergent validity.

### 3.3.4 Applications foreseen for SERVQUAL at the time of its development

Parasuraman *et al.* (1988:30) state that the SERVQUAL instrument has been designed to be applicable across a broad spectrum of service. They feel that it provides a basic skeleton, through its expectations / perceptions format encompassing statements, for each of their five service dimensions. The skeleton, when necessary, can be changed and supplemented to fit the needs of specific research or of a particular organisation.

SERVQUAL has some application possibilities in the evaluation of alternatives. A company can use SERVQUAL to compare the service provided by its different stores or to assess its performance in comparison to that of its competitors. Parasuraman *et al.* (1988:36) conclude that SERVQUAL has a variety of potential applications. It can be of assistance to a wide range of service and retail organisations in assessing consumer expectations and perceptions of service quality.

As with all instruments, SERVQUAL also has limitations. As only people informed on the subject can give meaningful opinions on that subject, people surveyed must have had prior exposure to the service being evaluated. Parasuraman *et al.* (1988:30) admit this by stating that the evaluator should have had exposure to the service under evaluation.

It is clear that SERVQUAL was developed in situations where a direct supplier / client relationship existed. Parasuraman makes no mention of SERVQUAL being designed for use by a party not directly paying for the service. In fact, all references by Parasuraman *et al.* in their initial report (1988) to people evaluating a service are to clients - implying paying clients. The conclusion is reached that SERVQUAL was not designed for use in an arena similar to the public entity corporate governance arena. The possibility exists, however, that SERVQUAL's utilisation may prove its reliability in this environment. The next section attends to refinements of SERVQUAL and its use.

### 3.3.5 Reaction to and refinements of SERVQUAL

The most important testimony to the value of an instrument such as SERVQUAL lies in its application, which will be discussed in the next section. This section concentrates on published reaction. Although some negative reaction was levelled against SERVQUAL (mainly by competition),



the substantial amount of published articles reporting its successful utilisation overshadow the negative reaction.

No criticism of SERVQUAL published before 1992 was noted. The development of an alternative service evaluation instrument during 1992, namely SERVPREF by Cronin and Taylor, led to an academic test of strength between the developers of SERVQUAL and those of SERVPREF. During this debate the developers criticised each other's instruments. Cronin and Taylor (1994:130) summarises the two-year debate by saying that the criticism identified by Parasuraman *et al.* (1994) against their instrument appears to relate more to issues of interpretation than issues of substance and that the emerging literature supports their original conclusions. Teas (1994:132) argues that SERVQUAL's scores may sometimes not correspond to increasing levels of perceived quality and therefore the SERVQUAL perceived quality framework may not always be theoretically valid. Parasuraman *et al.* (1994:123) in turn conclude that although they agree that the current approach for assessing service quality can be refined, abandoning it altogether in favour of an alternate approach is unwarranted. They feel that the collective conceptual and empirical evidence diminishes the alleged severity of the concerns about the SERVQUAL approach.

In 1991 Parasuraman *et al.* (1991:420) published a refinement of their SERVQUAL instrument. Due to the consistently higher standard deviations for negatively worded questions (2.07 for negatively worded and 0.77 for positively worded questions), negatively worded items were all changed to a positive format. In addition two items were changed: one item under tangibles was reworded to refer to "materials associated with the service" instead of "appearance of physical facilities" and one item under assurance where "adequate support from their companies" was replaced by "employees have adequate knowledge". After reassessing SERVQUAL, Parasuraman *et al.* (1991:422) concluded that the findings provided consistent support for the reliability and validity of the SERVQUAL scores on the five dimensions. In their guidelines for further use, Parasuraman *et al.* (1994:445) recommend

that SERVQUAL be used in its entirety as much as possible, that items can be used to supplement SERVQUAL but that additional items should be in a similar form (general rather than transaction-specific), and that SERVQUAL can be supplemented with additional qualitative or quantitative research.

As no consensus was reached in the above debate between the developers of SERVQUAL and SERVPREF the opinion of uninvolved experts is perhaps pertinent. One assessment was done by Carman, (1990:34-42). He concluded that professional service organisations and consumer service organisations will find SERVQUAL's measures equally valid and that the wording of the items can be changed to fit the particular service situation. In addition, he states that researchers using the SERVQUAL instrument should not be concerned about omitting items that testing has shown to be irrelevant to their research. No similar support for SERVPREF was found and it had to be concluded that the application of the two instruments will have to provide the final answer as to which one is superior.



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#### 3.4 Past use of SERVQUAL

In refining and reassessing SERVQUAL, Parasuraman *et al.* (1991:420) list some of the users of SERVQUAL who have published their findings. They are: Crompton and Mackay, 1989; Webster, 1989; Woodside, Frey, and Daly, 1989; and Johnson, Dotson and Dunlap, 1988. These who have assessed the scale's reliability and validity are: Babakus and Boller, 1991; Brensinger and Lambert, 1990; Carman, 1990; and Finn and Lamb 1991.

Hebert (1994:3-21) successfully applied the SERVQUAL instrument in large public libraries in Canada and found that most users of their interlibrary loan service received poorer service than they expected.

Kettinger and Lee (1994:744) applied SERVQUAL successfully to the information systems environment and conclude that the research results

provide consistent support for the reliability, face validity, and predictive validity of SERVQUAL. They feel that SERVQUAL is the most important instrument within marketing research for assessing a client's perceived service quality.

Chaston (1995:332) found that SERVQUAL could be used to evaluate internal customer service. He used the instrument in United Kingdom clearing banks adapting the standard item battery to cover the dimensions of the bank's internal customer model and to direct respondents to consider only service delivery issues inside the organisation. Although an internal service, a fairly direct supplier / client relationship existed, substantially stronger than with corporate governance service.

Pitt *et al.* (1995:173) examined content validity, reliability, convergent validity, nomological validity and discriminant validity in three different types of companies in three countries and concluded that SERVQUAL was an ideal instrument for researchers seeking ways to measure the service quality of information systems. Here also, the persons who used the service, and probably paid for it, evaluated the service. It is probable that the users of this service paid for the service through internal charges. This makes the supplier / client relationship weaker than with an external client paying in "real" money. Clearly, however, the supplier / client relationship between a non-executive director as supplier of the corporate governance service and an executive director representing the taxpayer as client is still substantially weaker and less direct.

SERVQUAL's applications are limited as it relies on the expectations of "consumers" (Parasuraman *et al.* 1988:36). Consumers are, according to Sinclair and Hanks (1994:164), persons who use services. The persons asked about corporate governance are not consumers as they do not use the service. The published literature has never reported SERVQUAL's use in an area where the person doing the service evaluation is not a direct and paying client. It has to be concluded that its application may not deliver a proper evaluation and that a new instrument had to be developed. Little

doubt, however, can exist that SERVQUAL is very successful at measuring what it was designed to measure and that its 22 items are worth considering for inclusion in a new instrument. The methodology used in SERVQUAL's development, namely Churchill's paradigm for developing better measures of marketing constructs, has proven itself by resulting in a very successful SERVQUAL and it is concluded that this methodology is ideal to use in developing a new instrument.

### 3.5 The Churchill paradigm for developing better measures

The development of SERVQUAL used Churchill's paradigm for developing better measures of marketing constructs (Parasuraman, 1988:13). No criticism of Churchill's methodology was found in the literature and the excellent results achieved through SERVQUAL testify to the quality of this methodology. SERVQUAL has, over the years proved to be a very reliable instrument to evaluate service quality where a direct supplier / client relationship exists. Although the supplier / client relationship is different for corporate governance service, a lot can be learned from the development of SERVQUAL for application in the development of a new instrument. Churchill's methodology is therefore used in Chapter four to develop a new instrument.

### 3.6 Summary

Since 1988 SERVQUAL gained general recognition (Carman, 1990:34-42) as the leading instrument in evaluating service quality in the arena it was designed for namely that of a paying client. It was, however, neither reported as being designed for nor tested in an environment where the person evaluating the service was not the direct and paying client. SERVQUAL has been used successfully several times and the development process used resulted in a very reliable and valid instrument.

The process used to develop the SERVQUAL instrument was based on a widely recognised technique for this purpose, namely Churchill's paradigm for developing better measures of marketing constructs. (Parasuraman, 1988:13). There was no reason to believe that using the SERVQUAL process to develop an instrument to evaluate the quality of corporate governance service would lead to a less reliable instrument than SERVQUAL. As SERVQUAL was regarded as not necessarily suitable to evaluate the quality of corporate governance service, it was decided to develop a new instrument. It was further decided to use Churchill's paradigm for developing better measures for this purpose. The second supplementary objective in Chapter one will most likely be achieved using Churchill's paradigm.



## CHAPTER FOUR: DEVELOPMENT OF AN EVALUATION OF CORPORATE GOVERNANCE SERVICE INSTRUMENT (ECGSI)

### 4.1 Introduction

This chapter addresses the development of a purpose-made instrument to measure the quality of corporate governance service rendered by the non-executive boards of South African public entities. It is intended to build on the findings reached in Chapter three namely the fact that utilisation of Churchill's paradigm for the development of measures of marketing construct, is likely to result in a reliable instrument. In addition some of the SERVQUAL items have potential for incorporation into the new instrument.



### 4.2 The process to develop ECGSI

The procedure advocated by Churchill (1979:65-72) in his paradigm for developing of measures of marketing constructs, contains a sequence of steps. Churchill's procedure (1979:66) can be represented best through his own diagram, as illustrated below.

## SUGGESTED PROCEDURE FOR DEVELOPING BETTER MEASURES

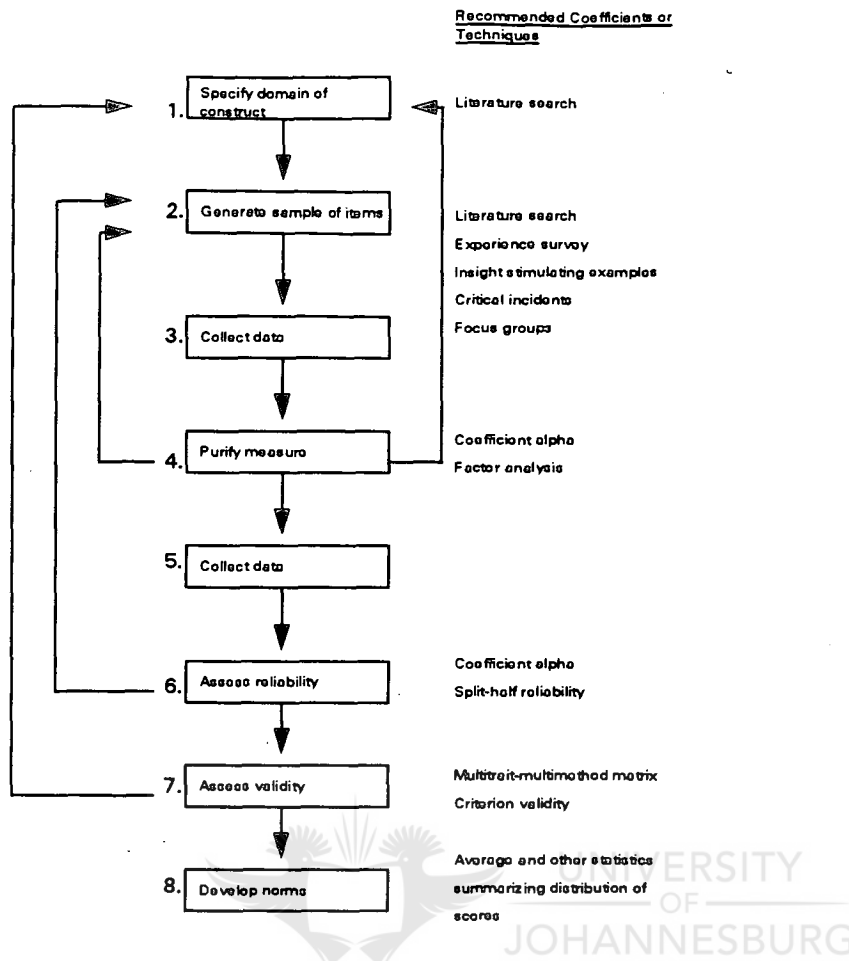


FIGURE 4.1 CHURCHILL'S PARADIGM FOR DEVELOPING OF MEASURES OF CONS

### 4.2.1 The technique advocated to generate a sample of items

The first step in Churchill's (1979:67) procedure, namely specifying the domain of construct was done in Chapter one. The second step is to generate items that capture the activity of interest - corporate governance. Churchill refers to literature searches, experience surveys and insight-simulating examples as some of the techniques regularly used in such exploratory research.

#### 4.2.2 Generating a list of items to serve as governance standards or criteria

Churchill (1979:67) indicates that the search for items that capture the specified domain would include a review of literature such as product brochures and articles in trade magazines and newspapers. The corporate governance literature was reviewed in Chapters two and three and a comprehensive initial criteria list prepared. This list was based mainly on the *King Report on Corporate Governance in South Africa*, published reaction to the *Cadbury Report on Corporate Governance in the United Kingdom* and the SERVQUAL instrument for evaluating service quality in general.

The next phase of development of the corporate governance service quality evaluation questionnaire entailed validating it against the opinion of corporate governance experts.

#### 4.2.3 Obtaining expert opinion about standards or criteria for good governance

The importance of using experts with insight into the phenomenon being studied (Churchill, 1979:67) severely restricted the number of stakeholder groups available to assist in developing service standard or criteria items. Using the Delphi technique in this regard, Hellriegel and Slocum (1982:207) regarded a group of between 15 and 20 experts as adequate to serve on a Delphi panel. In an attempt to improve the list of items considered for inclusion in the new instrument, two groups of experts were considered as fit for inclusion on a panel of Delphi experts. These people and their possible contribution are discussed next.



#### 4.2.3.1 The King Committee

The most comprehensive South African investigation into corporate governance was done by the King Committee on Corporate Governance. King (1994) produced a comprehensive report on corporate governance and their work is regularly referred to in corporate governance debate. Fifteen members served on the King committee and they could be regarded as some of South Africa's leading experts on corporate governance.

Flowing from the King report, a permanent body to monitor corporate governance was established. This corporate governance committee has 14 members, some of whom are ex-King committee members while some are new appointees.

As a result of recent publicity about corporate governance due to the King report, members of the King committee and its successor were so inundated with requests for all kinds of assistance with research that they were not available to participate on a panel of experts for this study. The committee's secretary, Mr Richard Wilkington, reported that members approached for assistance in other research returned questionnaires to him for disposal.

#### 4.2.3.2 The Shareholders Association of South Africa

The Shareholders Association of South Africa has over one thousand members, some representing private shareholding and some corporate shareholding interests. The knowledge of such members about corporate governance may not be proven but they all meet the basic criterion of having been exposed to the service of corporate governance. The chair of this association, Mr David Silvester was however unwilling to provide contact details of its members for research purposes as such detail was regarded as confidential.

#### 4.2.3.3 The South African Institute of Directors' experts' opinion

In view of the difficulties encountered in establishing a panel of experts, and therefore to use the Delphi technique to evaluate the questionnaire, this approach was abandoned and the questionnaire was tested by substituting the Delphi panel of experts with a different procedure. The South African Institute of Directors markets a comprehensive video on corporate governance. In this video a group of senior directors in leading South African companies and experts on corporate governance are asked to review corporate governance and the role of directors on boards.

After checking the questionnaire items against one another to eliminate duplication, this list of corporate governance standards or criteria was checked for comprehensiveness and content against the opinions expressed by the corporate governance experts in the South African Institute of Directors' video. A few items were added or reworded as a result of this review.

#### 4.2.4 The criteria identified

Based on the insight gained in Chapters two and three, a list containing 52 items was developed. The questions were all evaluative criteria for assessing quality of service and included all 22 SERVQUAL items supplemented with 30 items identified during a literature review of corporate governance and service quality.

This list was presented to a group of research specialists employed at the Human Sciences Research Council (HSRC), some of whom were employed as developers of evaluative testing questionnaires. Parasuraman *et al.* (1994:204) also used a group of five people in a similar role and five were

regarded an adequate number for this purpose. These persons were asked to evaluate the suitability of the items for the required purpose. The persons were:

Dr. H. S. van der Walt - Chief Research Specialist in the unit Human Resources Assessment

Dr G. K. Schuring - Chief Research Specialist in the unit Education: African Languages

Mrs A Maree-Snijders - Manager: Research Funding in the group Research Capacity Building

Mr J. S. Ncongwane - Chief Researcher in the unit Education: African Languages

Mr A. R. van den Berg - Chief Research Specialist in the unit Science and Technology



Feedback from the HSRC group indicated that four of the SERVQUAL questions were inappropriate, namely those included under the dimension “tangible” and were eliminated from the questionnaire. A few questions were also added to the questionnaire, dealing with delivery through connections and networking. This resulted in a questionnaire of 55 items (Annexure 2) used when a group of 97 public entity executives were asked to evaluate the corporate governance service rendered by their non-executive boards.

#### 4.2.5 The scale of measurement

Parasuraman *et al.* (1988:40) used a seven-point scale “... with no verbal labels for the intermediate scale points (i.e. 2 through 6)” as the range to evaluate each statement. This approach was followed in the ECGSI questionnaire.

With respect to the capturing of the desired service level, the minimum acceptable service level and the actual service level, Parasuraman *et al.* (1994:218) found a three-column format to be superior. This format was accordingly used for the ECGSI questionnaire.

#### 4.3 Collecting data with and purifying the ECGSI questionnaire

Step three in Churchill's (1979:68) procedure for developing better measures entails data collection using the instrument under development. This was done as explained below.

##### 4.3.1 Applying ECGSI to the group of executives

###### 4.3.1.1 Population



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Chapter one defined the population as executive managers who had been exposed to public entity boards but excluded chief executive officers. It was found that approximately 139 people would be available in this capacity to give their opinion about the corporate governance service of non-executive boards.

In view of Churchill's (1979:66) requirement to provide for multiple rounds of data collection and instrument purification should this be necessary, the executives in only 14 public entities were used in data collection. This left the executives in six entities for a second round of instrument purification should that be necessary.

#### 4.3.1.2 Sample

Ninety seven managers at 14 selected public entities were asked in writing to complete and return the ECGSI questionnaire. Eighteen questionnaires were returned during the first three weeks after the questionnaires were mailed.

The written request was followed up by telephoning the remaining 79 managers. Five persons were not available, 17 were spoken to directly and the remaining 57 requested through their secretaries to attend to the questionnaire. Eight had left their employers since publication of their annual financial statements and one could not be traced. One name was removed from the list as this person had been chief executive officer for quite some time. One person had recently been appointed as chief executive officer but was willing to complete the questionnaire with his/her previous capacity in mind. One person reported through his/her secretary that he/she was uncomfortable about completing the questionnaire and was unwilling to discuss the matter. Thirteen persons reported that they never received the questionnaire and copies were faxed to them. One person completed only two of the three pages of the questionnaire and was faxed the third page but did not respond.

Respondents who queried items on the questionnaire were given telephonic feedback and minor issues were resolved in this way. During this process it became increasingly clear that some executives felt threatened when asked to assess their politically appointed boards and that confidentiality was critical.

Six weeks after mailing and two weeks after the follow-up actions, 49 of the 97 questionnaires (50,5 %) were returned. These 49 responses were regarded as adequate as Parasuraman *et al.* (1988:18) used an average of 40 responses for each service type to develop SERVQUAL. The 49 responses were then processed using the SAS and SPSS statistical analysis

packages to develop an instrument to assess corporate governance service quality as described below.

#### 4.3.1.3 Instrument development results

##### 4.3.1.3.1 Dimensions expected

It was anticipated that the 55 questions would converge into dimensions largely in line with the face interpretation of the questions. Seven dimensions were expected to emerge namely four of the five SERVQUAL dimensions (“Intangibles” eliminated as explained above) and the dimensions “direction”, “monitoring and reporting” and “board capacity” identified as important through the literature study. The expected dimensions are set out below. Question 43 (“refraining from acting as if they were the executives”) did not have an obvious alliance.



##### 4.3.1.3.1.1 Assurance

“Assurance” is one of the SERVQUAL dimensions and it was anticipated that the following criteria would align with this dimension:

10. Having the confidence of stakeholders
11. Making stakeholders feel safe with their governance
12. Being courteous towards stakeholders
13. Having the knowledge to govern optimally
22. Disallowing each other private, conflicting agendas

32. Governing as if they personally financed the entity

52. Avoiding conflict with personal interests

#### 4.3.1.3.1.2 Board capacity

It was anticipated that the following criteria would align with the dimension of “board capacity”:

21. Providing adequate networking

23. Being balanced in composition (e.g. financial, legal)

31. Utilising the best external advice and assistance

34. Having members with expert financial knowledge

37. Being always properly prepared for meetings

39. Knowing what information is needed to govern and getting it

46. Asking appropriate, intelligent questions

49. Doing their homework thoroughly

53. Displaying care and skill as with their own affairs

#### 4.3.1.3.1.3 Direction

It was anticipated that the following 10 criteria would align with the dimension “direction”:

- 24. Being assertive (not rubber stamps) with the chief executive officer
- 25. Attending to the important and not to the sensational
- 26. Providing overall direction to the chief executive officer
- 30. Adding value through their strategic guidance
- 38. Knowing the entity's objectives and strategies
- 41. Taking politically unpopular action when needed
- 48. Neutralising dominating persons during meetings
- 50. Obtaining inputs from reserved people
- 51. Knowing the problems of the industry
- 55. Preventing the chief executive officer from misleading the board

#### 4.3.1.3.1.4 Empathy

"Empathy" is one of the SERVQUAL dimensions and it was anticipated that the following five criteria would align with this dimension:

- 14. Giving individual attention to different stakeholders
- 15. Caring adequately for stakeholders



16. Having the stakeholders' best interests at heart
17. Understanding what is expected from governors
18. Governing continually and not only when convenient

#### 4.3.1.3.1.5 Monitoring and reporting

It was anticipated that the following 10 criteria would align with the dimension "monitoring and reporting":

27. Properly monitoring the chief executive officer
29. Issuing error-free unbiased financial statements
35. Evaluating and publicly reporting their own performance
36. Ensuring that sound financial controls are in place
40. Ensuring organisational objectives are met
42. Taking their accountability seriously
44. Attending all board and committee meetings
45. Meeting with optimum regularity
47. Being optimally alert during meetings
54. Measuring the entity's output

#### 4.3.1.3.1.6 Reliability

“Reliability” is a SERVQUAL dimension and it was anticipated that the following nine criteria would align with this dimension:

1. Providing governance as expected
2. Dependability in handling stakeholders' problems
3. Performing the governance right the first time
4. Providing the governance service at the right time
5. Maintaining good records about their governance
19. Delivering tangible benefits by knowing important people
20. Being punctual and time-disciplined
28. Being consistent in their judgement
33. Displaying impeccable integrity and honesty, e.g. in their own financial claims.

#### 4.3.1.3.1.7 Responsiveness

“Responsiveness” is a SERVQUAL dimension and it was anticipated that the following four criteria (all SERVQUAL criteria) would align with this dimension:

6. Informing stakeholders about their governance
7. Promptness in taking governance actions

8. Willingness to help shareholders

9. Readiness to respond to stakeholders' requests

#### 4.3.1.3.2 Deductions from the completed questionnaires

Three respondents did not answer Question 2: "Dependability in handling stakeholders' problems". This question originated from SERVQUAL and was regarded as too important to remove. Two respondents did not answer Question: 22 "Disallowing each other private, conflicting agendas". Again the question was regarded as too important to eliminate and it was kept despite lack of two responses.

The word "shareholders" in Question 8: ("Willingness to help shareholders") was queried and "stakeholders" suggested.

One person each did not answer Questions 12 ("Being courteous towards stakeholders") and 24 ("Being assertive - not rubber stamps - with the chief executive officer"). Both questions appeared very important and they were not removed from the questionnaire.

#### 4.3.2 Refinements and assessments of ECGSI

The statistical analyses explained below were done with the assistance and guidance of Mr J.J. Pietersen, Chief Statistician at the Human Sciences Research Council.

The procedure used by Parasuraman *et al.* (1988:19-22) to purify SERVQUAL was used to purify ECGSI. Coefficient alphas were calculated in accordance with Churchill's (1979:68) recommendations. The data used

in these calculations were the difference scores created by subtracting perceptions from expectations on the different items. This was in line with Parasuraman *et al.* (1988:19) where the "difference scores" (between expected and perceived service levels) were used to compute coefficient alphas in purifying SERVQUAL. The corrected item-to-total correlations and a factor analysis were used to evaluate the 55 items and, following the same procedure Parasuraman *et al.* (1988:19), the corrected item-to-total correlations were used to delete items from the dimensions to improve the alpha values. By eliminating items with low correlations and those whose correlations produced sharp drops in the pattern, the alpha values were improved.

Items loading on an inappropriate dimension were eliminated by examining the dimensionality of the 55 items. Oblique rotation was used in accordance with the OBLIMIN procedure in SPSS (Parasuraman *et al.*, 1988:20) through a factor-loading matrix. When such items were eliminated from the matrix, two dimensions became meaningless due to low correlations with remaining items. Following Parasuraman *et al.* (1988:20) some items were reassigned to other dimensions and by repeating the item deletion and reassigning process several times the number of items was reduced to 31, representing four distinct dimensions.

After executing the above procedure the alpha values ranged between 0,84 and 0,95 on the four dimensions, with factor loadings ranging between 0,42 and 0,93. The average pairwise correlation among the four factors following oblique rotation was 0,29 and in all three of the above areas (alpha values, factor loadings and pairwise correlation) the results were similar to or better than those achieved by Parasuraman *et al.* (1988:24). Churchill (1979:68) reports that Nunally proposed alphas between 0,50 and 0,60 for similar early-stage basic research and that increasing alphas beyond 0,80 is regarded as wasteful.

The final four dimensions with their concise definitions were as follows:

- \* Directing and monitoring: Giving direction to and monitoring the entity
- \* Board capacity: Having the capacity to execute the corporate governance
- \* Responsiveness and reliability: Having the willingness and dependability to act
- \* Assurance: Caring for the stakeholders

Only three of the five SERVQUAL dimensions featured in the final ECGSI. "Tangibles" as a dimension was eliminated in Chapter three. Parasuraman *et al.* (1994:211) raised the possibility of three of their dimensions collapsing into a single factor. The difference between the dimensions of SERVQUAL and those of ECGSI therefore does not pose a problem. Rather it supports the argument in Chapter three that corporate governance differs too much from commercial services to use SERVQUAL for this study.

#### 4.3.3 Summary of the results of the final scale purification

The results of the scale purification described above can be summarised as follows:

<u>Dimension</u>	<u>No. of items</u>	<u>Reliability coefficients (Alphas)</u>	<u>Factor loadings of items on their assigned dimensions</u>
Directing and monitoring	14	0,9466	93;67;53;42;71;56;60 82;48;70;53;79;79;75
Board capacity	5	0,8546	70;67;81;53;64
Responsiveness & reliability	7	0,9244	71;76;78;72;82;46;64
Assurance	5	0,8353	64;61;75;66;51

TABLE 4.1: RELIABILITY COEFFICIENTS (ALPHAS) OF ECGSI

Reliability of linear combination (total scale reliability) was 0,96. This alpha substantially exceeds the 0,90 required by Churchill (1979:68) for applied research as well as his 0,95 requirement to base important decisions on.

Factor loadings in the above table are loadings multiplied by 100.

The percentage variance extracted by the four factors was 70,3 %.

#### 4.3.4 The final ECGSI

The final ECGSI dimensions and the items allocated to them are set out below. To facilitate comprehension, items in every dimension were sorted using logical association and not only order of correlation.

##### 4.3.4.1 Directing and monitoring

- 1) Providing overall direction to the chief executive officer (Question 26)
- 2) Being assertive (not rubber stamps) with the chief executive officer (Question 24)
- 3) Utilising the best external advice and assistance (Question 31)
- 4) Taking politically unpopular action when needed (Question 41)
- 5) Preventing the chief executive officer from misleading the board (Question 55)
- 6) Knowing what information is needed to govern and getting it (Question 39)
- 7) Properly monitoring the chief executive officer (Question 27)
- 8) Ensuring that sound financial controls are in place (Question 36)
- 9) Being always properly prepared for meetings (Question 37)
- 10) Ensuring organisational objectives are met (Question 40)

- 11) Asking appropriate, intelligent questions (Question 46)
- 12) Doing their homework thoroughly (Question 49)
- 13) Displaying care and skill as with their own affairs (Question 53)
- 14) Measuring the entity's output (Question 54)

This dimension had a reliability coefficient (alpha) of 0,9466.

#### 4.3.4.2 Board capacity

- 1) Being balanced in composition (e.g. financial, legal) (Question 23)
- 2) Having members with expert financial knowledge (Question 34)
- 3) Disallowing each other private, conflicting agendas (Question 22)
- 4) Displaying impeccable integrity and honesty, e.g. own financial claims (Question 33)
- 5) Avoiding conflict with personal interests (Question 52)

This dimension had a reliability coefficient (alpha) of 0,8546.

#### 4.3.4.3 Responsiveness and reliability

- 1) Promptness in taking governance action (Question 7)



- 2) Willingness to help stakeholders (Question 8)
- 3) Readiness to respond to stakeholders' requests (Question 9)
- 4) Dependability in handling stakeholders' problems (Question 2)
- 5) Providing the governance service at the right time (Question 4)
- 6) Having the knowledge to govern optimally (Question 13)
- 7) Governing continually and not only when convenient (Question 18)

This dimension had a reliability coefficient (alpha) of 0,9244.

#### 4.3.4.4

#### Assurance



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- 1) Having the confidence of stakeholders (Question 10)
- 2) Making the stakeholders feel safe with their governance (Question 11)
- 3) Delivering tangible benefits by knowing important people (Question 19)
- 4) Providing adequate networking (Question 21)
- 5) Adding value through their strategic guidance (Question 30)

This dimension had a reliability coefficient (alpha) of 0,8358.

#### 4.4 Validity of the findings

The above section demonstrates the reliability and internal consistency of ECGSI. Parasuraman *et al.* (1988:28) argue that this is not good enough. In addition to reliability and consistency, which are required characteristics for construct validity and the instrument's ability to fully and unambiguously capture the underlying unobservable construct, the instrument has to satisfy the criteria of construct validity, namely that validity and convergent validity.

##### 4.4.1 Content validity

Parasuraman *et al.* (1988:28) regard content validity or face validity as the most important criterion of construct validity. They feel that the questions of extent of measurement, of what is supposed to be measured, and of capturing all the key facets of the unobservable construct are qualitative rather than quantitative questions.

By following the SERVQUAL approach in developing ECGSI, Churchill's (1979:64-73) requirements have been met. The construct and its domain, as well as the extent to which the scale items represent the construct's domain, have been fully described above.

##### 4.4.2 Convergent validity

In assessing SERVQUAL's convergent validity, Parasuraman *et al.* (1988:28) measured the association between the responses to the SERVQUAL scores and to a question that provided an overall rating of the service under evaluation. This was also done for ECGSI, as detailed below.

#### 4.4.2.1 Association with measures of other related variables

Respondents were asked to rate the corporate governance service's overall quality by marking one of the four words "poor", "fair", "good" and "top". The correspondence between this rating of overall quality and the ECGSI scores was examined using a one-way analysis of variance. As was done by Parasuraman *et al.* (1988:28) the categories "poor" and "fair" were combined for this analysis.

Separate analyses of variances were conducted for the total ECGSI scale and for each dimension with the MSS and MSA scores as dependent variables during separate runs. Duncan's (Parasuraman *et al.*, 1988:29) multiple-range test was then applied to further investigate the analysis of variance results. This resulted in the following findings:



Individual scale dimensions	Overall quality		
	Top	Good	Fair / Poor
Directing & monitoring	-0,71 <sup>a</sup>	-1,33 <sup>a</sup> -	2,49 <sup>b</sup>
Board capacity	-0,53 <sup>a</sup>	-1,04 <sup>a</sup>	-2,42 <sup>b</sup>
Assurance	-0,68 <sup>a</sup>	-1,31 <sup>a</sup>	-3,08 <sup>b</sup>
Responsiveness & reliability	-0,75 <sup>a</sup>	-1,32 <sup>a</sup> -	2,53 <sup>b</sup>
Combined scale	-0,87 <sup>a</sup>	-1,27 <sup>a</sup> -	2,68 <sup>b</sup>

TABLE 4.2: MEASURE OF SERVICE SUPERIORITY: VARIABLE NUMBER ONE

Individual scale dimensions	Overall quality		
	Top	Good	Fair / Poor
Directing & monitoring	0,68 <sup>a</sup>	-0,24 <sup>a</sup>	-1,55 <sup>b</sup>
Board capacity	0,33 <sup>a</sup>	-1,11 <sup>a</sup>	-1,64 <sup>b</sup>
Assurance	0,64 <sup>a</sup>	0,03 <sup>a</sup>	-1,83 <sup>b</sup>
Responsiveness & reliability	0,75 <sup>a</sup>	-0,02 <sup>a</sup> -	1,54 <sup>b</sup>
Combined scale	0,67 <sup>a</sup>	-0,14 <sup>a</sup>	-1,72 <sup>b</sup>

TABLE 4.3: MEASURE OF SERVICE ADEQUACY: VARIABLE NUMBER ONE

Notes regarding Tables 4.2 and 4.3:

<sup>a</sup>, <sup>b</sup> = Means with the same superscripts are not significantly different for each dimension and means with different superscripts are significantly different for each dimension.

Significant differences in mean scale values of respondents (0= indifference) - segmented according to the overall quality variable Number one

Only three to four respondents rated the service “top” resulting in the “top”/“good” categories not being statistically significantly different. However, the above figures clearly indicate that the categories in practice are significantly different. The “good”/“fair” and “poor” categories are both practically and statistically significantly different. The conclusions on the dimensions are the same, namely respondents in the “good” category had a higher score than those in the “fair”/“poor” category and respondents in the “top” category had a higher score than those in the “good” category.

The above findings are similar to those of Parasuraman *et al.* (1988:30), and meet Churchill’s (1979:70) requirement of correlating with other measures of the same variable. It was concluded that the strengths and persistence of the linkages between overall quality and the ECGSI scores offered support equal to that of SERVQUAL for ECGSI’s convergent validity.

#### 4.4.2.2 Association with measures of overall quality

In the final instance ECGSI’s validity was assessed (following Churchill, 1979:70 and Parasuraman *et al.*, 1988:30) by analysing whether the construct evaluated was empirically associated with measures of other conceptually related variables. Respondents were asked two general questions (marked “Recommend” and “Problem” in tables 4.4 and 4.5 below) that were expected to correlate conceptually with perceived quality.

If respondents answered “yes’ to the question “would you recommend the board for appointment at another company” and “no” to the question “have you ever seriously questioned the board’s governance’, those boards were hypothesised to convey better service quality than others.

Individual scale dimensions	Recommend		Problem	
	Yes	No	Yes	No
Directing & monitoring	-1,13 <sup>a</sup>	-2,57 <sup>b</sup>	-2,12 <sup>a</sup>	-1,57 <sup>a</sup>
Board capacity	-0,97 <sup>a</sup>	-2,36 <sup>b</sup>	-2,38 <sup>b</sup>	-1,07 <sup>a</sup>
Assurance	-1,17 <sup>a</sup>	-3,04 <sup>b</sup>	-2,50 <sup>a</sup>	-1,75 <sup>a</sup>
Responsiveness & reliab	-1,18 <sup>a</sup>	-2,52 <sup>b</sup>	-2,28 <sup>b</sup>	-1,47 <sup>a</sup>
Combined scale	-1,15 <sup>a</sup>	-2,75 <sup>b</sup>	-2,31 <sup>b</sup>	-1,60 <sup>a</sup>

TABLE 4.4: MEASURE OF SERVICE SUPERIORITY: VARIABLES NUMBERS TWO AND THREE

Individual scale dimensions	Recommend		Problem	
	Yes	No	Yes	No
Directing & monitoring	0,02 <sup>a</sup>	-1,60 <sup>b</sup>	-1,20 <sup>b</sup>	-0,42 <sup>a</sup>
Board capacity	0,03 <sup>a</sup>	-1,62 <sup>b</sup>	-1,52 <sup>b</sup>	-0,22 <sup>a</sup>
Assurance	0,26 <sup>a</sup>	-1,84 <sup>b</sup>	-1,13 <sup>a</sup>	-0,51 <sup>a</sup>
Responsiveness & reliab	0,22 <sup>a</sup>	-1,54 <sup>b</sup>	-1,14 <sup>b</sup>	-0,14 <sup>a</sup>
Combined scale	0,09 <sup>a</sup>	-1,80 <sup>b</sup>	-1,20 <sup>b</sup>	-0,47 <sup>a</sup>

TABLE 4.5: MEASURE OF SERVICE ADEQUACY: VARIABLES NUMBERS TWO AND THREE

Notes regarding Tables 4.4 and 4.5:

<sup>a</sup>, <sup>b</sup> = Means with the same superscripts are not significantly different for each dimension and means with different superscripts are significantly different for each dimension.

Significant differences in mean scale values of respondents (0= indifference) - segmented according to the overall quality variables Numbers two and three

The above findings are similar to those of Parasuraman *et al.* (1988:30), and meet Churchill's (1979:70) requirement of correlating with other measures of the same variable. It was concluded that the strengths and persistence of

the linkages between overall quality and the ECGSI scores offered support equal to that of SERVQUAL for ECGSI's convergent validity.

#### 4.5 Summary of the development of ECGSI

This chapter describes the compilation of a list of items and from it the development of an instrument (called ECGSI) to assess the quality of corporate governance service in public entities. The process recommended by Churchill (1979:64-73) and followed by Parasuraman *et al.* (1988:19-22) was used in this study. ECGSI was developed with reliability properties recommended by Churchill and comparable to those of SERVQUAL (Parasuraman *et al.*, 1988:24). The alpha values were between 0,84 and 0,95 with factor loadings between 0,42 and 0,93. The average pairwise correlation among the four factors following oblique rotation was 0,29 and it was concluded that the newly developed ECGSI passed the test and could be used to assess the quality of corporate governance in public entities.



## CHAPTER FIVE: RESULTS AND ASSESSMENT OF THE QUALITY OF CORPORATE GOVERNANCE SERVICE IN PUBLIC ENTITIES

### 5.1 Introduction

This chapter is aims to satisfy both the executive reader and the researcher, as recommended by Dawson (1984:38) in his eleventh research step. The detailed findings are reported in both tabular and text format and are summarised in graphical format. All data references in the text as well as graphical data are from Table 5.1 "Measures of quality".

### 5.2 Responses and response processing

The items included in ECGSI all formed part of the list of items used to develop ECGSI and none needed rewording. The 49 responses obtained to develop ECGSI contained all the information needed to evaluate corporate governance in public entities. The 42 persons who remained (after 97 out of the population of 139 were approached during the first test) were likely to bring in only 20 responses if the response rate were similar to the first test. Churchill (1979:70) advises against approaching respondents for a second time because of respondents' memories. It was concluded that the 49 responses in hand were better than what could be achieved with a second test.

A calculation using the formula presented by Anderson *et al.* (1984:229) revealed that a sample of 39 respondents would give a 99 % probability that the sample mean would not differ from the population mean by more than



0,2. The 49 responses in hand implied a 99,5 % probability that the sample mean did not differ from the population mean by more than 0,2. It was therefore concluded that the responses in hand were adequate and the responses received from the 49 respondents were processed in assessment of the service.

### 5.3 Findings: Measures of quality

The findings of the assessment of quality of corporate governance in public entities are set out in Table 5.1 and discussed in the rest of this chapter. The table shows dimensions in decreasing order according to the measure of service adequacy and in the dimensions items are reported in decreasing order, also according to the measure of service adequacy.



ECGSI Statement	Mean Scores (MS) and Standard Deviation (SD)									
	Desired		Lowest acceptable		Actual perception		MSS		MSA	
	MS	SD	MS	SD	MS	SD	MS	SD	MS	SD
<b>Directing &amp; monitoring - overall mean scores</b>	<b>6,3</b>	<b>0,5</b>	<b>5,3</b>	<b>0,8</b>	<b>4,6</b>	<b>1,0</b>	<b>-1,8</b>	<b>1,1</b>	<b>-0,8</b>	<b>1,2</b>
24 Being assertive (not rubber stamps) with the CEO	6,2	0,9	5,1	1,3	4,8	1,3	-1,4	1,4	-0,3	1,6
36 Ensuring that sound financial controls are in place	6,6	0,8	5,9	1,1	5,4	1,4	-1,1	1,3	-0,4	1,5
46 Asking appropriate, intelligent questions	6,2	0,8	5,2	1,1	4,5	1,3	-1,7	1,4	-0,7	1,7
54 Measuring the entity's output	6,3	0,7	5,3	1,1	4,7	1,3	-1,6	1,4	-0,7	1,4
27 Properly monitoring the CEO	6,1	0,8	5,1	1,1	4,4	1,3	-1,7	1,4	-0,8	1,5
31 Utilising the best external advice and assistance	5,9	1,1	4,8	1,1	4,0	1,2	-1,9	1,4	-0,8	1,5
40 Ensuring the organisational objectives are met	6,2	1,0	5,0	1,3	4,2	1,2	-2,0	1,2	-0,8	1,4
53 Displaying care and skill as with their own affairs	6,4	0,7	5,6	1,1	4,8	1,2	-1,7	1,3	-0,8	1,4
55 Preventing the CEO from misleading the board	6,6	0,7	5,8	0,9	5,0	1,5	-1,5	1,5	-0,8	1,7
26 Providing overall direction to the CEO	6,5	0,6	5,4	1,0	4,5	1,4	-2,0	1,5	-0,9	1,7
39 Knowing what info is needed to govern and getting it	6,2	0,7	5,1	1,0	4,1	1,2	-2,1	1,2	-0,9	1,5
41 Taking politically unpopular action when needed	6,3	0,7	5,2	1,2	4,2	1,7	-2,1	1,7	-0,9	2,1
49 Doing their homework thoroughly	6,4	0,6	5,4	0,9	4,4	1,3	-2,0	1,3	-1,0	1,6
37 Being always properly prepared for meetings	6,5	0,6	5,5	1,0	4,3	1,5	-2,1	1,4	-1,2	1,7
<b>Board capacity</b>	<b>6,5</b>	<b>0,5</b>	<b>5,7</b>	<b>0,7</b>	<b>4,8</b>	<b>1,1</b>	<b>-1,6</b>	<b>1,1</b>	<b>-0,8</b>	<b>1,2</b>
23 Being balanced in composition (e.g. financial, legal)	6,3	0,8	5,0	1,0	4,7	1,2	-1,6	1,3	-0,3	1,5
34 Having members with expert financial knowledge	6,1	1,0	5,2	1,1	4,8	1,4	-1,3	1,5	-0,4	1,5
33 Displaying impeccable integrity & honesty e.g. own claims	6,9	0,3	6,4	0,8	5,4	1,5	-1,4	1,5	-1,0	1,4
52 Avoiding conflict with personal interests	6,6	0,7	5,9	1,1	4,9	1,6	-1,7	1,5	-1,0	1,6
22 Disallowing each other private, conflicting agendas	6,5	0,7	5,7	1,2	4,6	1,4	-1,9	1,3	-1,1	1,6
<b>Assurance</b>	<b>6,3</b>	<b>0,5</b>	<b>5,2</b>	<b>0,8</b>	<b>4,4</b>	<b>1,1</b>	<b>-1,9</b>	<b>1,2</b>	<b>-0,8</b>	<b>1,4</b>
19 Delivering tangible benefits by knowing important people	5,6	1,4	4,5	1,5	4,3	1,5	-1,4	2,0	-0,2	2,0
21 Providing adequate networking	6,0	0,8	4,8	1,1	4,3	1,2	-1,7	1,2	-0,5	1,5
11 Making the stakeholders feel safe with their governance	6,6	0,7	5,5	1,2	4,6	1,4	-2,0	1,5	-0,9	1,8
30 Adding value through their strategic guidance	6,6	0,5	5,3	0,9	4,2	1,3	-2,3	1,3	-1,0	1,7
10 Having the confidence of stakeholders	6,6	0,6	5,7	0,8	4,5	1,4	-2,1	1,3	-1,2	1,5
<b>Responsiveness &amp; reliability</b>	<b>6,3</b>	<b>0,5</b>	<b>5,0</b>	<b>0,9</b>	<b>4,2</b>	<b>1,2</b>	<b>-2,1</b>	<b>1,2</b>	<b>-0,9</b>	<b>1,5</b>
8 Willingness to help stakeholders	6,1	0,9	4,9	1,1	4,7	1,3	-1,4	1,3	-0,2	1,4
9 Readiness to respond to stakeholders' requests	6,0	0,8	4,8	1,1	4,4	1,3	-1,6	1,3	-0,3	1,4
4 Providing the governance service at the right time	6,2	0,8	4,8	1,2	4,0	1,5	-2,2	1,6	-0,8	1,9
2 Dependability in handling stakeholders' problems	6,4	0,8	4,9	1,2	4,0	1,5	-2,4	1,5	-0,9	1,7
7 Promptness in taking governing action	6,5	0,6	5,2	1,1	4,2	1,5	-2,3	1,5	-1,1	1,8
18 Governing continually and not only when convenient	6,3	0,7	5,0	1,3	4,0	1,4	-2,3	1,5	-1,1	1,9
13 Having the knowledge to govern optimally	6,6	0,6	5,5	0,9	4,0	1,6	-2,5	1,7	-1,5	1,8
<b>ECGSI overall mean scores</b>	<b>6,3</b>	<b>0,4</b>	<b>5,3</b>	<b>0,8</b>	<b>4,4</b>	<b>1,0</b>	<b>-1,9</b>	<b>1,0</b>	<b>-0,9</b>	<b>1,2</b>
* Numbers refer to the question numbers in the original instrument and are provided for reference purposes										

TABLE 5.1: MEASURES OF QUALITY

### 5.3.1 Desired service level expected of corporate governors

Table 5.1 shows that the respondents expect a high level of service from corporate governors when asked what their desired level of service was. On a seven-point scale for the overall ECGSI a mean desired service level of 6,3 (standard deviation 0,4) was expected.

The item with the highest desired service level was “displaying impeccable integrity and honesty” with a mean score of 6,9 and a standard deviation of 0,3. The item with the lowest desired service level was “delivering tangible benefits by knowing important people”, with a mean score of 5,6 and a standard deviation of 1,4.

The dimension “board capacity” recorded the highest desired mean score of 6,5 (standard deviation 0,5) with the remaining three dimensions all recording desired mean scores of 6,3.

A graphical summary of dimensional aspects of these findings looks as follows:

	Mean service level	
	Low	High
<b>1. Directing and monitoring</b>		
Scale	1	2 3 4 5 6 7
Desired service level	6,3	
<b>2. Board capacity</b>		
Scale	1	2 3 4 5 6 7
Desired service level	6,5	
<b>3. Assurance</b>		
Scale	1	2 3 4 5 6 7
Desired service level	6,3	
<b>4.Responsiveness &amp; reliability</b>		
Scale	1	2 3 4 5 6 7
Desired service level	6,3	

## FIGURE 5.1: ECGSI ASSESSMENT: DIMENSIONAL DESIRED SERVICE LEVEL

### 5.3.2 Lowest acceptable level of corporate governance service

Table 5.1 indicates that the respondents expect a high level of service from corporate governors when asked what their lowest acceptable level of service was. On a seven-point scale for the overall ECGSI, a mean lowest acceptable service level of 5,3 (standard deviation 0,8) was expected. The item with the best lowest acceptable service level was “displaying impeccable integrity and honesty” with a mean score of 6,4 and a standard deviation of 0,8. The item that scored worst in this category was “delivering tangible benefits by knowing important people” with a mean score of 4,5 and a standard deviation of 1,5.

The dimension “board capacity” recorded the best lowest acceptable mean score of 5,7 (standard deviation 0,7) with “directing and monitoring” second (mean score 5,3 and standard deviation 0,8), “assurance” third (mean score 5,2 and standard deviation 0,8) and “responsiveness and reliability, last (mean score 5,0 and standard deviation 0,9).

A graphical summary of dimensional aspects of these findings looks as follows:

	Mean service level	
	Low	High
1. Directing and monitoring		
Scale	1	2 3 4 5 6 7
Lowest acceptable service level		5,3
2. Board capacity		
Scale	1	2 3 4 5 6 7
Lowest acceptable service level		5,7
3. Assurance		
Scale	1	2 3 4 5 6 7
Lowest acceptable service level		5,2
4. Responsiveness & reliability		
Scale	1	2 3 4 5 6 7
Lowest acceptable service level		5,0

## FIGURE 5.2: ASSESSMENT: DIMENSIONAL LOWEST ACCEPTABLE SERVICE LEVEL

### 5.3.3 Perceptions about corporate governance service

Table 5.1 shows that the respondents experience a relatively low level of service from corporate governors. On a seven-point scale for the overall ECGSI a mean actual service level of 4,4 (standard deviation 1,0) was recorded.

The item with the highest experienced service level was “ensuring that sound financial controls are in place” with a mean score of 5,4 and a standard deviation of 1,4. The item with the lowest experienced service level was “utilising the best external advice and assistance with a mean score of 4,0 and a standard deviation of 1,2.

The dimension “board capacity” recorded the highest experienced mean score of 4,8 (standard deviation 1,1) with “directing and monitoring” second (mean score 4,5 and standard deviation 1,0), and “assurance” third (mean score 4,4 and standard deviation 1,1). “Responsiveness and reliability” received the lowest mean score of 4,2 with a standard deviation of 1,2).

### 5.3.4 Measure of corporate governance service superiority (MSS)

Parasuraman *et al.* (1994:202) recommend that this service level measure be calculated by subtracting the desired service level from the experienced service level. This is done not only for each item but also for each dimension and for the overall ECGSI. On items and dimensions where this measure gives a positive answer the experienced service level exceeded the desired service level. On items and dimensions where this measure gives a negative answer the experienced service level is lower than the desired service level. Table 5.1 indicates that the calculated MSS for the overall ECGSI resulted in a mean service level of -1,9 (standard

deviation 1,0). This implies that the mean experienced service falls short of the expected by 1,9 when measured on a seven-point-scale.

Without exception the service level on all items fell short of the desired expectation when the MSS was used. The item with the least negative score was "ensuring that sound financial controls are in place" with a mean score of -1,1 and a standard deviation of 1,3. Three items recorded the third most-negative score of -2,3, namely "adding value through their strategic guidance" (standard deviation 1,3), "promptness in taking governance action" (standard deviation 1,5) and "governing continually and not only when convenient" (standard deviation 1,5). The item "dependability in handling stakeholder's problems" recorded the second most negative score of -2,4 with a standard deviation of 1,5. The item "having the knowledge to optimally govern" recorded the most negative score namely -2,5 with a standard deviation of 1,7.

Without exception the service level on all four dimensions falls short of desired expectation when the MSS is used. The dimension with the least negative score was "board capacity" with a mean score of -1,6 and a standard deviation of 1,1. The dimension with the second least negative score was "directing and monitoring" with a mean score of -1,8 and a standard deviation of 1,1. The dimension with the second highest negative score was "assurance" with a mean score of -1,9 and a standard deviation of 1,2. The dimension with the highest negative score was "responsiveness and reliability" with a mean score of -2,1 and a standard deviation of 1,2.

A graphical summary of dimensional aspects of these findings looks as follows:

5.3.4.1 Directing and monitoring

## ECGSI ASSESSMENT Measure of Service Superiority

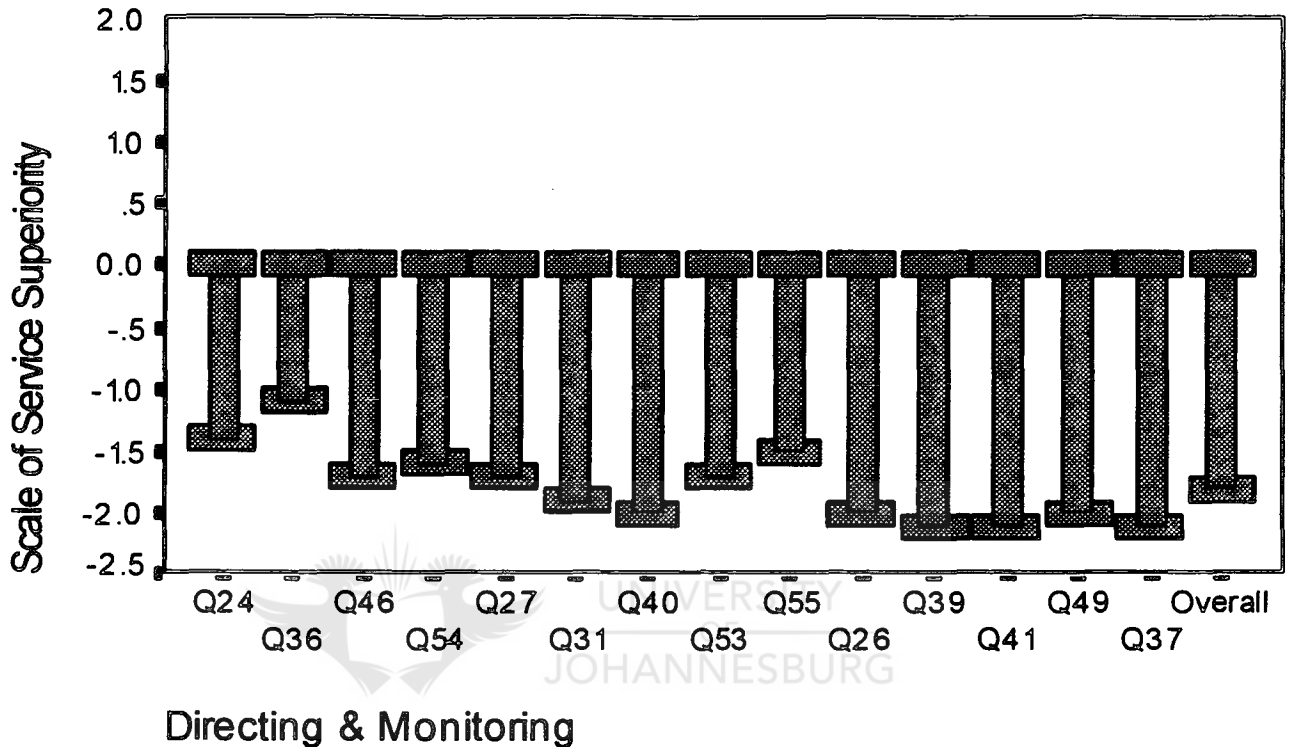


FIGURE 5.3: ECGSI ASSESSMENT: DIRECTING AND MONITORING MSS

- Question 24: Being assertive (not rubber stamps) with the CEO
- Question 36: Ensuring that sound financial controls are in place
- Question 46: Asking appropriate, intelligent questions
- Question 54: Measuring the entity's output
- Question 27: Property monitoring the CEO
- Question 31: Utilising the best external advice and assistance
- Question 40: Ensuring the organisational objectives are met
- Question 53: Displaying care and skill as with their own affairs
- Question 55: Preventing the CEO from misleading the board
- Question 26: Providing overall direction to the CEO
- Question 39: Knowing what information is needed to govern and getting it
- Question 41: Taking politically unpopular action when needed
- Question 49: Doing their homework thoroughly
- Question 37: Being always properly prepared for meetings

5.3.4.2 Board capacity

## ECGSI ASSESSMENT Measure of Service Superiority

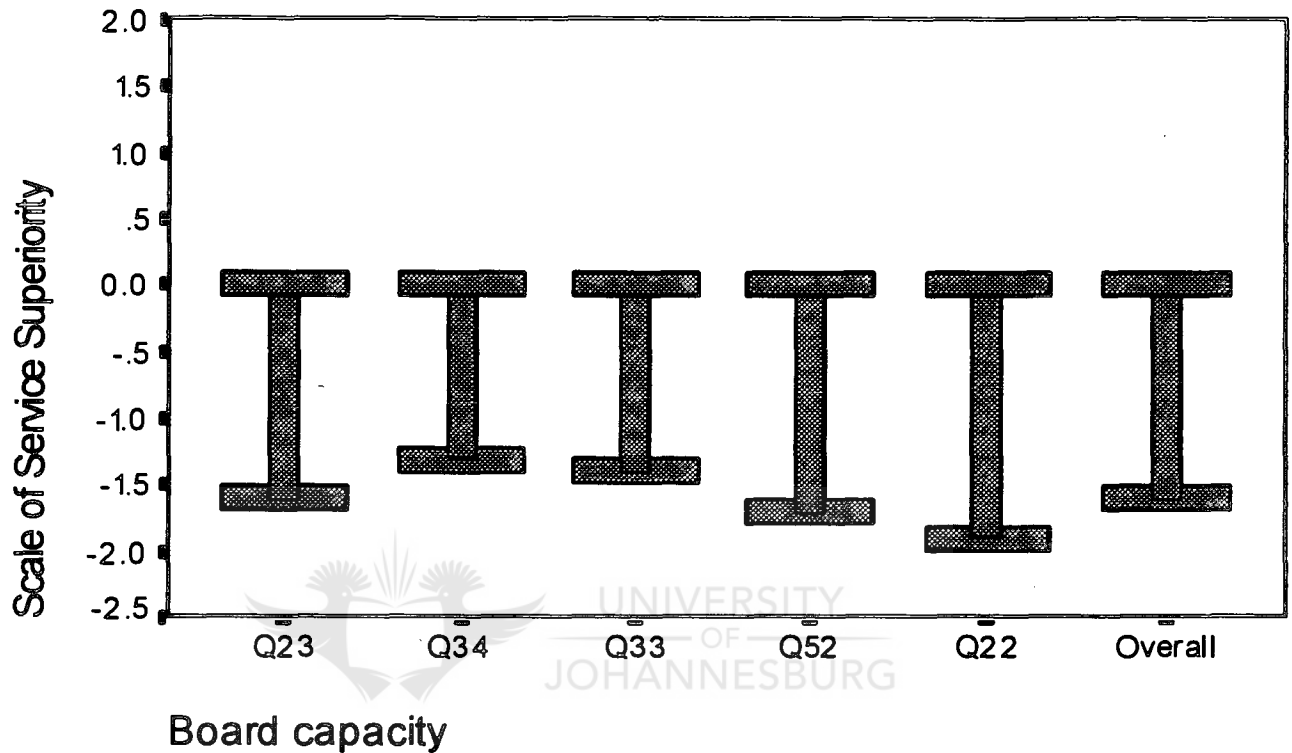


FIGURE 5.4: ECGSI ASSESSMENT: BOARD CAPACITY MSS

- Question 23: Being balanced in composition (e.g. financial, legal)
- Question 34: Having members with expert financial knowledge
- Question 33: Displaying impeccable integrity and honesty, e.g. own claims
- Question 52: Avoiding conflict with personal interests
- Question 22: Disallowing each other private, conflicting agendas



5.3.4.3 Assurance

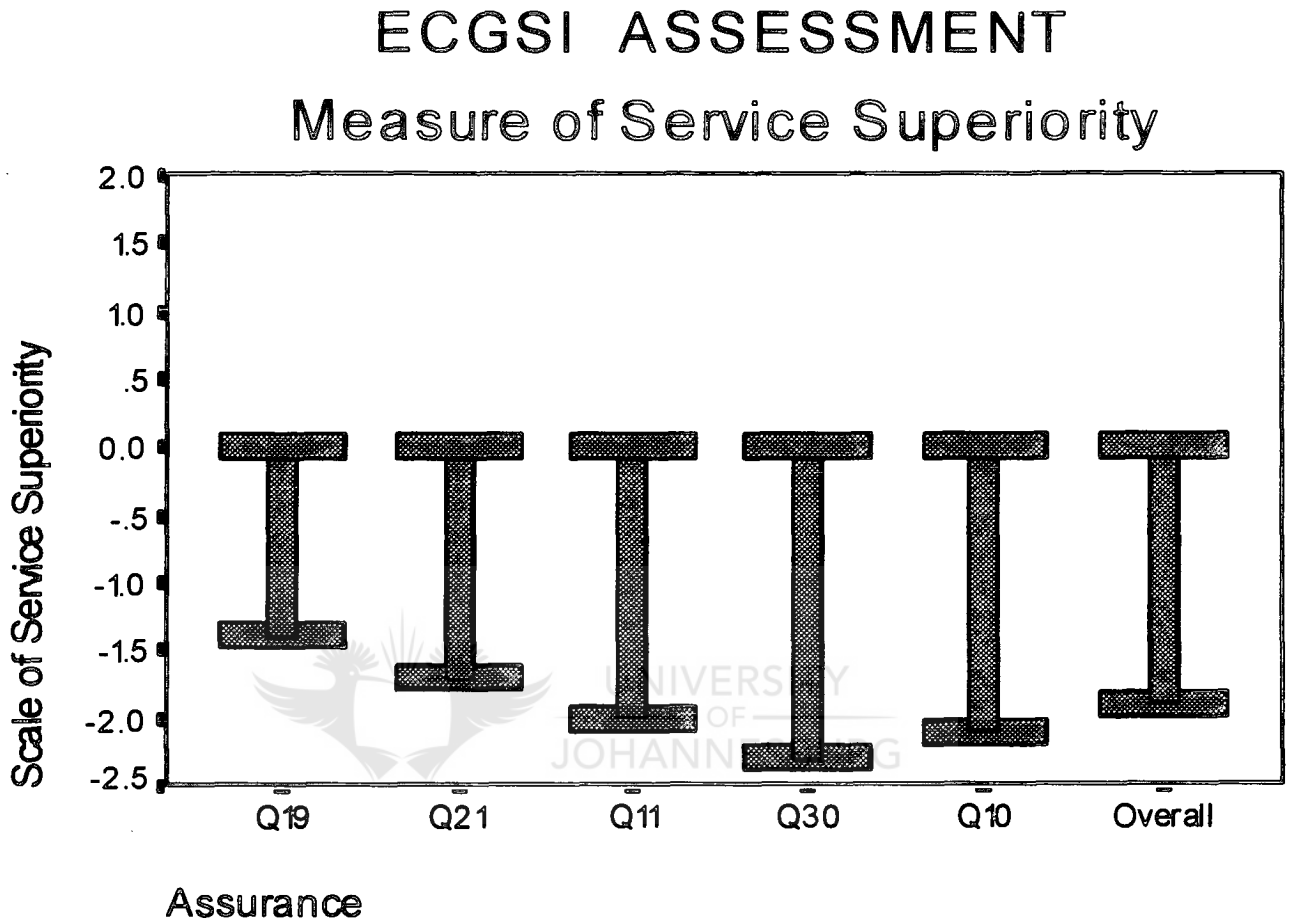


FIGURE 5.5: ECGSI ASSESSMENT: ASSURANCE MSS

- Question 19: Delivering tangible benefits by knowing important people
- Question 21: Providing adequate networking
- Question 11: Making the stakeholders feel safe with their governance
- Question 30: Adding value through their strategic guidance
- Question 10: Having the confidence of stakeholders

5.3.4.4 Responsiveness and reliability

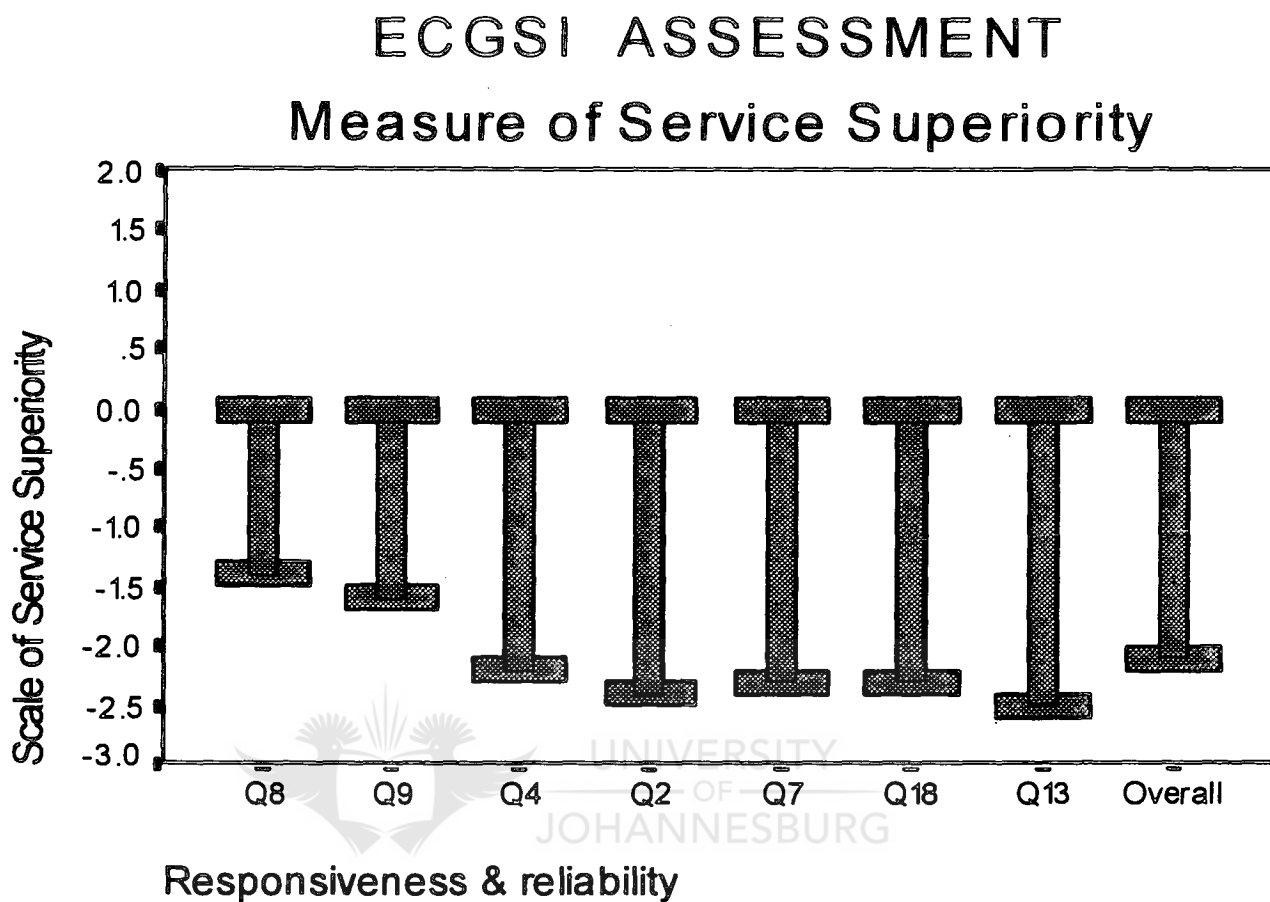


FIGURE 5.6: ECGSI ASSESSMENT: RESPONSIVENESS MSS

- Question 8: Willingness to help stakeholders
- Question 9: Readiness to respond to stakeholders' requests
- Question 4: Providing the governance service at the right time
- Question 2: Dependability in handling stakeholders' problems
- Question 7: Promptness in taking governance action
- Question 18: Governing continually and not only when convenient
- Question 13: Having the knowledge to govern optimally

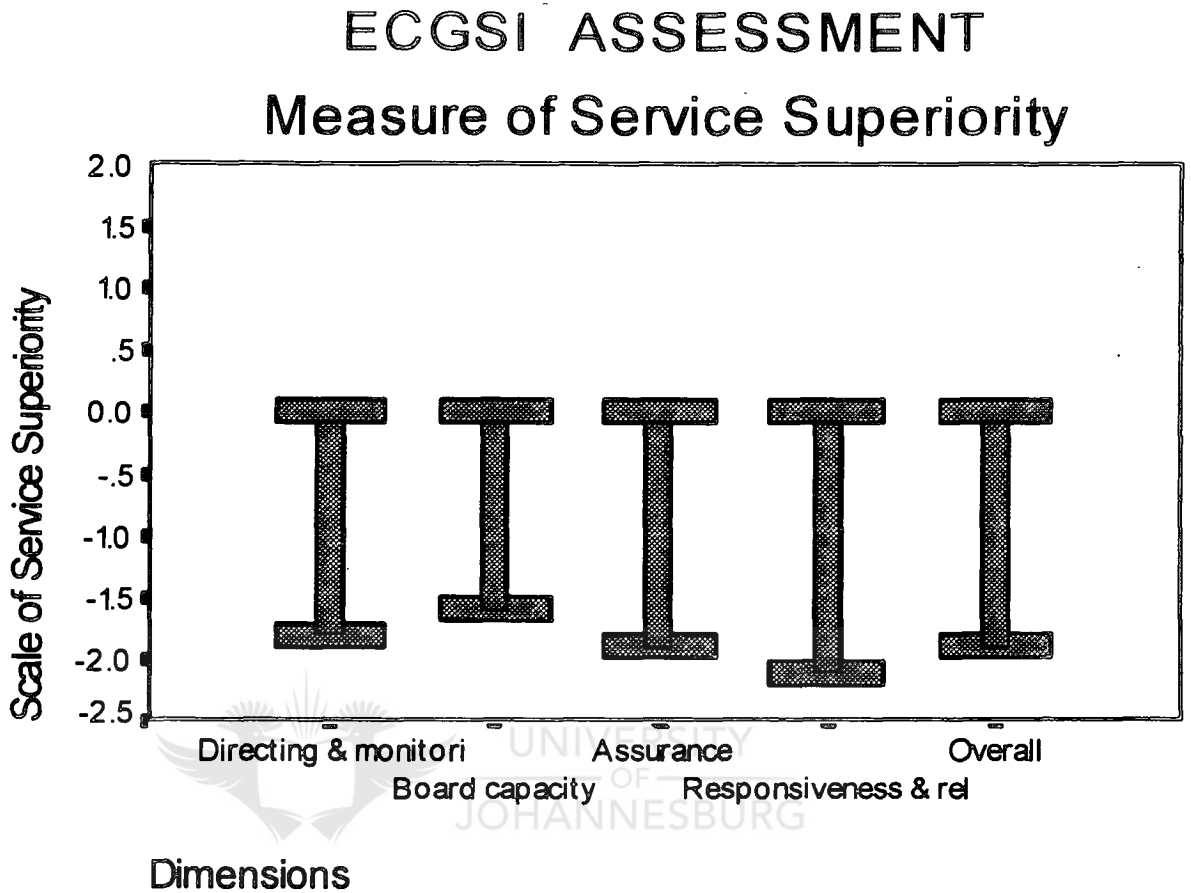


FIGURE 5.7: ECGSI ASSESSMENT: DIMENSIONAL AND OVERALL MSS

#### 5.3.5 Measure of corporate governance service adequacy (MSA)

Parasuraman *et al.* (1994:202) recommend that this service level measure be calculated by subtracting the lowest acceptable service level from the experienced service level. This is done not only for each item but also for each dimension and for the overall ECGSI. On items and dimensions where this measure gives a positive answer the experienced service level exceeds the lowest acceptable service level.

On items and dimensions where this measure gives a negative answer the experienced service level is lower than the lowest acceptable service level. Table 5.1 shows that the calculated MSA for the overall ECGSI resulted in a mean service level of -0,9 (standard deviation 1,2). This implies that the mean experienced service fell short of the lowest acceptable by 0,9 when measured on a seven-point scale.

Without exception, when measured against this lowered standard, the service level on all items still fell short of the lowest acceptable expectation when the MSA was used. The two items that had the same least negative mean score of -0,2 were "delivering tangible benefits by knowing important people" (standard deviation 2,0) and "willingness to help stakeholders" (standard deviation 1,4). Three items recorded the third most-negative score of -1,1, namely "disallowing each other private, hidden agendas" (standard deviation 1,6), "promptness in taking governance action" (standard deviation 1,8) and "governing continually and not only when convenient" (standard deviation 1,9). Two items recorded the second most-negative mean score of -1,2, namely "having the confidence of stakeholders" (standard deviation 1,5) and "being always properly prepared for meetings" (standard deviation 1,7). The item "having the knowledge to optimally govern" recorded the most negative mean score namely -1,5 with a standard deviation of 1,8.

Without exception the service level on all four dimensions fell short of the lowest acceptable expectation when the MSA was used. Three dimensions recorded the same negative mean score of -0,8 with "directing and monitoring" and "board capacity" having standard deviations of 1,2 and "assurance" having a standard deviation of 1,4. The dimension with the highest negative score was "responsiveness and reliability" with a mean score of -1,5 and a standard deviation of 1,8.

A graphical summary of dimensional aspects of these findings looks as follows:

## ECGSI ASSESSMENT Measure of Service Adequacy

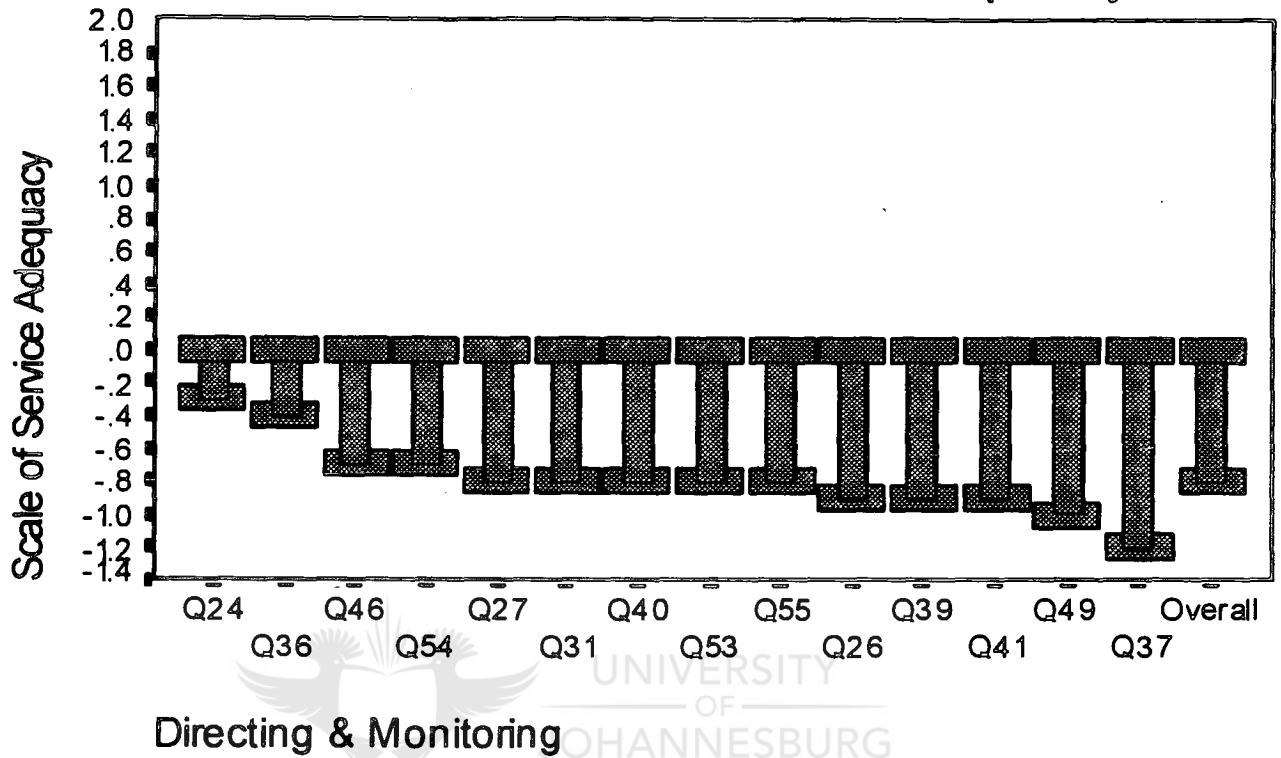


FIGURE 5.8: ECGSI ASSESSMENT: DIRECTING AND MONITORING MSA

- Question 24: Being assertive (not rubber stamps) with the CEO
- Question 36: Ensuring that sound financial controls are in place
- Question 46: Asking appropriate, intelligent questions
- Question 54: Measuring the entity's output
- Question 27: Property monitoring the CEO
- Question 31: Utilising the best external advice and assistance
- Question 40: Ensuring the organisational objectives are met
- Question 53: Displaying care and skill as with their own affairs
- Question 55: Preventing the CEO from misleading the board
- Question 26: Providing overall direction to the CEO
- Question 39: Knowing what information is needed to govern and getting it
- Question 41: Taking politically unpopular action when needed
- Question 49: Doing their homework thoroughly
- Question 37: Being always properly prepared for meetings

5.3.5.2 Board capacity

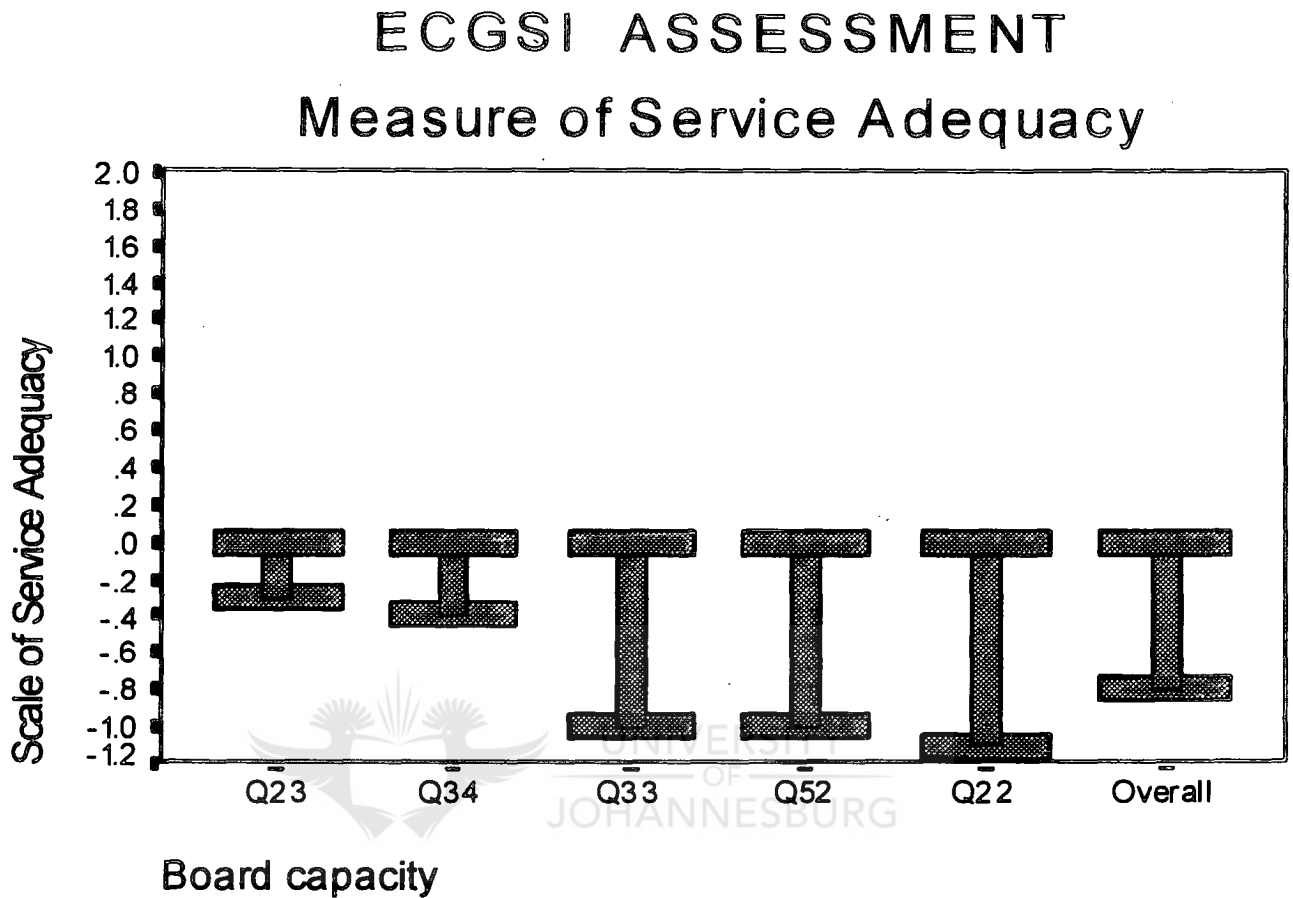


FIGURE 5.9: ECGSI ASSESSMENT: BOARD CAPACITY MSA

- Question 23: Being balanced in composition (e.g. financial, legal)
- Question 34: Having members with expert financial knowledge
- Question 33: Displaying impeccable integrity and honesty, e.g. own claims
- Question 52: Avoiding conflict with personal interests
- Question 22: Disallowing each other private, conflicting agendas

5.3.5.3 Assurance

## ECGSI ASSESSMENT Measure of Service Adequacy

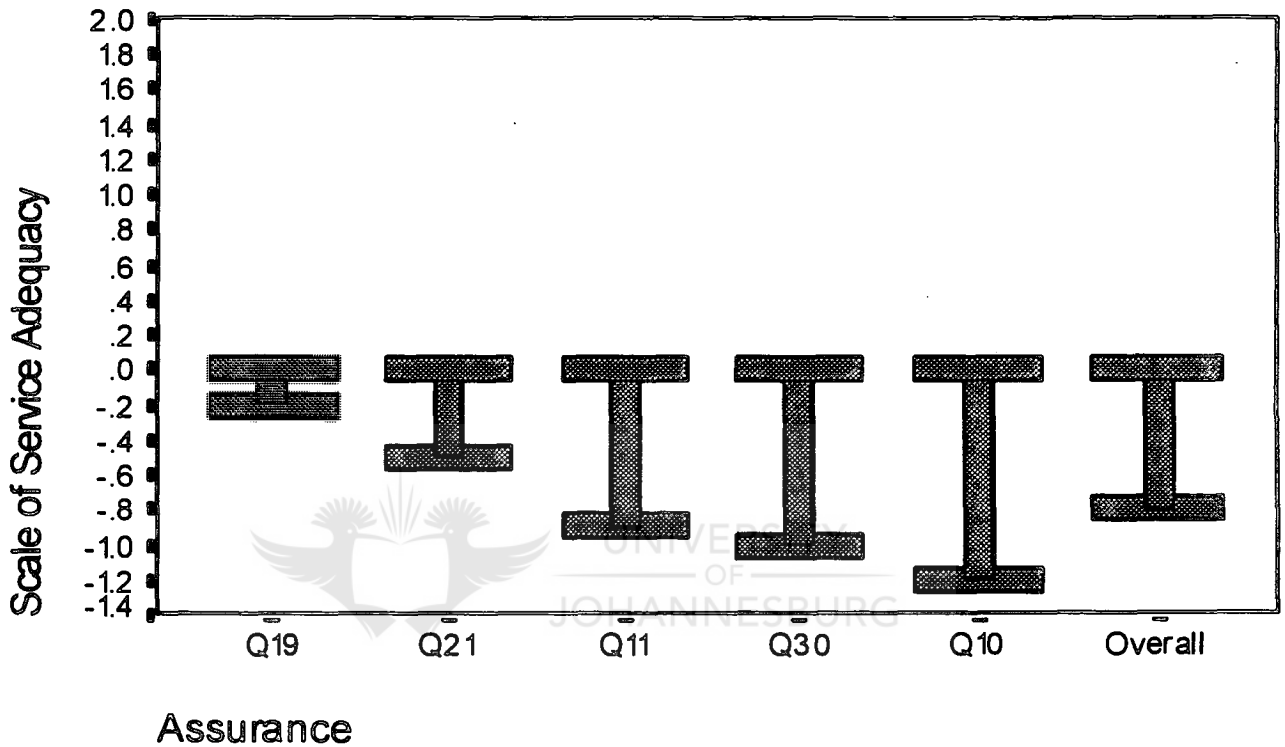


FIGURE 5.10: ECGSI ASSESSMENT: ASSURANCE MSA

- Question 19: Delivering tangible benefits by knowing important people
- Question 21: Providing adequate networking
- Question 11: Making the stakeholders feel safe with their governance
- Question 30: Adding value through their strategic guidance
- Question 10: Having the confidence of stakeholders

5.3.5.4 Responsiveness and reliability

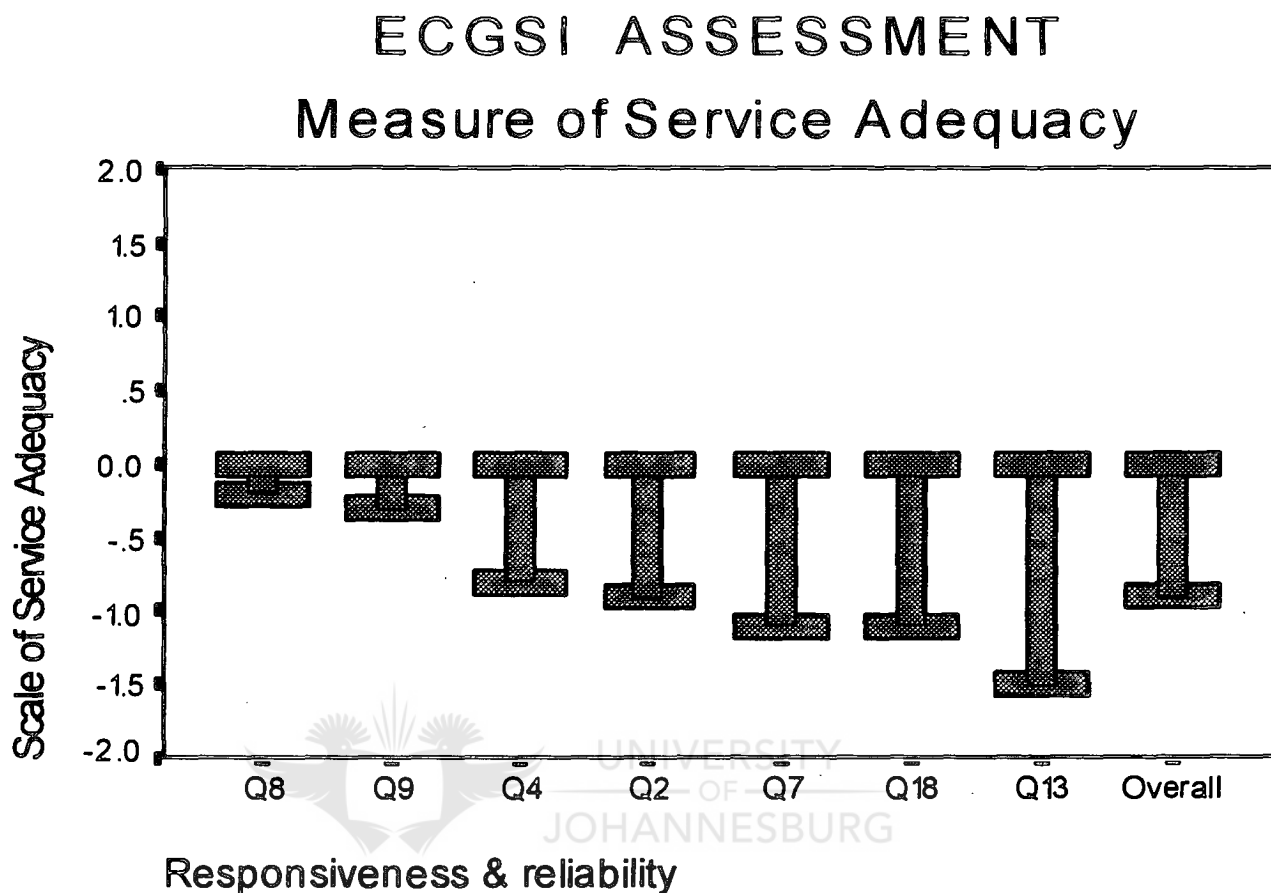


FIGURE 5.11: ECGSI ASSESSMENT: RESPONSIVENESS AND RELIABILITY MSA

- Question 8: Willingness to help stakeholders
- Question 9: Readiness to respond to stakeholders' requests
- Question 4: Providing the governance service at the right time
- Question 2: Dependability in handling stakeholders' problems
- Question 7: Promptness in taking governance action
- Question 18: Governing continually and not only when convenient
- Question 13: Having the knowledge to govern optimally



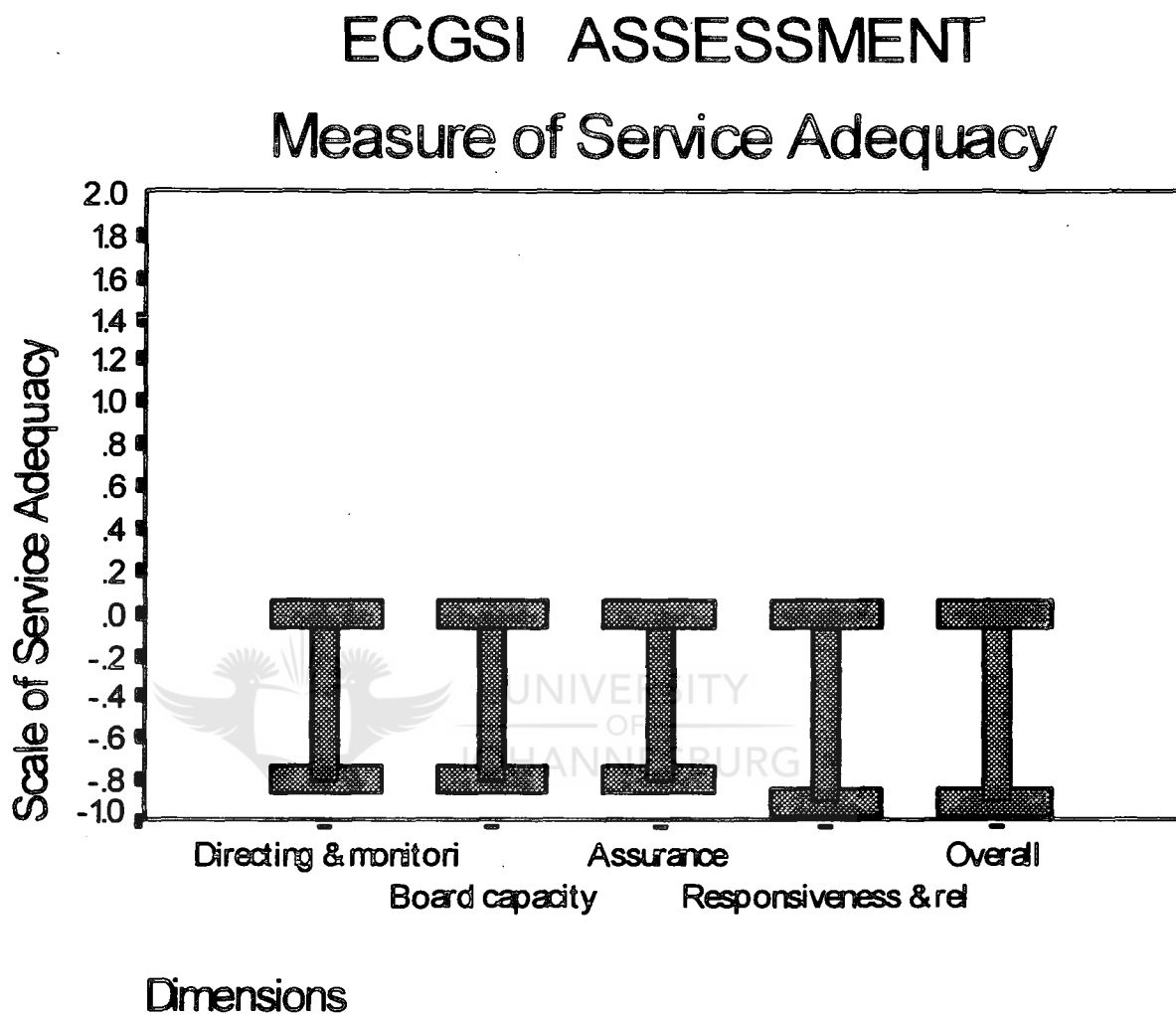


FIGURE 5.12: ECGSI ASSESSMENT: DIMENSIONAL AND OVERALL MSA

#### 5.4 Discussion of the assessment findings

##### 5.4.1 Zone of tolerance: expectations versus lowest acceptable

Parasuraman *et al.* (1994:202) report that a desired service level and an adequate service level are separated by a zone of tolerance. This area represents the range of

service performance that is regarded as acceptable. In Parasuraman *et al.*'s (1994:216) assessment of the service levels of four companies the zones of tolerance on the dimensions are just over one on a nine-point scale.

The ECGSI respondents' overall mean tolerance was the difference between the mean desired service level of 6,3 and the mean lowest acceptable service level of 5,3 resulting in a tolerance of 1,05. The zones of tolerance on the four dimensions are indicated in Table 5.2 below:

<u>Dimension</u>	<u>Mean zone of tolerance</u>
Directing and monitoring	1,0
Board capacity	0,8
Assurance	1,1
Responsiveness and reliability	1,3

TABLE 5.2: ECGSI ASSESSMENT: DIMENSIONAL ZONES OF TOLERANCE

Judging by the zones of tolerance reported by Parasuraman *et al.* (1994:216, Figure 1), i.e. approximately one on a nine-point scale in respect of the life insurance company, the South African ECGSI respondents were at least as tolerant as those in the United States. The poor MSA scores reported for the corporate governors are therefore not a result of intolerance of the South African respondents. The actual service is the point in issue. A graphical summary of dimensional aspects of these findings looks as follows:

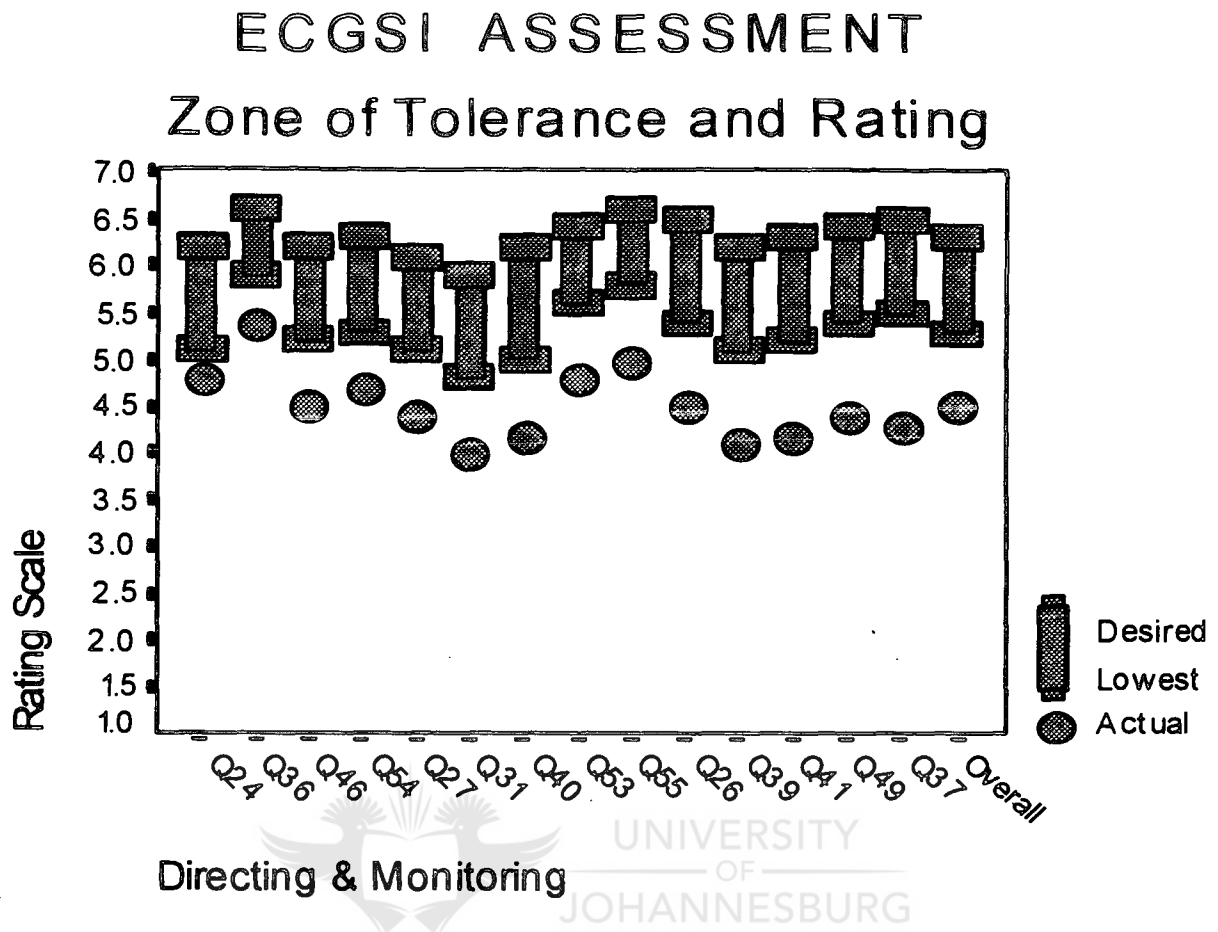


FIGURE 5.13: ECGSI ASSESSMENT: DIRECTING AND MONITORING ZONES OF TOLERANCE AND RATINGS

- Question 24: Being assertive (not rubber stamps) with the CEO
- Question 36: Ensuring that sound financial controls are in place
- Question 46: Asking appropriate, intelligent questions
- Question 54: Measuring the entity's output
- Question 27: Properly monitoring the CEO
- Question 31: Utilising the best external advice and assistance
- Question 40: Ensuring the organisational objectives are met
- Question 53: Displaying care and skill as with their own affairs
- Question 55: Preventing the CEO from misleading the board
- Question 26: Providing overall direction to the CEO
- Question 39: Knowing what information is needed to govern and getting it
- Question 41: Taking politically unpopular action when needed
- Question 49: Doing their homework thoroughly
- Question 37: Being always properly prepared for meetings

5.4.1.2 Board capacity

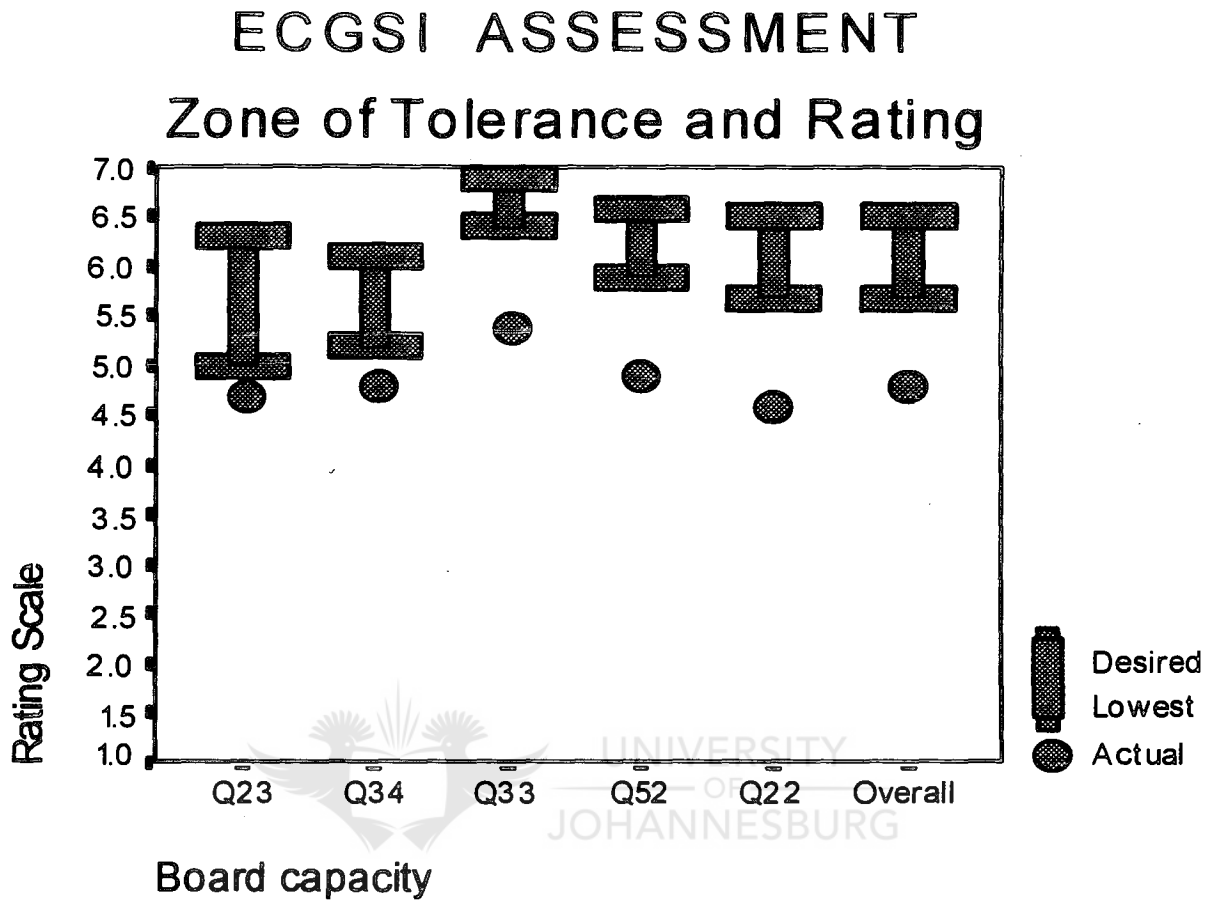


FIGURE 5.14: ECGSI ASSESSMENT: BOARD CAPACITY ZONES OF TOLERANCE AND RATINGS

- Question 23: Being balanced in composition (e.g. financial, legal)
- Question 34: Having members with expert financial knowledge
- Question 33: Displaying impeccable integrity and honesty, e.g. own claims
- Question 52: Avoiding conflict with personal interests
- Question 22: Disallowing each other private, conflicting agendas

5.4.1.3 Assurance

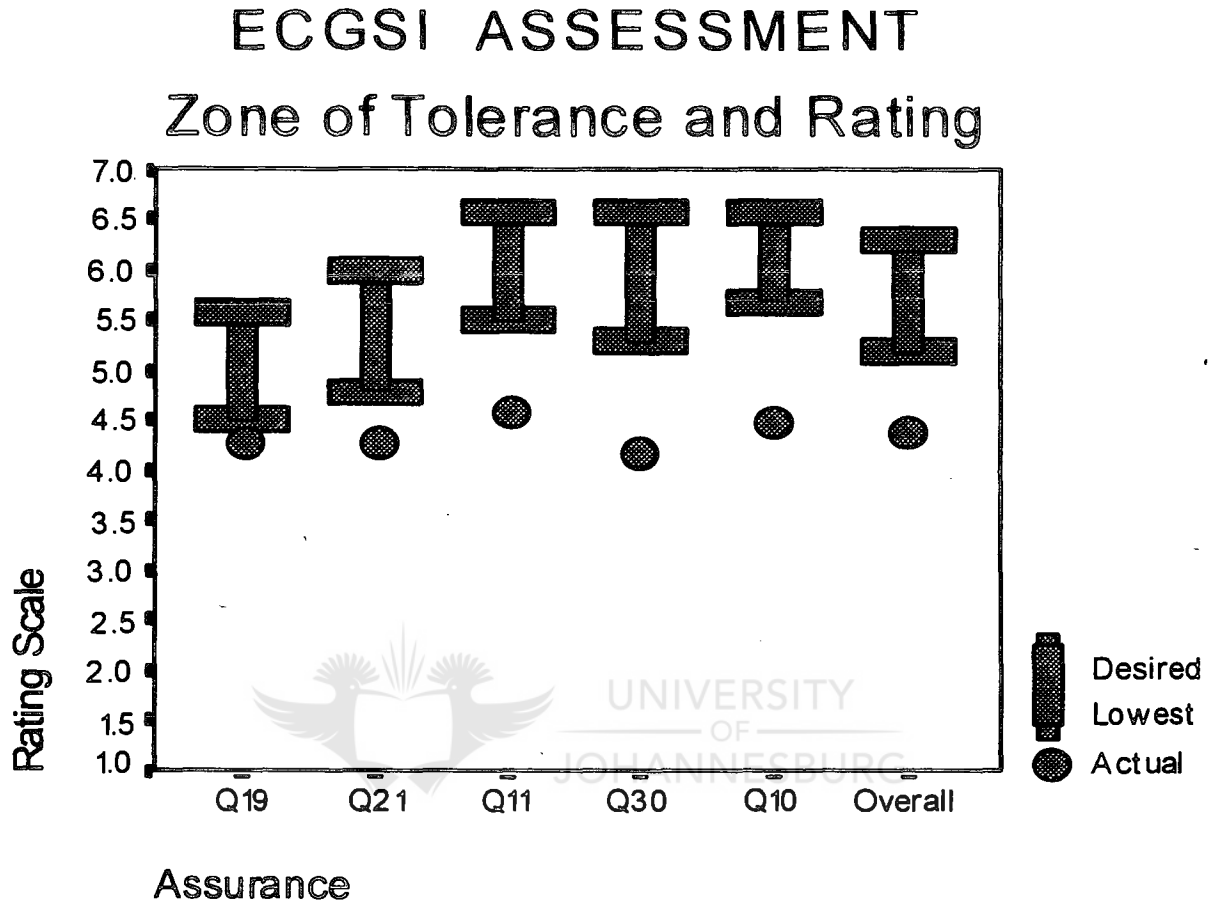


FIGURE 5.15: ECGSI ASSESSMENT: ASSURANCE ZONES OF TOLERANCE AND RATINGS

- Question 19: Delivering tangible benefits by knowing important people
- Question 21: Providing adequate networking
- Question 11: Making the stakeholders feel safe with their governance
- Question 30: Adding value through their strategic guidance
- Question 10: Having the confidence of stakeholders

5.4.1.4 Responsiveness and reliability

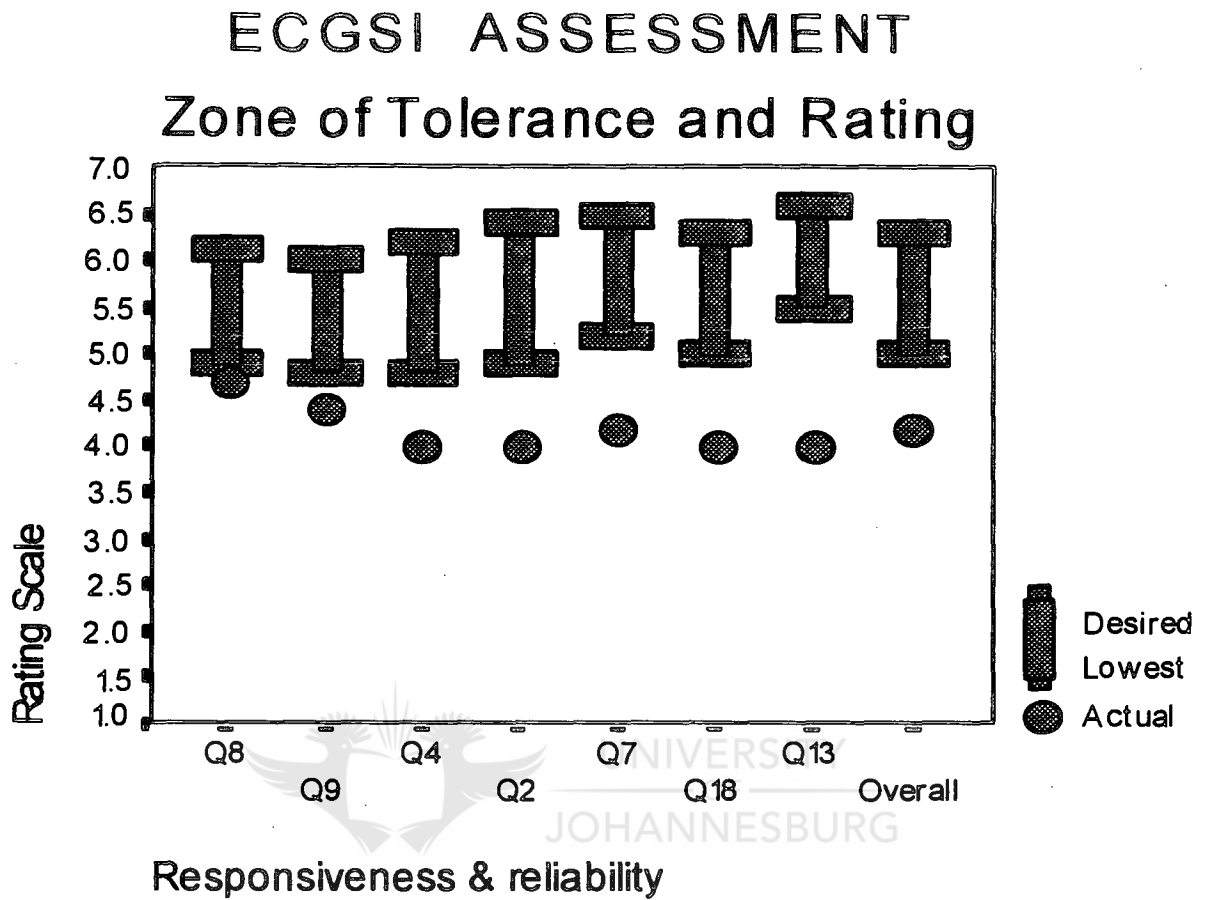


FIGURE 5.16: ECGSI ASSESSMENT: RESPONSIVENESS AND RELIABILITY ZONES OF TOLERANCE AND RATINGS

- Question 8: Willingness to help stakeholders
- Question 9: Readiness to respond to stakeholders' requests
- Question 4: Providing the governance service at the right time
- Question 2: Dependability in handling stakeholders' problems
- Question 7: Promptness in taking governance actions
- Question 18: Governing continually and not only when convenient(
- Question 13: Having the knowledge to govern optimally

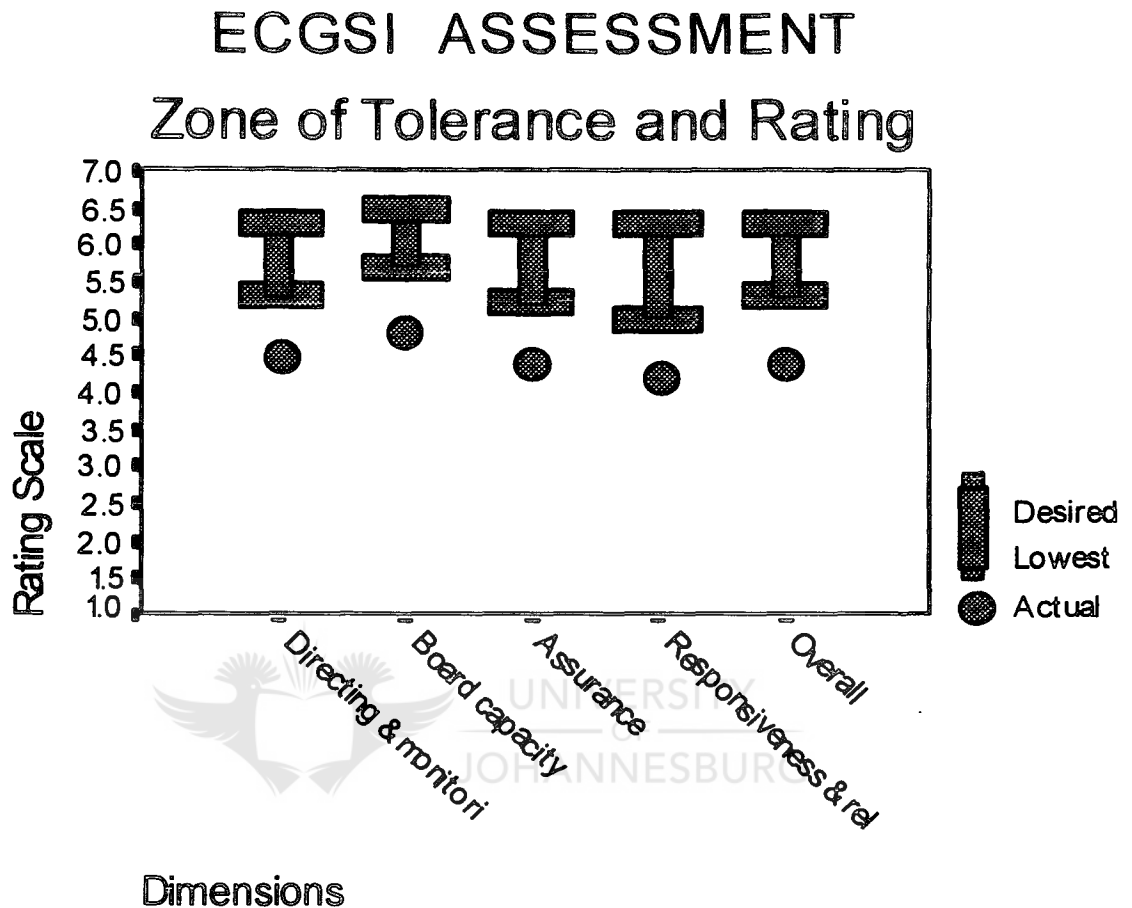


FIGURE 5.17: ECGSI ASSESSMENT: DIMENSIONAL AND OVERALL ZONES OF TOLERANCE AND RATINGS

#### 5.4.2 Comparing the assessment with assessments of other services

Churchill (1979:72) recommended that, as a final step in developing an instrument, the assessment be compared with the assessment of other services. To further analyse the results of this assessment of corporate governance service, these results were compared with the results of assessments of services where SERVQUAL was

used. These comparisons were done on two levels, namely the Measure of Service Superiority and the Measure of Service Adequacy.

#### 5.4.2.1 Comparing the assessment with other assessments at MSS level

Two sets of published assessments of service at the MSS level where SERVQUAL was used, were compared with the ECGSI assessment of corporate governance service at the MSS level. Parasuraman *et al.* (1993:147), read alongside Parasuraman *et al.* (1991:446), produced an MSS assessment of an insurance company on a seven-point scale. This assessment is compared below with the ECGSI assessment of corporate governance service.

<u>DIMENSION</u>	<u>INSURANCE</u>	<u>CORP. GOVERN</u>
Tangibles	0,0	
Assurance	-1,0	-1,9
Empathy	-1,1	
Responsiveness	-1,3	
Reliability	-1,6	
Responsiveness and reliability		-2,1
Board capacity		-1,6
Directing and monitoring		-1,8

TABLE 5.3: COMPARISON OF CORPORATE GOVERNANCE SERVICE AND OTHER SERVICES AT MSS LEVEL

Although the dimensions were not the same, the insurance company managed to give superior service on one of the dimensions. The worst assessment of the insurance company, namely -1,6, is the same as the best assessment received by corporate governors. The worst assessment received by corporate governors (-2,1) is substantially worse than that received by the insurance company (-1,6).



Herbert (1994:17) reported library service findings using SERVQUAL as an instrument. Herbert's results and the ECGSI findings are compared in Table 5.4 below:

<u>DIMENSION</u>	<u>LIBRARY</u>	<u>CORP. GOVERNANCE</u>
Tangibles	+1,2	
Assurance	-0,57	-1,9
Empathy	-0,68	
Responsiveness	-0,77	
Reliability	-1,10	
Responsiveness and reliability		-2,1
Directing and monitoring		-1,8
Board capacity		-1,6

**TABLE 5.4: COMPARISON OF CORPORATE GOVERNANCE SERVICE AND LIBRARY SERVICES AT MSS LEVEL**



In their best dimension the library service was superior by 1,2 while corporate governors fell short by 1,6 on theirs. Corporate governors also did substantially worse on their best dimension than the library service providers on their worst dimension.

This shows conclusively that, using MSS as a yardstick, corporate governors did not deliver any superior service on the measured dimensions. When compared with similar studies other service providers rendered superior service in one of the measured dimensions. Regarding magnitude, the corporate governors' service was rated substantially worse than other comparable services that have been reported on.

#### 5.4.2.2 Comparing assessment with other assessments at MSA level

Parasuraman *et al.* (1994:217) at MSA level reported the service assessments for four companies. As these assessments were done on a nine-point scale a comparison with the corporate governance service (done on a seven-point scale) should favour the corporate governance service. The comparison resulted in Table 5.5 below:

<u>DIMENSION</u>	<u>IT CO</u>	<u>RETAIL</u>	<u>AUTO</u>	<u>INSURER</u>	<u>CORP</u>
<u>GOV</u>					
Tangibles	+1,5	+0,6	+0,8	+0,5	
Assurance	+0,6	-0,2	+0,5	+0,2	-0,8
Responsive	+0,4	-0,4	+0,5	+0,2	
Reliability	+0,3	-0,5	+0,3	+0,2	
Responsiveness & reliability					-0,9
Empathy	+0,3	-0,4	+0,4	+0,2	
Directing and monitoring					-0,8
Board capacity					-0,8

**TABLE 5.5: COMPARISON OF CORPORATE GOVERNANCE SERVICE AND OTHER SERVICES AT MSA LEVEL**

At this lower level of service expectation, the Measure of Service Adequacy (MSA) level, three of the four companies provided the service at least adequately on all the measured dimensions. The company rated worst outperformed corporate governors as it was rated more than adequate on one dimension while on its worst rated dimension it did better than corporate governors on their best dimension. The providers of the corporate governance service in public entities were rated as giving inadequate service on all the measured dimensions by a substantial margin.

## 5.5 Summary

This chapter discusses the respondents' assessment of corporate covariance in South African public entities as practised by non-executive directors.

It was found that respondents held expectations of this service comparable to those held about several American companies' service. This was true for both levels of expectation, namely the service level desired as well as the lowest service level regarded as acceptable. The difference between these two service levels, also called the zone of tolerance, was for corporate governance service similar to several American companies. Therefore tolerance is not the issue but actual service.

Respondents felt that the service rendered by public entity corporate governors was below expectations. The overall mean score, on a seven-point scale, was 1,9 points below the desired service level and 0,9 points below the lowest acceptable service level. On all four dimensions and even on all the evaluation items the service was assessed as below both the desired and lowest acceptable service levels. This was out of line with the assessments done in the United States where services were assessed as generally above lowest acceptable level and substantially better than the corporate governance service at the desired service level.

On the lowest acceptable service level assessment, the two items that had the same least negative mean score of -0,2 were "delivering tangible benefits by knowing important people" and "willingness to help stakeholders". Three items recorded the third most-negative score of -1,1, namely "disallowing each other private , hidden agendas", "promptness in taking governance action" and "governing continually and not only when convenient". Two items recorded the second most-negative mean score of -1,2, namely "having the confidence of stakeholders" and being always properly prepared for meetings". The item "having the knowledge to optimally govern" recorded the most negative mean score, namely -1,5.

The reliability and validity of ECGSI was verified in Chapter four. It is concluded that the corporate governance service rendered by non-executive directors has been validly and reliably assessed as not only being lower than desired but also below what is acceptable. The worst-rated issues are the non-executive directors' knowledge to govern, not always being properly prepared for meetings, their allowance of each other's private agendas, not having the confidence of stakeholders, their lack of promptness in taking governance action, and not governing continually but only when convenient.

A graphical summary of the findings looks as follows:

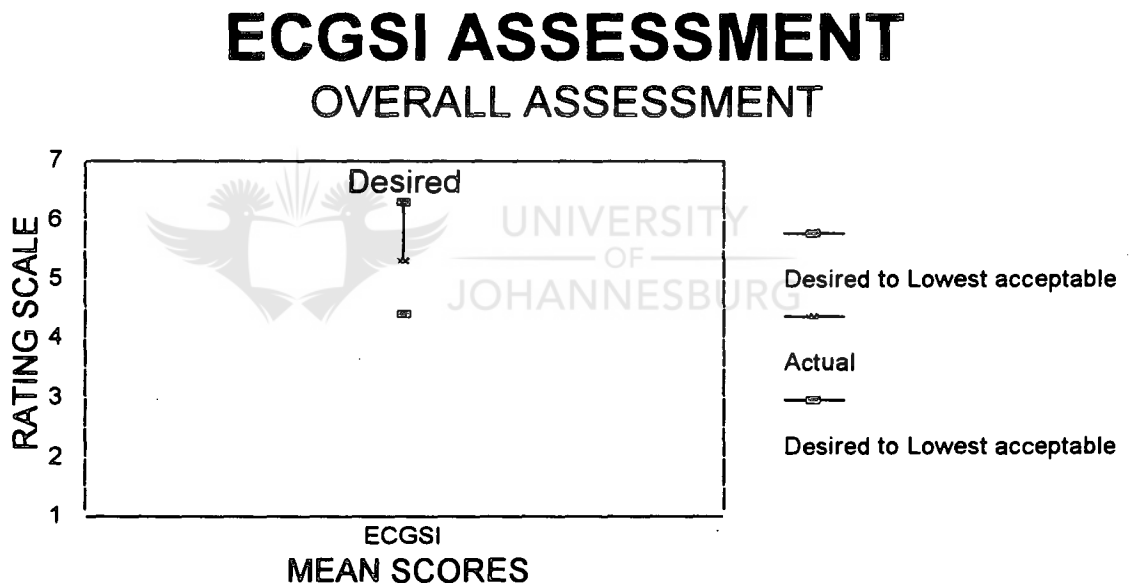


FIGURE 5.18: ECGSI ASSESSMENT: OVERALL ZONE OF TOLERANCE AND RATING

## CHAPTER SIX: A MODEL TO ADDRESS IDENTIFIED PRIORITIES

### 6.1 Introduction

The priorities discussed in this chapter originate from two sources, namely the literature review and the assessment of the quality of non-executive directors' corporate governance service.

Chapter two identified a few problems during the literature review on corporate governance and concluded that legislation regulated these issues, which were largely beyond the control of non-executive directors. These problems now have to receive attention.

Chapter five highlighted several serious problems through the respondents' assessment of the quality of corporate governance as practised by public entities' non-executive directors. Section 5.5 concluded that the service rendered was substantially below both the expected and the lowest acceptable service levels. It was further noted that this service level was substantially below service levels assessed internationally and something should be done to improve the quality of non-executive directors' governance in public entities.

The first part of this chapter presents a model to address the priorities identified through the above mechanisms. The second part demonstrates how the model will solve most of the problems identified. The third part recommends further studies to address outstanding issues. Finally a summary is provided of the chapter.

The model intends to address the priorities identified. The objectives of this model, with its several possible variations, is to ensure that non-executive directors are appointed from a pool of professionally trained and constantly evaluated people. It entails putting the recruitment, training, admission, performance and workload monitoring, quality control, discipline and expulsion in the hands of an independent body. This “professional body approach”, if accepted, will not only address the problems identified below as the most critical, but will also maintain and improve other service dimensions.

As indicated in section 5.5, the non-executive directors’ service quality falls short of the lowest acceptable service level on all service dimensions and evaluation items. Section 6.3, gives attention only to items with a service quality deficit greater than the average of the dimension to which they belong. This was done to address the biggest problems first. The proposed model will, however, ensure that the service criteria items not specifically addressed will not be neglected.



## 6.2 A model to address the identified priorities

### 6.2.1 International trends in the appointment and management of non-executive directors

An analysis revealed that the most major countries using western corporate governance models are upgrading the professionalism of their non-executive directors.

Although not through legislation but through co-operation, Gilson and Kraakman (1993:82) advocate a system for the United States of America in which ‘top-notch professionals’ would serve full time on the boards of perhaps six corporations. In a similar move, Vogel (1993:27) reports Ira Millstein as talking to the California Public Employees Retirement System as well as to

others about putting together an organisation to manage a pool of professional directors.

During a visit to three USA research foundations in November 1994 executives of all three admitted that they experienced problems with the professionalism of at least some of the non-executive directors who held positions on the boards of their foundations. It was stated that in view of difficulties to remove a non-performing director and in the absence of a professional structure, non-executive directors are only approached for appointment after extensive homework and based on strong evidence about a director's professionalism. The idea of a self regulating body for directors was seen as the ideal solution to replace the cumbersome and embarrassing techniques of redirecting or removing unprofessional directors. Legislation was however not excluded as an alternative to enforce professionalism.

In Great Britain, Stiles (1993:121) suggests that 'cadres' of people, trained and professional, should be established and substantially rewarded to serve as non-executive directors. Two research institutions visited in this country mentioned problems similar to the above and supported the idea of a professional body such as the Institute of Directors having legal backing to, among other things, discipline unprofessional directors. Their feeling however was that the situation in Britain was neither serious enough nor was the political climate right to introduce legislation. In their view the voluntary Cadbury code of conduct for directors in combination with the level of sophistication in the British governmental structures was adequate and legislation should be left as a measure of last resort.

The 14<sup>th</sup> annual congress of the Canadian Comprehensive Auditing Foundation (held during the fall of 1994) had as its theme good governance. The CCAF at that congress presented their six pillars for good corporate governance which include criteria such as knowledge and which were summarised by several speakers with the word 'professionalism'. A visit to the Canadian ministry responsible for most crown corporations revealed that

the work of Canadian non-executive directors in state funded entities was, in the absence of a professional body, attended to by public service officials advising the responsible minister. The official visited regarded their non-executive directors as professional enough and did not see a need for legislation in this regard.

Stiles (1993:124) concludes that regulatory bodies should be vigilant in checking that governance standards are adhered to. However, if codes of practice are ignored, legislation is seen as the answer. Neither in literature nor in personal contact (with Australian, New Zealand and Canadian authorities) was legislation regulating non-executive directors' work, mentioned as under serious current consideration. This study has however demonstrated that the corporate governance service as rendered by non-executive directors of South African public entities is on a substantially lower level than any service measured with similar instruments in the United States of America and more drastic measures are thus needed. It is submitted that the substantial difference between the actual service level of non-executive directors and the desired service level necessitates the use of legislation to correct corporate governance in this vital section of the South African economy.

#### 6.2.2 Requirements for treatment as a an enacted profession

De Beer and Roux (1994:42) report two recognised approaches for distinguishing between a profession and an occupation. Their investigation shows that:

the Trait Approach emphasises an esoteric knowledge base, advanced education, need for a professional code of ethics, professional association, occupational licensing and altruistic service



the Functional Approach requires that the functions have “relevance for society as a whole”.

It seems that corporate governance meets the requirements of both above approaches:

In terms of the Trait Approach, esoteric knowledge, advanced education and a professional code of ethics were identified in Chapter five as critical. Professional association and occupational licensing are not currently statutory requirements for holding non-executive directorships. However, such statutory requirements can, through loyalty to professional regulations and obedience to rules, be keys to the solution. The respondents' opinions clearly express the need for altruistic service as emphasised in the Trait Approach.

In terms of the Functional Approach, the national character, R 55-billion annual turnover and monopolistic service-rendering nature of the public entities leave no doubt as to their relevance to society.

Since the occupation of non-executive director largely meets the requirements for a profession, it is concluded that the occupation of non-executive director should to be treated as such. In reality, Section 5.5 demonstrates that those characteristics are what the respondents believe are needed and currently absent in the non-executive directors' make-up.

A model and three levels of purity in application are presented here to address the lack of professionalism displayed by non-executive directors in their governance of public entities. The model is based on that proposed by Stiles (1993:121), Vogel (1993:27) and Gilson and Kraakman (1993:82) namely to create cadres of professional directors who make directorships a full-time career but only serve in non-executive capacity at several entities.

### 6.2.3 Core of the model

This model it is recommended that a body of full-time career professional non-executive directors be established under the control of an independent professional statutory body. Such a body and its members can operate in a way similar to a medical council and its doctors, an auditors' board and its accountants or a law society and its attorneys. Although bodies such as the South African Institute of Directors and the Shareholders' Association of South Africa can be considered for changing into such a statutory body, a new body is preferred to such a conversion as this will minimise the effect of vested interests.

This controlling body can recruit, screen, examine, admit, train, issue guidelines on workload, discipline and suspend non-executive directors. Such a controlling body can provide for both full and associate membership, thus recognising experience and qualifications at several levels and providing for further education. It can also be responsible for ensuring that international best practices or at least generally accepted corporate governance practices are adhered to by all its members.

It is probable that if educational entrance standards are set and examinations managed by a controlling body, the higher education system will align itself with such a new profession and present entry-level education for sitting such a professional examination. Alternatively, the controlling body can recognise appropriate higher-education qualifications as acceptable for registration and employment without administering its own examination. If these recommendations lead to a truly professional and legally recognised institute of directors, there is no reason not to extend its sphere of application to include other entities such as listed companies.

The Auditor-General can be responsible for doing annual performance audits on the corporate governance of public entity boards for the attention of both the authority appointing directors to public entities and the controlling body.

#### 6.2.4 Ideal variation

Under this variation of the model, decision makers will only be allowed to appoint members of the controlling body as non-executive directors on public entity boards.

The legislation introducing the controlling body can provide for transitional arrangements to address the implementation phase. Such legislation can empower the controlling body to ensure, through a veto system, that a proper mix of full members and possible associate members as well as members with diverse technical backgrounds is appointed.

It is, however, understood that, as the appointment process of public entity directors has always been a political one and without restraints, to now ask for such a radical change may be politically unacceptable. For this reason some alternatives are set out below.

#### 6.2.5 First alternative variation

This variation allows for politicians to appoint the non-executive directors from the membership of the controlling body without the controlling body having a say in the full member / associate member or member background mix. This can be done on the condition that the controlling body submits the names of two or three persons for every directorship with the politicians making the choice.

## 6.2.6 Second alternative variation

Under this variation of the model the political powers can be allowed to appoint the majority of non-executive directors (e.g. say 75 %) without requiring that the directors be members of the controlling body. The requirements above can then apply to the rest of the directors. If all directors are not appointed from the controlling body's members, directors appointed by the controlling body can be empowered by giving them a veto on governance and procedural matters such as declaring of interests in decisions and the removal of non-performers.

## 6.2.7 Implementation

Several combinations of the above variations of the model are possible. The final model has to be the result of a consultative process between interest groups such as the state and the Auditor-General.

A move to improve the professionalism of non-executive directors, regardless of format, proved to be in line with international trends. As demonstrated above, an analysis revealed that the most major countries using western corporate governance models are upgrading the professionalism of their non-executive directors.

## 6.3 Priorities identified in the assessment of the corporate governance

Section 5.3 indicated that the quality of the corporate governance service rendered by non-executive directors was assessed as inferior both at the

expected and at the lowest acceptable service levels. Not on a single dimension or even on a single evaluation item did the service quality equal the lowest acceptable service level. For this reason, Section 6.3 focuses mainly on the deficit in service quality indicated when perception about actual service are compared with the lowest acceptable service level.

The discussion of problems in this section is intended only to illustrate the contribution the proposed model can make and does not attempt to be comprehensive.

### 6.3.1 Priorities in the dimension: Directing and monitoring

The dimension "directing and monitoring" was assessed as having a mean service quality deficit of 0,8 on a seven-point scale when perceived service quality was compared with the lowest acceptable service quality. The four evaluation items below were assessed as having a service quality deficit in excess of the mean service quality deficit in this dimension.

#### 6.3.1.1 Providing overall direction to the chief executive officer

In the literature study in Section 2.5 on corporate governance concluded that "the term "directors" says it all: the directors must provide direction. This is the board of directors' most important function. The literature confirms that companies without quality strategic direction run into trouble".

In Section 5.3 reported that respondents, on a seven-point scale, regarded a mean 5,4 as the lowest acceptable service level in the non-executive directors' provision of overall direction to the chief executive officer.

Respondents assessed the non-executive directors' service in this regard as only 4,5, resulting in a mean 0,9 service quality deficit.

If a professional body manages all matters regarding professional non-executive directors, the directing of entities will be in capable hands. Directors will only be accepted as members if their knowledge is of an acceptable level. In addition, continued professional education will be high on the agenda of the controlling body, contributing towards greater recognition of the directing role of directors.

#### 6.3.1.2 Knowing what information is needed to govern and getting it

Information is as fundamental to good governance as it is to good management. Its importance is summarised by Trueman (1994:15), stating the Canadian Comprehensive Auditing Foundation's fourth "characteristic of effective governance" as follows: "We understand what constitutes reasonable information for good governance... and we obtain it."

Section 5,3 reported that respondents, on a seven-point scale, regarded a mean 5,1 as the lowest acceptable service level for non-executive directors to know what information is needed to govern and to get it. They assessed the non-executive directors' service in this regard as only 4,1, resulting in a mean 0,9 service quality deficit.

It is submitted that the answer to this problem lies mainly in training and developing non-executive directors. The model recommended in this chapter holds a solution for this service quality deficit, i.e. knowledge and use of information. By having a professional body manage all matters regarding a panel of professional non-executive directors, the training of non-executive directors will get adequate attention. This training should include education on information issues and on techniques to obtain the needed information.

### 6.3.1.3 Taking politically unpopular action when needed

Section 5.3 reported that respondents, on a seven-point scale, regarded a mean 5,2 as the lowest acceptable service level for the non-executive directors to take politically unpopular action when needed. They assessed the non-executive directors' service in this regard as only 4,2, resulting in a mean 0,9 service quality deficit.

When a professional body manages all matters regarding a panel of professional non-executive directors, the directors are removed, at least some distance, from politicians exercising undue influence over them. They will thus be better able to exercise their fiduciary duty of putting the entity first.

### 6.3.1.4 Doing their homework thoroughly and being always properly prepared for meetings

Chapter two referred to a report by Demb and Neubauer (1992:15) stating that to properly prepare for a meeting takes two days.

Section 5.3 reported that respondents, on a seven-point scale, regarded a mean 5,4 as the lowest acceptable service level for non-executive directors to do their homework. They assessed the non-executive directors' service in this regard as only 4,4, resulting in a mean 1,0 service quality deficit. Respondents regarded a mean 5,5 as the lowest acceptable service level for non-executive directors to be always properly prepared for meetings. They assessed the non-executive directors' service as only 4,3, resulting in a mean 1,2 service quality deficit.

Under this dimension the non-executive directors received the worst assessment on the two items “homework” and “preparedness” that were not beyond their control. If a professional body managed all matters regarding non-executive directors (including investigations regarding negligence and unprofessional conduct), one of its tasks would be to issue guidelines on homework and levels of preparedness.

### 6.3.2 Priorities in the dimension: Board capacity

The dimension “board capacity” was assessed in Section 5.3 as having a mean service quality deficit of 0,8 on a seven-point scale when perceived service quality was compared with the lowest acceptable service quality. The three evaluation items below were assessed as having a greater service quality deficit than the mean service quality deficit in this dimension. All three of these items address integrity and they are therefore discussed together.



#### 6.3.2.1 Displaying impeccable integrity and honesty, avoiding conflict with personal interest and disallowing each other private, conflicting agendas

As discussed in Chapter two, King (1994:34) recommends that a board be part of the development of and be committed to a public entity’s code of ethics. Sheridan and Kendall (1992:71) make it clear that directors have to put their own interests aside when dealing with corporate affairs, that they by law have to act in the best interest of the entity and can be sued if they fail in this duty.

Chapter five reported that respondents, on a seven-point scale, gave the following mean responses as the lowest acceptable service level:

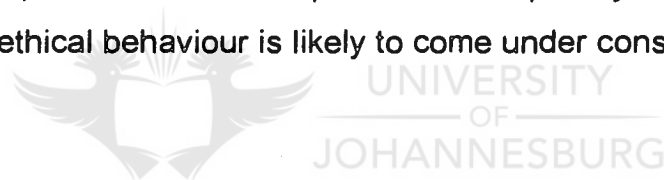


Displaying impeccable integrity and honesty - lowest acceptable 6,4, actual 5,4 and deficit 1,0

Avoiding conflict with personal interests - lowest acceptable 5,9, actual 4,9 and deficit 1,0

Disallowing one another the pursuance of private or conflicting agendas - lowest acceptable 5,7, actual 4,6 and deficit 1,1

The areas where integrity is of utmost importance to the community are without exception managed through professional bodies such as the Medical and Dental Council and the Public Accountants and Auditors Board. The model recommended in this chapter requires exactly that, the establishment of a professional body to take responsibility for, *inter alia*, integrity in the directors' profession. If the founding legislation of the controlling body provides for powers to summon parties to disciplinary hearings and discipline culprits, unethical behaviour is likely to come under considerable pressure.



### 6.3.3 Priorities in the dimension: Assurance

The dimension "assurance" was assessed in Section 5.3 as having a mean service quality deficit of 0,8 on a seven-point scale when perceived service quality was compared with the lowest acceptable service quality. The three evaluation items below were assessed as having a service quality deficit worse than the mean service quality deficit in this dimension.

#### 6.3.3.1 Making stakeholders feel safe with their governance

Section 5.3 reported that respondents, on a seven-point scale, regarded a mean 5,5 as the lowest acceptable service level on the item: “non-executive directors making stakeholders feel safe with their governance”. They assessed the non-executive directors’ service in this regard as only 4,6 resulting in a mean 0,9 service quality deficit.

People generally feel safest in the hands of a true professional such as a medical doctor. The model proposed in this chapter can be seen to be making non-executive directors professionals by regulating their activities through a professional body. If a professional code of conduct and disciplinary constraints are enacted, the model recommended in this chapter would hold a solution for this substantial service quality deficit on integrity in corporate governance.

#### 6.3.3.2 Adding value through their strategic guidance

Section 5.3 reported that respondents, on a seven-point scale, regarded a mean 5,3 as the lowest acceptable service level on the item: “non-executive directors adding value through their strategic guidance”. They assessed the non-executive directors’ service in this regard as only 4,2, resulting in a mean 1,1 service quality deficit.

The problem of lack of guidance also surfaced under the dimension “directing and monitoring with a perceived lack of overall direction provided to the chief executive officer. It is understandable that lack of guidance again appears under the heading “assurance”. As this has been addressed in Section 6.3.1.1 this topic is not discussed here.

### 6.3.3.3 Having the confidence of stakeholders

Section 5.3 reported that respondents, on a seven-point scale, regarded a mean 5,7 as the lowest acceptable service level on the item: "non-executive directors having the confidence of stakeholders". They assessed the non-executive directors' service in this regard as only 4,5 resulting in a mean 1,2 service quality deficit.

By prescribing international best practices for corporate governance, or at least generally accepted corporate governance practices, and by providing some quality assurance through the controlling body, the stakeholders' confidence is likely to increase.

### 6.3.4 Priorities in the dimension: Responsiveness and reliability

The dimension "responsiveness and reliability" was assessed in Section 5.3 as having a mean service quality deficit of 0,9 on a seven-point scale when perceived service quality was compared with the lowest acceptable service quality. The three evaluation items below were assessed as having a service quality deficit worse than the mean service quality deficit in this dimension.

#### 6.3.4.1 Promptness in taking governance action

Section 5.3 reported that respondents, on a seven-point scale, regarded a mean 5,2 as the lowest acceptable service level on the item: "non-executive directors' promptness in taking governance action". They assessed the non-executive directors' service in this regard as only 4,2 resulting in a mean 1,0 service quality deficit.

If a professional body were to manage all matters regarding a panel of professional non-executive directors, promptness in governance action would be addressed.

#### 6.3.4.2 Governing continually and not only when convenient

Section 5.3 reported that respondents, on a seven-point scale, regarded a mean 5,0 as the lowest acceptable service level on the item: "non-executive directors governing continually and not only when convenient". They assessed the non-executive directors' service in this regard as only 4,0 resulting in a mean 1,0 service quality deficit.

If a professional body managed a panel of professional non-executive directors, directors would be trained in how and when to govern. In addition, the threat of professional discipline would also contribute towards continual governance rather than only when convenient.

#### 6.3.4.3 Having the knowledge to govern optimally

Chapter two referred to Clark's (1993:8) and English's (as quoted by Harding 1994:13) explanation that specialist knowledge was of paramount importance to the non-executive director.

Section 5.3 reported that respondents, on a seven-point scale, regarded a mean 5,5 as the lowest acceptable service level on the item: "non-executive directors having the knowledge to govern optimally". They assessed the non-executive directors' knowledge as only 4,0, resulting in the biggest mean service quality deficit measured, namely 1,5.

The reasons for this substantial service quality deficit in the knowledge of governors is probably a result of too low an emphasis on the knowledge requirements of non-executive directors during the appointment process. The reasons why non-executive directors do not adequately build their knowledge are more evasive. If a professional body were to manage panel of professional non-executive directors, the knowledge levels at appointment as well as continued professional education would be addressed. The emphasis in professionalism is on education and experience, or knowledge, and it is expected that some of the best and most rapid gains from the proposed model will be in improving the knowledge of non-executive directors.

#### 6.4 Priorities from the corporate governance literature

##### 6.4.1 Non-executive / executive mix on the board

King (1994:32) recommends the United Kingdom model of corporate governance for South Africa as opposed to the German model. He believes that the United Kingdom model, with its boards comprising both executive and non-executive directors, provides better learning opportunities for previously disadvantaged persons entering the corporate governance arena through non-executive appointments. In the German model executives and non-executives are separated into management boards and supervisory boards, depriving the new appointees the opportunity to learn.

Section 2.4.2 describes the supervisory boards of public entities, which in terms of their founding legislation (but in contradiction to the King recommendations) comprise almost exclusively non-executive directors. It is possible that the assessment of public entities' non-executive directors' governance service could have been more positive were King's

recommendation followed. Although further research on this topic is recommended, directors can learn from one another and the argument for boards with a balanced mix of executives and non-executives is convincing. It is therefore proposed that the King recommendation be adhered to in public entities and the requirement for boards with a proper mix of executives and non-executives be regulated through the Reporting by Public Entities Act (Act 93 of 1992).

#### 6.4.2 Non-executive remuneration

Section 2.4.3 addresses the issue of directors' remuneration. Together with several other writers, King (1994:33) and Stiles (1993:121) state that remuneration must recognise knowledge, effort and risk.

The annual financial statements of public entities indicate that non-executive directors earn between a few thousand and a few hundred thousand Rands a year. At the lower limit the remuneration is not more than R1 000 for each meeting, inclusive of time to prepare for the meeting. If Demb and Neubauer's (1992:15) statement is correct, i.e. that it takes two days to properly prepare for a meeting, it is understandable why non-executive directors go to meetings unprepared - they are not paid to prepare. While Gilson and Kraakman (1993:82) recommend that an annual fee in excess of \$200 000 for non-executive directors is reasonable, it is submitted that any simplistic approach to this issue will be fraught with problems.

Section 2.4.2 found that remuneration influenced the number of good quality people available for appointment as public entity non-executive directors, and their level of preparedness. To have access to the best quality people and to expect them to properly prepare, it is recommended that non-executive directors be remunerated at least at a level applicable to senior consultants. As in all employment situations the differences in supply and demand for

different kinds of skills have to be recognised in determining remuneration levels for people with diverse expertise. Remuneration must also provide for preparation time and for any risk involved. This can be based on, for example, the size and nature of the entity and is best structured along the lines of the professional fee directives issued regularly by professional bodies.

## 6.5 Conclusions

This chapter found that the occupation of non-executive director met the requirements to be classified as a profession and that the respondents in Chapter five to some extent indicated that professional attributes were missing. A model was therefore presented to address the deficiencies identified in Chapters two and five regarding non-executive directors' corporate governance of public entities. It is concluded that the most important motivation for enacting an occupation as a profession, namely to protect the public against abuse and poor service, is present and the need equally pressing in the occupation of non-executive director.

The model entails establishing an independent professional statutory body to regulate non-executive directors in public entities. This controlling body, through full and associate membership systems, can recruit, screen and examine, admit, train, manage the workload, discipline and suspend persons as non-executive directors. It can also be responsible for ensuring that international best practices or at least generally accepted corporate governance practices are adhered to by all its members.

A professional body for non-executive directors and the education system can align themselves to provide not only for entrance educational standards, but also for continued professional education. There is no reason why this

profession can not extend its sphere of application to include other entities such as listed companies.

Three variations of the model were presented, differing in the extent of political freedom to appoint non-members as non-executive directors. The most serious deficiencies reported in Chapter five can be largely resolved through this model's emphasis on education and ethics, and discipline for unprofessional behaviour.

Although further research in this area is recommended, King's (1994:32) argument for boards with a balance between executive and non-executive directors, is convincing. It is recommended that this balance become an enacted requirement of board composition.

To ensure that the quality of corporate governance is constantly monitored in future in the interest of taxpayers, it is recommended that the Auditor-General be responsible for conducting annual performance audits on the corporate governance of public entity boards, for attention of both the authority that appoints directors to public entities and the controlling body.

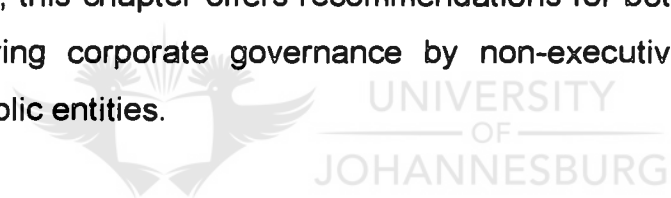


## **CHAPTER SEVEN: SUMMARY AND RECOMMENDATIONS**

### **7.1 Introduction**

This chapter revisits the objectives and results of this study and reaches conclusions about achieving the set objectives. More important, conclusions are made about the quality of corporate governance in South African public entities, based on the literature and the assessment with the newly developed instrument.

In addition, this chapter offers recommendations for both future research and for improving corporate governance by non-executive directors in South African public entities.



### **7.2 Summary on the literature**

#### **7.2.1 Proper corporate governance**

The first supplementary objective of this study (as set out in Chapter one) was to identify what proper corporate governance is and what can be expected of professional non-executive corporate governors, using a literature study. Chapter two summarised the literature about the standards of and criteria for good governance under six headings. These headings are: directing, accountability, quality of input, ethical behaviour, board composition and delivery.

The literature study described in Chapter two preceded the development in Chapter three of an instrument to assess the corporate governance service. The fact that the assessment instrument in Chapter three passed an evaluation against the Institute of Directors' training video for both comprehensiveness and applicability attests that this objective was achieved successfully.

### 7.3 Summary of the methodology and empirical assessment

#### 7.3.1 The development of an instrument to assess corporate governance service

The second supplementary objective of this study was to develop an instrument, using a recognised methodology, to measure the stakeholders' expectations and perceptions about the non-executive boards' corporate governance service.

It was accepted that Churchill's (1979:65-72) "paradigm for developing better measures" resulted in reliable instruments and was used to develop an instrument (ECGSI) for assessing corporate governance. The successful development of this instrument is described in Chapter four. ECGSI passed the reliability and validity tests for use to assess the quality of governors' service. The second supplementary objective was therefore successfully achieved.

#### 7.3.2 Assessment of the non-executive directors' service

The principal objective of this study was to measure the quality of non-executive boards of directors' corporate governance service in public entities

in South Africa. This was done by comparing the expectations and perceptions of one stakeholder group about this service.

This assessment was described in Chapter five and on all four dimensions assessed the service was both below expectation and below the lowest acceptable service level. The principal objective of the study, i.e. the measurement was therefore successfully achieved.

### 7.3.3 The observed service levels

The third supplementary objective of this study was to calculate or measure any differences between expectations and perceptions. Chapter five found that the corporate governors' service rated substantially worse than other comparable services assessed with an instrument called SERVQUAL. It is therefore concluded that the third supplementary objective of this study was successfully achieved.



### 7.4 Summary of the newly proposed model to improve corporate governance

Chapter six found that holding non-executive directorships in public entities meets all the important requirements this occupation to be considered a profession. the most important motivation for enacting an occupation as a profession, namely the occupation's relevance to society and the need for altruistic service, is overwhelmingly present. A model was therefore recommended to improve the quality of corporate governance rendered by non-executive directors in South African public entities. The model proposes establishing an independent professional statutory body to regulate non-executive directors in public entities. It is recommended that this controlling body recruit, screen and examine, admit, train, manage the workload of,

discipline and suspend non-executive directors using full and associate membership systems. It is also recommended that this new body be responsible for ensuring that international best practices or at least generally accepted corporate governance practices are adhered to by all its members.

A professional body for non-executive directors will probably align itself with the education system to provide not only for entrance educational standards, but also for continued professional education. The application of this new profession can be extended at later stage to include entities such as listed companies. Three variations of the model were presented, differing in the extent of political freedom to appoint non-members as non-executive directors.

Although further research on the balance between executive and non-executive directors is recommended, King's (1994:32) argument for boards with a balance between executive and non-executive directors is convincing. It is therefore recommended that this requirement of having boards balanced between executive and non-executive directors, be enacted.

To ensure that the quality of corporate governance is constantly monitored in future in the interest of taxpayers, it is recommended that the Auditor-General be responsible for conducting annual performance audits on the corporate governance of public entity boards, for attention of both the authority that appoints directors to public entities and the controlling body.

## 7.5 Recommendations

### 7.5.1 Recommendations to improve corporate governance in public entities

#### 7.5.1.1 Recommendations for immediate implementation

It is recommended that compliance with the King (1994) recommendations be enacted through the Reporting by Public entities Act (Act 92 of 1993) and be made compulsory for all public entities. In this way many good corporate governance practices, among them the unitary board system, will be implemented in public entities.

It is recommended that the performance audit section of the Office of the Auditor-General do regular audits on the performance of the boards of all public entities. This is in addition to the performance audits currently done on several other aspects of public entities. In this way the quality of corporate governance in public entities will receive continued professional and public attention.

#### 7.5.1.2 Recommendations for implementation through consultation

It is recommended that, through a consultative process, the occupation of holding non-executive directorships be converted into a profession. It is recommended that this be done by introducing a statutory body under legislation prohibiting non-members from holding non-executive directorships in public entities and preferably later also in other bodies.

#### 7.5.2 Results and recommendations for further research

Three issues for future research were indicated by this study. All these issues surfaced in Chapter two during the literature study on corporate governance.

The term of appointment of non-executive directors in South African public entities is legislated. The effect of the non-executive director's term of office was not studied and it is recommended that determining the optimal term of office for a non-executive director become the subject of future research.

Factors such as the advantages and disadvantages of second contract periods and the influence, if any, of the term in office on the quality of the directors' service can form part of such a study.

Although King (1994:32) recommends the unitary board structure for South Africa, public entities operate under the supervisory board system. The structure of public entity boards is enacted and beyond the control of the boards. This study did not compare the quality of corporate governance service of unitary versus dual boards. Although, based on King's (1994:32) recommendation, this study proposes the unitary board system for public entities, the advantages and disadvantages of the supervisory and unitary board system could be the subject of future research.

Public entities are under the Reporting by Public Entities Act (Act 92 of 1993) obliged to have audit committees with a non-executive chairman and a majority of non-executive members present at every meeting. Although having an audit committee is no longer a criterion for evaluating corporate governance in public entities, the measure of success achieved through this mechanism could be the subject of future research.

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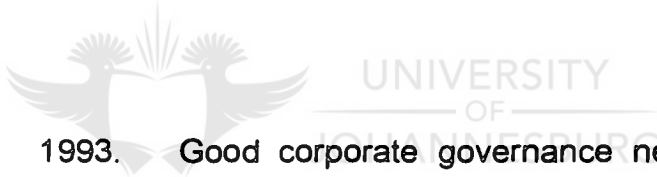
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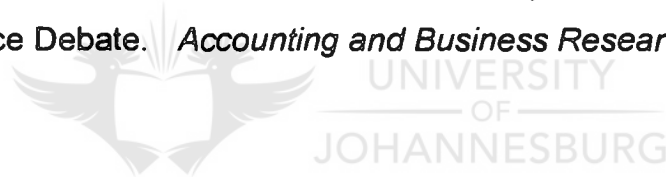
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## ANNEXURES

### ANNEXURE 1: Communication to the HSRC group.

To: Mrs. Asa Maree-Snijders  
Mr. Siphon Ncongwane  
Dr. Gerard Schuring  
Mr. Dries van den Berg  
Dr. Fanie van der Walt

From: Tikkie van Wyk  
Date: 25 October 1996

I am developing an instrument to evaluate the quality of governance service rendered by corporate boards such as the HSRC's board.

Through a literature study on service measurement instruments and corporate governance, I have developed the following list of criteria which I intend to use in this study.

I shall appreciate if you could read through the list and give me input on the suitability of the criterion for this purpose.

Kind regards

Tikkie van Wyk

## Background

Service can (due to its intangibility, heterogeneity and inseparability of production and consumption) not easily be measured objectively by indicators such as number of defects and design / outcome comparisons. Several experts in this field, feel that service quality is not an objective quality but a perceived quality namely the consumer's judgement of overall excellence or superiority. This view resulted in the development of very reliable instruments for evaluation of service quality where a paying client / service supplier relationship exists.

The paying client / service supplier relationship in corporate governance service is substantially different, even more so in public entities than in listed companies. It is however likely that a reliably scientific instrument for measuring the quality of corporate governance service will contribute towards improving the quality of corporate governance service in South Africa and I am currently attempting to develop such an instrument.

An important step in developing such an instrument is the development of criteria against which to measure the corporate governance service in different organisations and in different governance sectors. In this regard I would highly appreciate your assistance by rating the ability criteria set out below to evaluate quality of service. Please feel free to add additional criteria you feel will be of value. At a later stage you will be given feedback on the opinion of others and asked to what extent you can associate with the average opinion.

Each of the following statements has a value as criteria in evaluating the quality of corporate governance. Please indicate on the seven-point scale how important each criterion is in such an evaluation.

1. Providing the governance service as promised.

2. Dependability in handling stakeholders' problems.
3. Performing the governance service right the first time
4. Providing the governance service at the right time
5. Maintaining good record about their governance
6. Keeping stakeholders informed about governance services
7. Promptness in taking governance actions
8. Willingness to help stakeholders
9. Readiness respond to stakeholders' requests
10. Instilling confidence at stakeholders
11. Making stakeholders feel safe with their governance
12. Courteousness towards stakeholders
13. Having the knowledge to optimally govern
14. Giving individual attention to the different categories of stakeholders
15. Caring for stakeholders
16. Having the stakeholders' best interest at hart
17. Understanding what stakeholders expect from governors
18. Governing continually and not only when convenient
19. Utilising modern equipment
20. Visually appealing facilities
21. Have a neat, professional appearance
22. Visually appealing materials associated with the governance service
23. Being balanced (expertise; executives v/s non executives; dependence)
24. Appearing solid (not rubber stamps) against executives
25. Being committed
26. Providing overall direction
27. Properly monitoring management
28. Providing accountability
29. Issuing error-free unbiased annual financial statements
30. Adding value through their governance
31. Utilising the best advice, techniques and facilities.
32. Willingness to govern as if they were the stakeholders
33. Adding value through their governance

34. Comprised of people the necessary knowledge and ability
35. Demonstrate commitment to fulfil their responsibility
36. Demonstrate understanding of their purpose and who they represent
37. Setting the strategic direction
38. Understand the objectives and strategies of the organisation
39. Know what information is necessary to govern and get it
40. Willingness to ensure objectives are met
41. Willingness to take politically unpopular decisions
42. Are taking their accountability serious
43. Are evaluating and publicly reporting their own performance
44. Display impeccable integrity and honesty
45. Are consistent in their judgement
46. Put their constituency first





ANNEXURE 2: Communication to a sample of 97 executives.

Mr A. B. Executive  
Public Entity  
Private Bag  
Code City

Dear Mr Executive

**The directing and controlling (also called corporate governance) of public entities**

The directing and controlling of companies as it is practised in public entities by part-time (non-executive) boards of directors, comprise several activities. Knowing the relative importance of such activities and the level of service that is expected in respect of each activity is likely to contribute towards better governance.

The development of an instrument to do what is explained above is currently being attempted as part of a D Com degree at the Rand Afrikaans University. This is done by confidentially obtaining the perceptions of a small group of executives on the directing and controlling of public entities by non-executive boards.

Since you have apparently been exposed to board activities, it would be greatly appreciated if you would take approximately 20 minutes to complete the attached questionnaire and return it in the accompanying envelope. If you have had exposure to more than one board, please consider your most relevant experience in this regard. All information will be treated as confidential and as the findings reached will be about governance in general, **no specific entity or respondent will be identified.**

Should you require further information, please do not hesitate to contact Tikkie van Wyk at:

Telephone: 012\*3022825, Fax: 012\*3022675, E-Mail: [mfw@hsrcadm.hsrc.ac.za](mailto:mfw@hsrcadm.hsrc.ac.za)

Yours sincerely

M. F. van Wyk

**PS Should you experience difficulty with the questionnaire and are unable to return it within two weeks, you will be contacted and offered assistance through a telephone or a personal interview.**

**DIRECTIONS:** You are requested to give your expectations and impressions about attributes of the governance of non-executive board of directors of public entities. The study is aimed at the non-executive board's service in for example providing direction, monitoring and reporting and not at the performance of individual directors or at the quality of the public entity's service. Please consider the service rendered by the non-executive board in terms of two different levels of expectations:

- 1) Desired service level - the level of governance service you believe a board of directors can and should deliver.
- 2) Lowest acceptable service level - the lowest level of governance service you would consider acceptable.

For each of the following attributes, please indicate: (a) your *desired service level* on that feature by circling one of the numbers in the *first* column; and (b) your *lowest acceptable service level* on that feature by circling one of the numbers in the *second* column; and (c) your *perception of the governance service actually provided by boards of public entities* by circling one of the numbers in the *third* column.



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Answers will be treated as confidential and will be used for statistical purposes only <i>Please indicate your perception of the board's service regarding:</i>	My desired service level		My lowest acceptable service level		Their actual service level		Office use
	Low	High	Low	High	Low	High	
1. Providing the governance service as expected	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		01-03
2. Dependability in handling stakeholders' problems	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		04-06
3. Performing the governance service right the first time	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		07-09
4. Providing their governance service at the right time	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		10-12
5. Maintaining good records about their governance	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		13-15
6. Informing stakeholders <u>about their governance</u>	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		16-18
7. Promptness in taking governance actions	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		19-21
8. Willingness to help shareholders	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		22-24
9. Readiness to respond to stakeholders' requests	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		25-27
10. Having the confidence of stakeholders	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		28-30
11. Making stakeholders feel safe with their governance	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		31-33
12. Being courteous towards stakeholders	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		34-36
13. Having the knowledge to optimally govern	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		37-39
14. Giving individual attention to different stakeholders	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		40-42
15. Caring adequately for stakeholders	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		43-45
16. Having the stakeholders' best interest at heart	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		46-48
17. Understanding what is expected from governors	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		49-51
18. Governing continually and not only when convenient	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		52-54
19. Delivering tangible benefits due to their 'connections'	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		55-57

Answers will be treated as confidential and will be used for statistical purposes only <i>Please indicate your perception of the board's service regarding:</i>	My desired service level		My lowest acceptable service level		Their actual service level		Office use
	Low	High	Low	High	Low	High	
	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	
20. Being punctual and time disciplined	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	62-69
21. Providing adequate networking	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	61-63
22. Disallowing each other private, conflicting agendas	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	64-66
23. Being balanced in composition (e.g. financial, legal)	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	67-69
24. Being assertive (not rubber stamps) with the CEO	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	70-72
25. Attending to the important and not to the sensational	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	73-75
26. Providing overall direction to CEO	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	76-78
27. Properly monitoring the CEO	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	81-83
28. Being consistent in their judgement	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	84-86
29. Issuing error-free unbiased financial statements	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	87-89
30. Adding value through their strategic guidance	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	10-12
31. Utilising the best external advice, & assistance	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	13-16
32. Governing as if they personally financed the entity	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	18-19
33. Displaying impeccable integrity & honesty eg own claims	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	19-21
34. Having members with expert financial knowledge	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	22-24
35. Evaluating and publicly reporting their own performance	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	25-27
36. Ensuring that sound financial controls are in place	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	28-30
37. Being always properly prepared for meetings	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	31-33

Answers will be treated as confidential and will be used for statistical purposes only <i>Please indicate your perception of the board's service regarding:</i>	My desired service level		My lowest acceptable service level		Their actual service level		Office use
	Low	High	Low	High	Low	High	
	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	1 2 3 4 5 6	
38. Knowing the entity's objectives and strategies	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		34-36
39. Knowing what info is needed to govern and get it	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		37-39
40. Ensuring organisational objectives are met	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		40-42
41. Taking politically unpopular action when needed	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		43-45
42. Taking their accountability serious	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		46-48
43. Refraining from acting as if they were the executive	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		49-51
44. Attending all board and committee meetings	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		52-54
45. Meeting with optimum regularity	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		55-57
46. Asking appropriate, intelligent questions	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		58-60
47. Being optimally alert during meetings	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		61-63
48. Neutralising dominating persons during meetings	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		64-66
49. Doing their homework thoroughly	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		67-69
50. Alluding input from reserved people	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		70-72
51. Knowing the problems of the industry	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		73-75
52. Avoiding conflict with personal interests	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		76-78
53. Displaying care and skill as with own affairs	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		81-83
54. Measuring the entity's output	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		84-86
55. Preventing the CEO from misleading the board	1 2 3 4 5 6		1 2 3 4 5 6		1 2 3 4 5 6		87-89

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