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# **REGULATION: ITS IMPACT ON SENIOR MANAGEMENT DECISION-MAKING AND THE GROWTH OF PUBLIC COMPANIES**

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A research project submitted to the Gordon Institute of Business Science,  
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## ABSTRACT

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Various surveys conclude that regulation stifles the growth of South African SMEs. It is not known how regulation impacts on public companies.

The literature identified certain unintended consequences of regulation that result in companies' growth being stifled. Elements of an ideal strategic response that would prevent regulation from stifling companies' growth were also identified. The perceptions of fifteen compliance officers in public companies were tested as to whether there was evidence of firstly, the presence in public companies of the unintended consequences identified in the literature and secondly, elements of the ideal strategic response. The research process consisted of a gathering of data through face-to-face interviews and a questionnaire. Snowball sampling was used to select compliance officers in public companies for interviews. Data was analyzed through a combination of content and frequency distribution analysis.

The study confirmed that regulation does stifle the growth of public companies, but for different reasons than reported in the literature. Whilst some elements of the ideal strategic response were identified, companies' overall strategic response to the regulatory environment can be improved upon. The conclusion of the research is that companies can thrive in the regulatory environment if the ideal strategic response, which was developed through the study, is adopted. Lessons learned from the research are discussed and recommendations for companies and regulators are indicated.

## DECLARATION

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I declare that this research project is my own work. It is submitted in partial fulfillment of the requirements for the degree of Master of Business Administration at the Gordon Institute of Business Science, University of Pretoria. It has not been submitted before for any degree or examination in any other University.

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Gerhard Botha

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## LIST OF ABBREVIATIONS

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CEO	Chief Executive Officer
DME	Department of Minerals and Energy
EXCO	Executive Committee
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GIBS	Gordon Institute of Business Science, University of Pretoria
ISC	Integrated Strategic Change
JSE	Johannesburg Stock Exchange
King II	The King Report on Corporate Governance II
NGO	Nongovernmental Organisation
OHSA	Occupational Health and Safety Act
RIA	Regulatory Impact Assessment
SA	South Africa
SAICAS	South African Investment Climate Assessment Survey
SBP	Small Business Project
SME	Small and Medium Enterprises
USA	United States of America



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## 1. Chapter 1: Definition of the research problem

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### 1.1 Introduction

Tension appears to exist between government's regulatory initiatives to stimulate economic growth and the negative impact that an increasing focus on regulatory compliance appears to have on businesses. The question that remains unanswered is how regulation impacts on public companies' growth.

Weak enforcement of rules and regulations are a perennial concern for investors in emerging markets (Republic of South Africa, 2003). Regulation is a significant factor influencing international FDI decisions and proportionately smaller FDI inflows to less developed countries reflect investors' response to weak regulation (Smith-Hillman and Omar, 2005).

The SA government has been enacting regulation in order to bring SA on par with first world standards and to meet socio-economic challenges. Government aims to encourage investment that would stimulate economic growth (Hamlyn, 2006), with the overall objective to halve unemployment by 2014 (SA Government, 2006). However, SAICAS, a survey of 800 formal private enterprises, identified regulation as one of four major obstacles to economic growth. Some SMEs, for example, intentionally withhold the growth of their businesses simply in order to avoid reaching thresholds that would make them

liable for additional regulatory compliance burdens (Clarke, Eifert, Habyarimana, Ingram, Kapery, Kaplan, Schwartz and Ramachandran, 2005).

### **1.1.1 Regulation as an obstacle to economic growth**

The results of the SAICAS survey confirm that there is a negative relation between market regulation and economic growth: excessive regulation hinders economic growth (Koedijk and Kremers, 1996). Rölller (in Koedijk and Kremers, 1996) cautions however that this statement should be approached cautiously. He argues that it is not obvious that the unit of observation should be a country rather than an industry. Many industries (such as the pharmaceutical industry) are not national and may be global. Either the sales or production of multinational companies may not be affected as much by regulation as national companies may be as only a portion of a global company's production might take place in one country.

### **1.1.2 The need for faster economic growth**

There is general consensus amongst economists that regulation and particularly excessive regulation hinders economic growth. This consensus follows in the wake of the success of deregulation- and privatization programmes in developed countries since the 1960's and the failure of state-led economies (Koedijk and Kremers, 1996; Jalilian, Kirkpatrick and Parker, 2003). Faster economic growth makes it easier for governments to reduce unemployment, mitigate poverty and improve the social welfare of citizens (McAleese, 2004). A sluggish and

sometimes declining growth rate in SA in the 1990's contributed to an increase in unemployment (Mohr and Fourie, 2004).

### **1.1.3 Encouraging investment spending to reduce unemployment**

The problem that government grapples with is that in order to reduce unemployment, faster economic growth must be achieved. Economic growth is achieved by *inter alia* an increase in FDI and domestic investment spending. A robust regulatory environment in turn encourages investment spending. However, there is an equally compelling argument that the key to reducing unemployment lies in deregulation (Kirkpatrick, Parker and Zhang, 2005). Incentives should accordingly be established for employers to expand their businesses and reduce the cost of hiring labour. These steps are necessary in order to ensure that additional business can be translated into more jobs (McAleese, 2004).

## **1.2 Motivation for research**

### **1.2.1 The impact of regulation on SME's**

In its most recent Doing Business report, the World Bank ranks SA 28<sup>th</sup> overall in the world, higher than many developed countries, when comparing the burden of regulation across countries (Kaplan and Ramachandran, 2006). However, a study of nearly 2000 businesses carried out by the SBP (Paton, 2005) found that:

- Regulation is directly responsible for stifling growth in companies.

- SA has high compliance costs when compared with international standards, a burden of R79bn per year, approximately 6.5% of GDP.
- Businesses rate red tape as the biggest constraint to growth, outstripping labour market regulations and the shortage of skilled labour.
- SME's withhold growth simply to avoid reaching certain thresholds as reaching such thresholds would make them liable for additional compliance burdens.
- The regulatory environment results in significant inefficiency, reducing the propensity of firms to create jobs.

The results of surveys such as that of the SBP have led to The Financial Mail (2005) calling on government to seriously consider the impact over regulation has on the economy and to consider cutting the cost of compliance. Internationally, cutting back on compliance costs has been a quick fix for governments to boost growth (Financial Mail, 2005).

### **1.2.2 The emerging impact of regulation on public companies**

The calls for a reduction in the cost of compliance come at a time however when corporate scandals in the U.S.A (such as Enron) resulted in laws such as the Sarbanes-Oxley Act being passed to crack down on accounting fraud (Doherty, 2006). According to Doherty (2006) new legislation has however resulted in unintended consequences and bad incentives that appear to stifle the growth of larger, public, companies. Some executives are considering delisting while others

are not prepared to accept the risks associated with the position of company officials. This reaction follows as a result of the severe penalties for non-compliance with legislation by companies (Doherty, 2006). This type of reaction appears to mirror, to some extent, the reaction of South African SME's surveyed by the SBP.

### **1.2.3 Increasing regulation to boost investment spending**

Government however continues enacting more and more legislation that aims to bring SA in line with international standards and consequently boost FDI and domestic investment spending (Hamlyn, 2006). Government's response to calls for reduced regulation has been the implementation of RIAs. RIAs aim to appraise the cost and benefit associated with proposed regulation on a case-by-case basis before legislation is passed through Parliament (Loxton, 2006).

It is not known how the executives of public companies react to the increasing regulatory burden. Do they, like some SMEs, display anti-growth behaviour that is not associated with economic growth and job creation? If regulatory compliance does elicit this type of response, economic growth will slow down further, contributing to an increase in unemployment (McAleese, 2004).

## **1.3 The research problem**

The aim of this research is to ascertain how regulation impacts on SA public companies. In investigating this question the research aims to ascertain whether

regulation has any negative side effects, for example, in so far as executive decision-making processes or innovation is concerned.

This research further aims to identify the appropriate strategies for companies to adopt to thrive within the regulatory environment. Such strategic responses will then be compared with responses recommended in the literature. The research will finally attempt to ascertain whether public companies are inclined to grow or not to grow as a result of regulation.

## **2. Chapter 2: Literature Review**

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### **2.1 Introduction**

This chapter explores the concept and theory of regulation. The chapter first clarifies the meaning of “regulation” and some alternate terminology used. It follows with a review of the origins of regulation and why regulation is necessary. A review of the measures against which regulatory quality can be assessed is included and the direct consequences of regulation are highlighted.

The literature review identifies unintended consequences of regulation, consequences that stifle the growth of public companies and, consequently, the growth of the economy. The focus then shifts to the identification of a strategic response to the regulatory environment. The literature outlines the imperative for companies to gain a better understanding of their environment and their positioning in the relevant environment before deciding on the appropriate strategic response to regulation.

The chapter concludes with a summary of the literature and the identification of a gap in the theory base that the research aims to bridge.

### **2.2 Definition of constructs**

The terms regulation, governance and “red tape” are often used interchangeably when the topic of compliance is discussed. An interchangeable use of these

terms is inaccurate. It is accordingly necessary to distinguish clearly between these terms and to ascertain what the term “regulation” refers to within the context of this research report. Tables 1,2 and 3 below outline various theoretical definitions of regulation, corporate governance and red tape respectively, as developed over time. These definitions are ranked from oldest to the most recent.

### 2.2.1 Regulation

Table 1 outlines various theoretical definitions of regulation that developed over time.

**Table 1: Summary of theoretical definitions of constructs: regulation**

<i>Author</i>	<i>Theoretical definition</i>
George Stigler (1975) (in Wood, 2006,p.3)	“..the exercise of coercive government power”. “...telling people what to do and punishing them in some way if they do not perform as instructed”.
Ayres and Braithwaite (1992) (in Kingsford Smith, 2004,p.444)	“Standards and prohibitions backed by criminal sanctions and administered by a government agency. The so-called command and control approach.”
Black (2002) (in Kingsford Smith, 2004,p.470)	“The sustained and focused attempt to alter the behavior of others according to defined standards or purposes with the intention of producing a broadly defined outcome or outcomes, which may involve mechanisms of standard setting, information gathering and behavior modification.”
Jalilian, Kirkpatrick and Parker (2003.p.3)	“...is the means by which the state attempts to affect private sector behavior...”
Kingsford Smith (2004,p.443)	“Top down” government-created and implemented rules or standards, backed by sanctions”. The so-called “command and control” approach
Mohr and Fourie (2004,p.396)	“Regulation refers to all laws, rules and regulations that effect private behavior”.

Ayres and Braithwaite's definition (in Kingsford Smith, 2004) of regulation improves on Stigler's classical definition as it clarifies that regulation entails standards and prohibitions. Their definition also clarifies that regulation is administered by government and backed by criminal sanctions. Subsequent attempts to define regulation appear to fall short on including all the relevant elements of regulation.

Mohr and Fourie's (2004) definition of regulation is probably too wide as this definition does not exclude red tape and could also include corporate governance. The definition of Black (in Kingsford Smith, 2004) omits a crucial element of regulation namely that regulation is initiated and monitored by the state, and backed by criminal sanctions.

Although Kingsford Smith's (2004) definition attempts to encapsulate all of the elements contained in the definition of Ayres and Braithwaite, Kingsford Smith's (2004) definition omits the fact that government administers regulation. It is accordingly submitted that Ayres and Braithwaite's "command and control" definition is the most appropriate definition of regulation in the context of how the concept regulation is referred to in this research.

### **2.2.2 Corporate governance**

Within a SA context King's 1994 definition of corporate governance (in Wixley and Everingham, 2002) is probably the most authoritative as King

“...institutionalized...” (Institute of Directors, 2002, p.7) corporate governance in SA. The first King Report on Corporate Governance was published in November 1994. The purpose of King II remains to promote the highest standards of corporate governance in SA. In contrast to regulation, King II’s recommendations are voluntary. However, in so far as the JSE is concerned, companies must adhere to King II and indicate the extent to which King II is not observed. King II places a duty and responsibility on boards of directors to ensure that King II is observed (Wixley and Everingham, 2002). Table 2 below outlines various theoretical definitions of corporate governance that developed over time.

**Table 2: Summary of theoretical definitions of constructs: corporate governance**

<i>Author</i>	<i>Theoretical definition</i>
Tricker (1984) (in Wixley and Everingham, 2002, p.2)	“...concern supervising or monitoring management performance, and ensuring accountability of management to shareholders and other stakeholders...”
King (1994) (in Wixley and Everingham, 2002,p.1)	“...simply the system by which companies are directed and controlled...”
Tricker (2000) (in Masocha and Weetman, 2005,p.157)	“Corporate governance is concerned with the exercise of power over corporate entities”
Licht (2002) (in Aguilera, 2005,p.39)	“The rules and structures for wielding power over other people’s interests, including the use and abuse of power”
Cadbury, 2002 (in Cutler, 2004,p.66)	“...the system by which companies are controlled”
Wixley and Everingham (2002,p.1)	“...it is concerned with the structures and processes associated with management, decision-making and control in organisations.”

Demb and Neubauer (in Cutler, 2004,p.66)

“...the process by which corporations are made responsible to the rights and wishes of stakeholders”

Aguilera and Jackson (2003,p.41)

“...refers to the distribution of rights and responsibilities among the different actors involved in the corporate organisation”

Wood (2006,p.3)

“...involves setting up structures, inside or outside organisations, so as to make it desirable for organisations in the best service of their own interests to do what is thought to be in the public interest”

It is submitted that Wixley and Everingham’s (2002) definition is more appropriate than King’s definition as it clarifies what “the system” is that King refers to. It does not outline exactly what corporate governance is though. In the context that the concept corporate governance is used in this research, Tricker’s 1984 definition (in Wixley and Everingham, 2002) probably explains best what corporate governance entails, as it encapsulates all of the elements of corporate governance.

### 2.2.3 Red tape

Pandey and Scott (2002) provide a useful exposition of the various definitions of red tape, outlined in Table 3 below, as developed by various authors over time.

**Table 3: Summary of theoretical definitions of constructs: red tape (Pandey and Scott, 2002, p.557)**

<i>Author</i>	<i>Theoretical definition</i>
Buchanan, 1975	No explicit definition is offered. Mentions due process and the heavy emphasis on rules and procedures. “...a ponderous and often ineffective administrative style”.
Rosenfeld, 1990	Red tape is best measured through perceptions. “...may be best understood as a problem of individual perceptions rather than one of identifying objective measures for it...guidelines, procedures, forms and government interventions that are perceived as excessive, unwieldy, or pointless in relationship to

decision-making”

Bretschneider, 1990	No explicit definition is offered but discussion highlights the procedural delay aspect. “...often leads to more procedural steps...the concept of procedural delay related to many layers of oversight..”
Bozeman, Reed and Scott, 1992	“Red tape today refers not to the rules and procedures themselves but to the delays and subsequent irritation caused by formalization and stagnation..”
Pandey and Bretschneider, 1997	Distinguish red tape-based delays from ordinary delays. “...the excess amount of delay above and beyond that generated by other factors influencing time delays...”
Scott and Pandey, 2000	Constraints imposed by rules and procedures

The definitions in Table 3 above all contain one common element – that “red tape” refers more to the delays and constraints imposed by administrative procedures than the administrative procedures them self. In this regard it is submitted that Scott and Pandey’s definition (in Pandey and Scott, 2002) adequately describes what red tape is, as it is wide enough to include any constraints that are caused by rules and procedures.

## 2.3 Origins of regulation

### 2.3.1 Public policy that is affected by a changing environment

How regulation is translated into public policy has shifted over time as new evidence of its impact emerges and as changes in political ideology occur (Jalilian *et al*, 2003). An increasing belief appears to gain ground that “command and control” regulation should be replaced by regulation based on incentives such as taxes or subsidies. For example, the less pollution a firm causes, the less tax it pays and accordingly the firm is motivated and encouraged to adopt

policies, on a voluntary basis, for adopting cleaner production technologies (McAleese, 2004).

Those supporting the approach of self-regulation and incentives for compliance argue that markets should be encouraged to achieve perfect competition by themselves. According to Durden and Pech (2006), the recent interest in corporate governance and regulatory compliance has been driven by corporate scandals such as Enron in the USA. Similarly, SA corporate scandals such as Regal Treasury Bank, MacMed, Saambou and Unifer for example resulted in steps to overhaul the SA auditing profession's rules (Temkin, 2006).

### **2.3.2 Regulation is a means for addressing market failure**

Regulation by the state is also seen as a means by which the state can address the side effects of market failure (McAleese, 2004). Market failure refers to the occurrence where the market system is unable to achieve an efficient allocation of resources. It has been suggested that market failures may be more pronounced in developing countries and that the case for increased regulation in developing countries is therefore stronger (Kay and Vickers, 1988).

Market failure was used to legitimize government intervention in private sector activities in developing countries between 1960 and 1980 (Jalilian *et al*, 2003). As developed countries celebrated the success of liberalisation programmes and evidence of failures in state-led economies mounted, regulation was redefined.

In this context it was estimated that excessive regulation might impact negatively on GDP (Koedijk and Kremers, 1996). Deregulation was widely adopted to reduce the regulatory burden on market economies. The wave of privatization that spread through the developing world during the 1990's resulted in the establishment of numerous regulatory bodies to oversee and supervise functions that were previously under state control. This shift has led to the current regulatory state (Jalilian *et al*, 2003).

Regulation has accordingly seen a shift from the model of an interventionist state in the 1960's to a deregulation model, to the current focus on the regulatory state. The regulatory state model aims to adopt a more balanced approach by using government regulation only where significant market failure exists (Kay and Vickers, 1988). The corporate failures worldwide in the 1990's have triggered a new wave of regulation as policymakers attempt to achieve a balance between consumer protection and the establishment of effective regulatory structures.

### **2.3.3 A reflection of societal expectations**

Leone (1977) suggests that four basic forces precipitate a regulatory boom:

- Rising incomes make the pursuit of social and economic equality both more desirable and more realistic. A growing belief in the attainment of certain social goals requires a fundamental change in the structure of economic systems, and accordingly business regulation. Affluence and an increasing social awareness are increasing society's demands for

public goods and this increased demand is the primary force behind new business regulation.

- The increasing sophistication of both natural and social sciences. The erosion of traditional business boundaries complicates the existing regulatory process and necessitates development of new regulatory processes that can address the change in the status *quo*.
- Increased recognition by government and business of a convergence of interests.
- The success of prior policy interventions. Despite the fact that deficiencies in economic policies are easily pointed out by critics government policies, by and large, tend to be very successful – personal incomes are relatively stable and continue rising.

Leone (1977) is accordingly of the view that it is not regulation that is the cause of various forms of restrictions and compliance. Regulation simply reflects a formal contract between business and the society. In the absence of regulation informal agreements call upon companies to meet certain social responsibilities (Beardsley, Bugrov and Enriquez, 2005). Failure to meet these obligations can result in a shift from self-regulation toward “command and control”-type regulation described by Ayres and Braithwaite (in Kingsford Smith, 2004).

It therefore appears that regulation is formed through an ongoing negotiation process that seeks to reconcile the different objectives of government and

stakeholders. Regulation accordingly reflects fundamental changes in the environment and in societal expectations. As such regulation represents a legitimate expectation of what the marketplace wants in the way of public goods (Beardsley *et al*, 2005).

#### **2.3.4 A convergence between contractarianism and communitarianism**

Leone's (1977) view (and that of Beardsley *et al*, 2005) that regulation in essence stems from societal needs and reflects what society wants in public goods accords with the view of Durden and Pech (2006). They believe that the current regulatory boom is a convergence between the contractarian and communitarian approach to regulation.

The contractarian approach views regulation as a contract between management and shareholders - management must act in shareholders' best interests. The communitarian approach favours the view that management has a social responsibility not only to shareholders but to all of the firm's stakeholders. Greater regulation increases emphasis on protecting shareholders (which favours the contractarian approach) but also emphasizes the protection of all stakeholders (which favours the communitarian approach). Durden and Pech (2006) accordingly submit that the current motivation for increased regulation stems from a perceived need for a more rigorous protection of both shareholders and stakeholders, rather than any conceptual basis in either contractarianism or communitarianism.

## **2.4 Measures for assessing regulatory quality**

According to Kay and Vickers (1988) there exists a strong causal link between regulatory quality and economic performance. The effectiveness of regulatory institutions is an important determinant of how well a market functions. The effectiveness of regulation is not only concerned with the technical design of regulation – it is also concerned with and depends on the quality of the supporting regulatory institutions and their capacity to police the enforcement of the relevant regulations. Most regulatory institutions are publicly provided and their effectiveness plays a central role in how well markets function. The quality of regulatory governance accordingly affects regulatory outcomes that in turn impacts on economic growth.

There are two criteria for assessing regulatory quality – the quality of the outcomes and the processes of regulation (Jalilian *et al*, 2003). The former can be assessed against effectiveness and efficiency whilst the latter can be assessed against a balance of accountability, transparency and consistency.

### **2.4.1 Effectiveness and efficiency**

Effective regulation achieves the goals set down by the state for the regulatory authority. In developing countries these goals are mostly concerned with economic efficiency, the promotion of sustainable development and poverty reduction. Efficient regulation achieves the goals set down by government but

does so at minimum economic cost (Kirkpatrick, Parker and Zhang, 2005). The economic cost of regulation consists firstly of the internal cost of administering the regulatory system, which is carried by the state and reflected in the national budget. Secondly, it consists of the external cost of business complying with regulation, which is carried by consumers and producers in terms of the economic cost of conforming with and of evading or avoiding regulation.

Regulation may accordingly be efficient because it is relatively inexpensive to comply with and to enforce. The relevant regulation may however be completely ineffective in that it fails to achieve the goals set down by Parliament. Parker (1999) describes an effective regulatory system as one that meets customer and shareholder needs, maintains efficiency and investment incentives, minimizes inconsistency and provides management with the maximum freedom to manage their business at a minimum of compliance costs. The question that remains unanswered is how the quality of regulation impacts on SA public companies.

#### **2.4.2 Accountability, transparency and consistency**

According to Jalilian *et al* (2003) and Parker (1999) accountability relates to an observance by regulatory agencies of the rules of due process and engaging in proper consultation when arriving at decisions. Accountability requires that regulatory agencies operate within their legal powers and are accountable for their actions. At the heart of accountability lies the right of appeal – recourse

from a regulatory commission to the courts to review the regulator's decisions (Parker, 1999).

Transparency requires that regulatory agencies reach decisions in a way that is revealed and communicated to stakeholders in a consistent and clear manner. Inconsistency undermines public confidence in the regulatory system and creates uncertainty for investors (Kay and Vickers, 1988).

Discontent is likely to occur where the regulator acts arbitrarily. According to Parker (1999, p 215) "...private capital will not be injected and in particular competition will not develop where there is great uncertainty about future government policy". Inconsistent regulation will discourage investment and stymie the development of competition in the industry.

Regulation is accordingly a complex balancing act that seeks to advance the interests of consumers, competitors and investors whilst simultaneously balancing the industry, environmental and social needs. Regulation accordingly lacks quality when regulators act in a manner that is contrary to the measures highlighted above. This will occur when the interests of all stakeholders are not balanced but where the interests of certain stakeholders are placed above those of others.

### **2.4.3 Independence of regulators**

Coupled with the consistent behaviour of regulators is the independence of regulators. Political intervention undermines regulatory consistency, as politicians may be prone to manipulate the regulatory process for short-term political gain. It is accordingly crucial that regulators remain independent. It is suggested that balanced, strong regulatory institutions, independent from political intervention is a strong determinant of improved economic growth (Kirkpatrick *et al*, 2005).

“Independent” should not be misunderstood however – a regulator that is completely autonomous and with no public accountability would not be acceptable. A proper system of democratic accountability should exist and in this sense “independent regulator” is intended to convey a high degree of separation from political or government intervention but not complete independence from political scrutiny (Parker, 1999). According to Parker (1999) the overriding objective of an independent regulator is to foster an environment in which the industry can invest with confidence that expected returns on capital will not be compromised by political intervention.

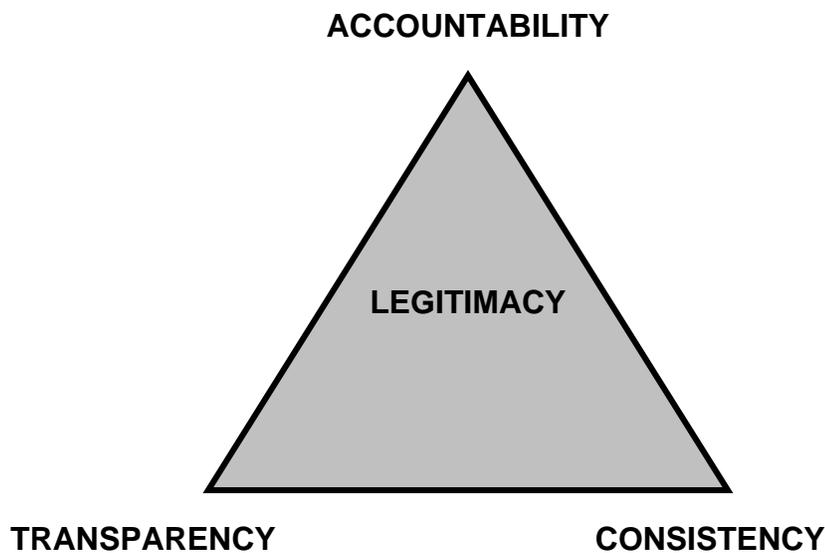
### **2.4.4 Legitimacy**

Jalilian *et al* (2003), like Parker (1999), also believe that a well-functioning regulatory system is one that balances accountability, transparency and consistency. When these three characteristics are present, legitimacy arises –

public confidence that the regulatory system achieves a balance between the needs of the company and those of its shareholders. In addition legitimacy will arise when the regulatory system maintains efficiency and investment incentives and minimizes regulatory uncertainty and risk. Companies should be permitted maximum freedom to manage their businesses with the minimum of compliance costs.

This relationship can be illustrated by way of the diagram in Figure 1 below.

**Figure 1: Model of a well-functioning regulatory system (Parker, 1999)**



## **2.5 The direct consequences of regulation**

The most obvious consequence of regulation is the cost of compliance, in so far as implementing measures required by regulation is concerned. Regulatory compliance siphons more and more revenue towards legal and auditing fees (Davis, 2004). In this regard, the SBP survey found that the ratio of compliance costs to turnover reduces as the size of the firm increases. Small firms, with a

turnover of less than R1million, can spend up to 8.3% of turnover on compliance whilst larger firms, with a turnover exceeding R5million, can face a burden of 0.2% of turnover (Paton, 2005).

The SBP survey further found however that compliance costs also tended to be sector specific in that certain firms tended to have high compliance costs compared to other companies of the same size, but in different sectors of the economy.

The SAICAS survey further found that senior managers could spend up to 10% of their time on regulatory compliance (Clarke *et al*, 2005). McCollum (2005) estimates that, in general, companies will spend 23% more on compliance programs over the period 2005-2007. These costs do not take into consideration remediation costs, penalties, fines and lost revenue. Despite the fact that companies are increasing their expenditure on regulatory compliance, 44% of executives surveyed in 2005 (McCollum, 2005) indicated that they could not pinpoint the value their companies' compliance programs delivered.

## **2.6 The unintended consequences of regulation**

The current regulatory boom is intended to "...significantly lessen opportunities for corporate mismanagement and instances of corporate collapse and thereby provide better protection for shareholders and other business stakeholders" (Durden and Pech, 2006, p. 84).

Whilst the intention and motivation behind increased regulation may be well founded, there is an emergence of evidence that regulation has some consequences that were not intended by governments. According to the World Bank (2004) heavier regulation is associated with more inefficiency, higher costs, and corruption. It also has the perverse effect of harming those it is intended to protect in that entrepreneurs are encouraged to operate in the informal economy (World Bank, 2004). It also appears to result in sluggish decision-making on the part of executives and to changes in the composition of boards of directors.

### **2.6.1 Sluggish decision-making**

Durden and Pech (2006) warn that the increasing focus on regulatory compliance brings about the following disturbing changes within corporations:

- Because boards of directors become more preoccupied with compliance, they become distracted and become more actively involved in customary tasks and decision-making of senior management.
- Because the board of directors becomes more involved in regulatory compliance, senior management start spending more time on compliance with the law and focus less on that which they are supposed to focus: company performance.
- The capricious regulatory environment where the focus is on achieving greater accountability of management to boards and boards to

- shareholders effectively restricts the scope of management to manage the business effectively.
- The fostering of a technical, legalistic mindset results in management becoming preoccupied with governance requirements and hesitant about taking risks, in relation to the running of business, for fear of contravening regulation.
  - This process results in so-called “decision speed bumps” that hamper the efficiency of corporations and starts impacting negatively on firm performance.
  - Decisions are delayed, meetings are held more often, are lengthy and indecisive.
  - Over time a “check-the-box” mentality develops, firstly impacting negatively on entrepreneurial behaviour and secondly resulting “boxes being ticked” without ensuring that decisions and actions are in fact in the best interests of shareholders and customers.
  - As companies are forced to act increasingly within the framework of a prescriptive regulatory system, decision templates are created that make it easier for competitors to predict the company’s moves.
  - At its most destructive, the increasing focus on regulatory compliance rewards managerialism and bureaucratic protocols. It also develops risk-averse and blame cultures.

Durden and Pech's (2006) findings concur with those of Davis (2004) who believes that increasing rules and codes have heightened expectations of directors and risk managers. These changes have created the danger that management teams may become lured into box ticking that tends to make businesses risk-averse. According to Davis (2004, p.17) "Managing risk lies at the heart of corporate regulation, and of business itself. Business risk is a good and necessary thing. To avoid it is to guarantee that business will wither and die".

According to a study by Porter (Koedijk and Kremers, 1996) an innovative business climate is fostered by, amongst other things, product market competition, which is stimulated by deregulation. Deregulation confronts producers with two effects: it exerts downward pressure on prices, and accordingly revenue and, on the other hand, encourages cost cutting and improved efficiency. Heavier regulation has the opposite effect. With the reduction in firm innovation and productivity, performance is affected negatively and this ultimately harms economic growth (Koedijk and Kremers, 1996).

### **2.6.2 Changes in composition of boards of directors**

Another unintended consequence that is brought about by regulation is the impact that regulation is beginning to have on the composition and the effectiveness of boards of directors. According to Story (2002) the recent regulatory changes are affecting the structure of boards of directors with

companies recruiting more non-executive directors to act as checks and balances. Analysts are also advocating for:

- A separation between the chairman and CEO, who are often one and the same person.
- Restrictions on former audit firm personnel being appointed as directors.

There is a growing resistance to directors' remuneration being linked to share options as many of the corporate collapses referred to above were in part brought about by short term agendas to increase share price. Increasing shareholder activism is also predicted by some (Story, 2002) to bring about numerous changes in boardrooms. Boards are predicted to develop a more active watchdog role. As workloads and directors' personal risks escalate companies will find it harder to fill board seats – until remuneration and market expectations change. Prospective directors are expected to undertake more “due diligence” investigations before accepting board positions. It is further expected that director positions will increasingly be offered more on merit than from social networks.

According to Story (2002) the shift in board composition could lead to a more adversarial and less cohesive boardroom further restricting the effectiveness of board performance and hampering the decision-making process. Ultimately this will stymie development, innovation and company performance.

## **2.7 An understanding of the organizational environment as a pre-requisite for decisions on strategic responses**

Companies are open systems existing in certain environmental contexts on which organisations depend for survival and growth (Cummings and Worley, 2005). According to Thompson, Strickland and Gamble (2005,p.45) “...managers must be able to perceptively diagnose a company’s external and internal environments to succeed in crafting a strategy that is an excellent fit with the company’s situation ...”. A decision on the appropriate strategy to respond to the external environment accordingly requires a comprehensive understanding of the organizational environment in which a company competes (Cummings and Worley, 2005).

Only by fully understanding the nature of the external environment and the required strategic response will companies be able to align business strategy and organizational design to outperform competitors. According to Beardsley *et al* (2005) this detailed understanding of the external environment, within the regulatory context, should start with a clarification of the main regulatory areas that could affect the business, both in the short – and the long term. Such an assessment would include a clarification of the positions of major stakeholders and an examination of the potential impact of regulation on the company.

An environmental analysis is accordingly advocated before companies decide on the appropriate strategy (Thompson *et al*, 2005; Cummings and Worley, 2005

and Beardsley, 2005). Only Cummings and Worley (2005) however define the different organizational environments. These will be elaborated on before the different possible strategic responses to a regulatory boom are examined.

### **2.7.1 Environmental Types**

According to Cummings and Worley (2005) there exist three types of environments that affect organizational responses. In general, organizational environments include everything that exists beyond the boundaries of organisations and that can directly or indirectly affect the performance of a company (Cummings and Worley, 2005).

#### **2.7.1.1 The general environment**

The general environment consists of all external forces that can influence an organisation in the attainment of its objectives. It can be described in terms of the uncertainty present in the different categories of forces that are the major underlying causes of changing industry and competitive conditions (Thompson *et al*, 2005). These driving forces would be, for example, technological-, legal and regulatory-, political-, economic-, social- and ecological forces.

Each of these forces can affect a company either directly or indirectly. The greater the uncertainty surrounding a particular force, such as, for example, regulatory uncertainty, the more difficult it will become for a company to design an effective strategy to respond to the external environment (Cummings and

Worley, 2005). This would be particularly evident in industries that are currently experiencing rapid change and growth (Beardsley *et al*, 2005).

### **2.7.1.2 The task environment**

The task environment consists of all individuals and organizations that interact directly with a company and that can affect the company in so far as the achievement of its goals is concerned (Cummings and Worley, 2005). Forces that interact directly with a company in this context would be customers, suppliers, competitors, financial institutions and regulators. These forces provide the medium through which an organization can potentially influence its environment. According to Porter (1998) the task environment consists of five forces: supplier power, threats of substitution, and threats of entry, buyer power and rivalry among competitors. These five forces represent the industry structure within which a company competes and must be examined by companies to assess the strengths and weaknesses of rivals in the industry (Thompson *et al*, 2005).

### **2.7.1.3 The enacted environment**

The enacted environment represents the company members' perception about the general and the task environment. Ideally members' actions and decisions should accurately reflect the company's general and task environment if the company's actions and decisions are to be effective (Cummings and Worley, 2005). It is in the task environment where strategy execution takes place.

Strategy-execution is an actions-orientated activity that “...revolves around the management of people and ...takes adept managerial leadership to convincingly communicate the strategy” (Thompson *et al*, 2005, p. 318).

Members of a company must actively observe, register and make sense of the environment in order to make accurate decisions. It is accordingly only the enacted environment that can affect the decisions and the actions chosen by a company (Cummings and Worley, 2005). The general and task environment can however influence whether such actions are correct.

### **2.7.2 Aligning company resources with the organisational environment**

A company’s general- or task environment (the industry within which the company competes) can be characterized along a dynamic-static continuum that reflects the amount of environmental turbulence that a company will experience (Adonisi, 2005). A dynamic environment will typically be complex and subject to rapid change and uncertainty, which will require that the company adopt a flexible strategy. The extent to which companies can thrive depends on their capacity to monitor and make sense of their environments and frame the appropriate responses (Cummings and Worley, 2005).

Environmental features that are highly relevant to the achievement of the company’s goals must be identified and the appropriate steps taken to align the company’s corporate strategy with the external environment and the company’s organizational design. Failure to align a company’s strategic orientation with the

environmental turbulence within which it operates will diminish a company's capability to compete, as its resources will be misaligned and unable to respond to the challenges posed by the environment (Adonisi, 2005). Companies faced with regulatory uncertainty within a complex and rapid changing industry therefore have to adopt flexible strategic responses, aligning company resources with the demands of the environment (Shimizu and Hitt, 2004).

## **2.8 Strategies to respond to the regulatory environment**

### **2.8.1 Definition of Strategy**

According to Collins and Montgomery (2005) there are many different definitions of strategy but not necessarily only one right strategy to create corporate advantage. Thompson *et al* (2005, p.3) define strategy as "...management's game plan for growing the business, staking out a market position, attracting and pleasing customers, competing successfully, conducting operations, and achieving targeted objectives". Strategy can also be defined as "... the creation of a unique and valuable position, involving a different set of activities" Porter (1996, p.68). Porter (1996) emphasizes that strategies are not supposed to be static and that companies may have to change their strategies if there are major structural changes in the industry, such as a regulatory boom.

### **2.8.2 The strategy hierarchy**

According to Thompson *et al* (2005, p.35) "...a company's overall strategy is really a collection of strategic initiatives and actions devised by managers and key employees up and down the whole organizational hierarchy...". In

multibusiness companies the strategy-making task can involve up to four distinct types or levels of strategy namely the corporate strategy, the business strategy, functional-area strategies and operating strategies. For ease of reference, these terms (as outlined by Thompson *et al* (2005) can be defined as set out in Table 4 below:

**Table 4: Definition of constructs: strategic hierarchy**

<b>Term</b>	<b>Theoretical definition</b>
Corporate strategy	Means the kind of initiatives a company uses to establish business positions in different industries. Senior corporate executives normally take the lead for devising corporate strategy and choosing among whatever actions that are recommended and “bubble up” from the organisation below.
Business strategy	Means the actions and approaches crafted to produce performance in specific lines of business within the organisation. General managers of the different lines of business often devise business strategies, often in consultation with heads of functional area activities. These strategies have to conform to corporate-level objectives and strategic themes
Functional-area strategy	Means the actions and approaches by the head of a particular function within a business. These strategies add specifics “...to the hows of the business-level strategy” (Thompson <i>et al</i> , 2005, p.36)
Operating strategy	Means the narrow strategic initiatives for managing key operating units and specific operating activities with strategic significance. It provides the game plan for the management of lower-echelon activities that have strategic significance.

Any reference to “strategy” in the context of this research report is intended to be a reference to the corporate strategy as defined above, unless a different intention is indicated. Similarly, any reference to “operational activities” or “operational agenda”, must be seen as a reference to the operating strategy and the operational activities associated with it, as outlined in Table 4 above.

### 2.8.3 Executing strategy

Changing circumstances and ongoing management by a company's executives to improve a strategy cause strategies to emerge and evolve over time (Thompson *et al*, 2005). Executives however increasingly fall into the trap of confusing strategic positioning with operational activities to achieve operational effectiveness. The former entails performing different activities from rivals' or performing similar activities differently whilst the latter does not (Porter, 1996).

This does not mean that operational effectiveness is not important. To the contrary, operational effectiveness and strategy are both essential to superior performance. Managers should however not be caught in the trap of pursuing only an operational agenda (a continuous improvement of practices that allow the company to better utilize its resources) – companies should simultaneously pursue a strategic agenda: choosing activities that are different from rivals' (Porter, 1996).

The operational and strategic agendas should be aligned with the turbulence caused by a capricious regulatory environment to enable companies to sustain growth. Put differently, the operational strategy (and accordingly the operational activities pursued to implement the operational strategy) should conform to the objectives of the corporate strategy. The corporate strategy should consecutively be aligned with the external environment, and any turbulence that may be caused by changes in the regulatory environment.

## 2.8.4 The operational agenda: activities to pursue

The current regulatory boom has given birth to a new breed of corporate managers called compliance officers, compliance practitioners or ethics officers whose sole purpose is to ensure that companies “toe the line” (Claasen, 2006). The activities pursued by compliance officers, although of strategic performance, are simply operational activities that are intended to ensure that companies do not fall foul of the law. Table 5 contains a list of operational activities that are recommended for companies to pursue in order to manage their compliance risk (Britt, 2005; Foster, 2005; Pocker, 2005).

**Table 5: Operational activities (Pocker, 2005)**

1	<b>Risk lexicon</b>	Companies should explicitly incorporate compliance risk as an exposure and discipline in its own right in addition to credit, market and operational risk.
2	<b>Broad allocation of compliance management</b>	Although the Chief Compliance Officer reports to the board of directors on compliance risk, the information required is only partially available from the compliance department. Management of compliance risk should be broadly allocated to various business levels within an organisation.
3	<b>Development of policy manuals</b>	The compliance standard of a company is set out in a series of policy manuals that must be developed by the compliance department. Policy manuals summarize the relevant regulations, describe regulations' interpretation and application and provide a general overview of control mechanisms. Parties involved in exercising compliance control are identified.
4	<b>Drafting compliance procedures</b>	Compliance policies need to be implemented through procedures that are drafted by the compliance department. These procedures provide a step-by-step guide on how the compliance department will check its own work and guide the compliance officer on how to ensure that various business levels follow through on their responsibilities.
5	<b>Translate policy into various business lines</b>	Compliance policies must be adopted by the various business units and translated into localized procedures. Business-level procedures must provide managers with step-by-step guidance on how employees are to apply compliance policies developed by the compliance department.
6	<b>Training of compliance department</b>	Although the compliance department has the main responsibility for compliance training, the compliance officer must ensure that his own department is current and up-to-date on an understanding of compliance laws, regulations and rules. This understanding must be translated into practical advice for various business levels.
7	<b>Training at business level</b>	The compliance department is responsible for the training of employees at various business levels and operational units. Training can be formal in-person training, e-training or one-on-one coaching. In

		addition, training can occur through business unit seminars and workshops.
8	<b>Surveillance, monitoring and testing</b>	To provide assurance that compliance controls are operating as intended, the compliance department must establish a process that is performed periodically to monitor whether compliance procedures are followed. Various tools and systems can be applied to perform monitoring functions. The results of these activities will enable the compliance officer to report to the board of directors on the current status of compliance risk.
9	<b>Structured review process</b>	Companies must annually conduct planning processes to ensure that there exists sufficient coverage of compliance risk and that sufficient compliance management responsibilities are allocated across various business levels and operational units.

As can be seen from Table 5, the approach that some authors (Pocker, 2005, Britt, 2005 and Foster, 2005) recommend to managing regulatory risk satisfies the definition of operational strategy as defined by Thompson *et al* (2005). The activities appear to be "...specific operating activities with strategic significance. It provides the game plan for the management of lower-echelon activities that have strategic significance" (Thompson *et al*, 2005, p 35).

Although these activities will ensure that a company toes the line, it will not assist a company in gaining a competitive advantage over competitors. These operational activities must conform to the corporate strategy that must be aligned with the general environment, for companies to gain a competitive edge over rivals (Cummings and Worley, 2005). The operational activities should accurately reflect the company's general and task environment if the company's actions and decisions are to be effective.

Operational activities alone will not prevent corporate disasters. Legal and regulatory frameworks have the inherent weakness that they can be manipulated

and exploited by unscrupulous managers that are intent on pursuing greed-based activities (Davis, 2004; Durden and Pech, 2006; Beardsley *et al*, 2005). On the contrary, there are however companies that are led by executives that are genuinely pursuing growth objectives, within the framework of regulatory compliance and adopting operational practices (such as those contained in Table 5), but fail, for a number of reasons, to achieve sustainable growth (Durdén and Pech, 2006).

Part of the reason for this failure to achieve sustainable growth may lie in the unintended consequences that regulation brings about. Executives may have fallen into the trap that Porter (1996) has warned about: that managers have become too focused on the operational agenda of continuously improving on compliance practices and procedures, at the expense of the strategic agenda.

### **2.8.5 Strategic positioning**

The essence of strategy lies in performing activities differently than competitors do and choosing a different set of activities to deliver a unique mix of value (Porter, 1996). Having identified the general and task environment that the company operates in and establishing where this environment is situated on the dynamic-static continuum, the question that remains to be answered is how the company should align its resources with the external environment. How should executives achieve an alignment between companies' enacted environment and the general and task environment where the general environment is

characterized by increasing regulation? According to Cummings and Worley (2005) companies can devise competitive and collaborative strategies to manage environmental interfaces.

### **2.8.5.1 Competitive strategies**

Competitive strategies focus on sets of administrative and competitive responses that will enable companies to improve their performance. Competitive strategies are accordingly concerned with the choices that are made to improve competitive performance (Cummings and Worley, 2005).

Porter (1998) describes a competitive strategy as “...taking offensive or defensive actions to create a defensible position in an industry, to cope successfully with the five competitive forces and thereby yield a superior return on investment for the firm”. Offensive and defensive actions can include overall cost leadership, differentiation, focus, mergers and acquisitions (Porter, 1998; Cummings and Worley, 2005).

A further competitive strategy that is recommended (Cummings and Worley, 2005) to enable a company to respond to a dynamic environment that is, for example, experiencing a regulatory boom, is ISC – aligning organisational design and business strategy. This process is elaborated on below.

### 2.8.5.1.1 Integrated Strategic Change

ISC "...is a deliberate, coordinated process that leads gradually or radically to systemic realignments between the environment and a firm's strategic orientation, and that results in improvement in performance and effectiveness "(Cummings and Worley, 2005, p. 451). ISC is intended to be a highly participative process that aims to eliminate the artificial separation that normally occurs between strategic thinking (executives and senior managers) and operational action (middle managers, supervisors and employees). ISC is applied in four phases.

It entails firstly a leader's willingness and commitment to change and the senior team's ability and willingness to follow the leader's initiative. To ensure that commitment and ownership of the analysis is achieved throughout the firm and to bridge the void that traditionally exists between strategic thinking and operational action this phase should include the whole firm – everyone should participate.

Secondly, organisational structures and processes are required to implement the change and support the new strategy. . "Aligning an organisation's design with a particular strategy can be a major source of superior performance and competitive advantage" (Cummings and Worley, 2005, p.454).

Thirdly, a comprehensive agenda for moving the firm from the status *quo* to the desired future strategic orientation must be designed. . The agenda will specify

how changes will be implemented, given power and deal with the current ability of the firm to implement the required changes.

In the final phase, it is crucial for senior managers to champion the different elements of the change plan. The burning platform having been created during phase one, leadership (or a group with enough power to lead the change effort) is required as the second step, in bringing about change (Kotter, 1995).

### **2.8.5.2 Collaborative strategies**

Forming strategic alliances with other organisations and developing networks is seen as a powerful way to improve companies' performance (Cummings and Worley, 2005). Companies can overcome pressures in the general environmental by collaborating with forces in the task environment. This can include collaborating with other firms in the same industry or lobbying regulators for change or some compromises where common ground can be found that meets all stakeholders' needs.

#### **2.8.5.2.1 Stakeholder Management**

Stakeholder management is an integral part of any regulatory strategy. It entails an understanding of the competing agendas of stakeholders that would enable a firm to create a consensus within the constraints of probable regulatory outcomes (Beardsley *et al*, 2005). According to Beardsley *et al* (2005) stakeholder

management involves three steps, namely stakeholder analysis, the management of trade-offs and the communication of the strategy.

Stakeholder analysis entails an assessment of each regulatory issue's strategic and economic impact on important stakeholders. This can enable a firm to identify coalitions that would support desired trade-offs. Managing trade-offs entails deciding on an achievable outcome by taking into account a trade-off between maximizing profit and broader economic and social considerations. The final step is to communicate the firm's stance to other stakeholders. Round-table discussions, lobbying and advertising can all be included in communicating the firm's position.

#### **2.8.5.2.2 Partnering with nongovernmental organisations**

Another collaborative strategy that is recommended is to partner with NGOs. NGOs have certain strengths that companies can leverage to influence proposed regulatory outcomes (Yaziji, 2004). The strengths that NGOs possess are legitimacy, awareness of social forces, distinct networks, and specialized technical expertise.

Companies "...live and die by the markets they compete in; NGOs, by the ebb and flow of people's concerns about the safety and fairness of conditions worldwide..." (Yaziji, 2004, p.112). Suspicion of corporate motives may be so entrenched that the soundest arguments do not receive a fair hearing (Yaziji,

2004). Firms may accordingly gain the edge and be able to better argue their case by partnering with NGOs.

Whilst an organisation's network may consist of other companies in the industry and those organisation identified in Michael Porter's five forces model (Porter, 1998), NGOs will consist mainly of other NGOs, donors and public-interest lobbyists (Yaziji, 2004). According to Yaziji (2004) there are five benefits to partnering with NGOs:

- It pre-empts potential problems. As soon as NGOs voice their concerns over proposed regulation, a new product or a new plant, companies should invite NGOs for discussions. Only by establishing dialogue can companies ward off trouble (Yaziji, 2004).
- It accelerates innovation. According to Durden and Pech (2006) one of the unintended consequences of regulation is that it stifles innovation. Davis (2004) supports this view. Many companies have found that NGOs often demand more from companies than they themselves do. Many innovations are, for example, launched as result of NGOs refusal to accept the *status quo* (Yaziji, 2004).
- It foresees shifts in demand. NGOs often see some latent burgeoning concern before the corporate world does. This often results in NGOs leading social movements. By staying close to groups that shape public

opinion, companies can anticipate shifts in demand before competitors do (Yaziji, 2004).

- It shapes legislation. NGOs sometimes learn, through their networks, of legislative maneuvering long before it becomes public knowledge. This is where a partnership with NGOs becomes especially useful, as NGOs can be powerful lobbyists that will enable companies to influence legislative outcomes and bring about better-informed legislation (Yaziji, 2004).
- It sets industry standards. Many companies discover that in agreeing to certain compromises NGOs demand that certain minimum standards are adhered to. Often these standards are much higher than the prevailing industry standards, resulting in the NGOs partner setting the benchmark for others in the industry to follow (Yaziji, 2004).

However, partnering with NGOs carry the risk that it is likely that the NGO (and competitors) may learn sensitive information about the firm. Companies are accordingly cautioned to have strict disclosure policies in place before entering into partnerships (Yaziji, 2004).

### **2.8.5.3 Simultaneously pursuing competitive and collaborative strategies**

According to Cummings and Worley (2005) only those companies that are able to establish and maintain effective linkages with the environment survive and prosper. In this regard a two-pronged approach is recommended where

companies simultaneously pursue competitive- and collaborative strategies (Cummings and Worley, 2005). Firstly, companies should manage external constraints and contingencies and take advantage of the opportunities that present themselves in the external environment through competitive strategies that are implemented through processes such as ISC. Secondly, companies should influence the environment to better suit the objectives and the goals of the organisation through methods such as lobbying or collaborating with NGOs (Yaziji, 2004).

#### **2.8.5.4 Incorporating regulation as a core element of strategy**

According to Beardsley *et al* (2005) many companies are able to manage downside risks and create opportunities through a process of continuous negotiation and other collaborative strategies. However, this is only possible if regulation is considered as a core element of strategy. The integration of regulation as a core element of strategy entails:

- Developing a deep and thorough understanding of regulatory scenarios and choices;
- Understanding the interests of other stakeholders;
- Support from the CEO and the board of directors.

According to Thompson *et al* (2005) this integration process is crucial to a successful execution of any strategy and depends on leadership to succeed.

Companies can only maximize long-term value by linking regulatory strategy with product, business unit and corporate strategy. Often a new strategy does not fit in with a company's existing culture. Bringing about a change requires competent leadership that is committed to the new course of action: "It requires symbolic actions and substantive actions that unmistakably indicate serious commitment on the part of top management...it [has] to become a way of life through training, strict compliance and enforcement procedures, and reiterated management endorsement" (Thompson *et al*, 2005, p.399-p.400). According to Beardsley *et al* (2005) failure to link regulatory strategy with every aspect of a firm's business results in a delayed, reactionary response to the general and task environment.

Companies should also focus their response strategy around the decision-making process in firms, as regulation tends to constrain effective decision-making that results in slow and inefficient corporate behaviour (Durden and Pech, 2006). In this regard it is recommended that:

- Reforms that facilitate transparency, the effective sharing of information and open communication should be prioritized;
- The whole organisation should be designed to be sleek, responsive, cost-effective and market oriented;
- Firms should focus on maintaining flexibility as a strategic performance enabler.

## **2.9 Conclusion**

### **2.9.1 Introduction**

The evidence provided in motivation of this research suggests that few SMEs are able to effectively manage downside risks and the opportunities brought about by the regulatory environment. The SAICAS- and SBP surveys indicate that most firms believe that regulation constrains growth by, amongst others, hampering decision-making. Is it because its leadership does not buy in to the integration of regulatory compliance as a core element of strategy or because, as Durden and Pech (2006) allege, firms lose their strategic flexibility?

The literature available on regulation has shown that regulation impacts negatively on company performance, for a variety of reasons, ranging from delayed decision making on the part of executives (Durden and Pech, 2006) to companies being lured into a box-ticking mentality that impinges innovation (Davis, 2004). However, companies must learn to prosper within the general and task environment that is becoming increasingly dynamic and complex, as regulation is not only necessary to encourage FDI in SA, it is also a reflection of societal expectations (Leone, 1977).

### **2.9.2 The gap in the theory base**

The literature has shown that there are numerous generic competitive strategies that are recommended (Thompson *et al*, 2005, Porter, 1998) for companies to gain a competitive edge over rivals. However, there is apparently no

recommended strategy on how companies can thrive through the appropriate response to a turbulent regulatory environment. The value of strategic alliances and collaborative strategies are recognized but it appears that various authors on strategy limit the value in collaborative strategies to only one dimension. Strategic alliances and collaborative strategies are recommended with other companies that will enable organisations to breach certain resource- or technology gaps. A collaborative strategy to the regulatory environment, with organisations that do not compete in the industry, appears to be overlooked.

The literature has however shown that a strategic response to the regulatory environment can be developed. Companies can thrive by simultaneously pursuing operational activities (Table 5) and through strategic positioning (Porter, 1996). This entails incorporating regulation as a core element of strategy (Beardsley *et al*, 2005) and simultaneously pursuing collaborative and competitive strategies (Cummings and Worley, 2005). According to Cummings and Worley (2005) an alignment between the company's strategic orientation and the external environment through processes such as ISC should then be pursued. This approach presupposes that the regulatory agenda must be initiated and driven from the top of the organisation (Thompson *et al*, 2005).

One of the aims of this research is to bridge this gap and identify a strategy that will enable companies to thrive in an increasingly demanding regulatory environment.

### **3. Chapter 3: Restatement of research questions**

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#### **3.1 Introduction**

This chapter sets out the purpose of the research project and establishes the research questions the study aims to answer.

#### **3.2 Purpose of the research**

There were three aims to this research. Firstly this research aimed at identifying how regulation impacts on SA public companies and in particular how regulation affects the decision-making processes of executives. Secondly the purpose was to identify a strategic response for companies to follow that would enable them to thrive within a general environment that is characterised by an increasing focus on regulatory compliance. Finally the research aimed to ascertain whether SA public companies are inclined to grow or not to grow as a result of regulation.

#### **3.3 Research questions**

Little is known about the unintended consequences of regulation and in particular, how regulation impacts on the growth of public companies and accordingly the growth of economies. In order to address the three aims of this study, five research questions were formulated:

##### **3.3.1 Research question 1: How does regulation impact on executive decision-making processes?**

Arising out of the literature review it appears that one of the unintended consequences of regulation is that regulation impedes efficiency in the decision-

making processes of senior executives in that boards of directors become more preoccupied with regulation and consequently become increasingly involved in the customary tasks of management (Durden and Pech, 2006). This question aimed to determine the extent to which regulation in SA elicits similar behaviour in senior executives in public companies and whether regulation creates “decision speed bumps” as it does in SMEs.

### **3.3.2 Research question 2: How does the quality of regulation stifle the growth of public companies?**

Based on the literature review that there is a direct correlation between economic growth and the quality of regulation (Kay and Vickers, 1988), this question aimed at determining how the quality of regulation affects the behaviour of senior executives in public companies and whether the resultant behaviour is conducive to an improvement of company performance and, consequently, economic growth.

### **3.3.3 Research question 3: Does the integration of regulation as a core element of strategy and executive support, enable public companies to grow?**

The literature shows that companies must integrate regulation as a core element of corporate strategy in order to manage downside risks and create opportunities, through a continuous process of negotiation and other collaborative strategies (Beardsley *et al*, 2005). This question sought to determine whether companies that do integrate regulation as a core element of corporate strategy survive, prosper and gain a competitive advantage over rivals.

#### **3.3.4 Research question 4: What strategies are pursued to enable public companies to thrive in the current regulatory environment?**

The benefit of adopting a two-pronged approach in strategic positioning has been described as enabling companies to thrive in a general environment that is characterized by a regulatory boom (Cummings and Worley, 2005). This question sought to identify strategies that are adopted by companies to the regulatory environment.

#### **3.3.5 Research question 5: Are public companies inclined to grow or halt their growth as a result of regulatory compliance?**

Regulation has been shown to stifle the growth of SMEs (Paton, 2005). This question sought to determine whether regulation has a similar impact on SA public companies.

## **4. Chapter 4: Research Methodology**

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### **4.1 Introduction**

This chapter sets out the research methods that were used in this study.

### **4.2 Research Method**

This research was exploratory in nature. It aimed at identifying the impact of regulation on the decision-making processes of senior management and, accordingly, the inclination of SA public companies to grow or not to grow their businesses. In addition the research aimed at identifying an ideal strategic approach for public companies to adopt to the regulatory environment.

Henning (2004, p.3) submits that when “...we want to find out not only what happens but also how it happens and, importantly, why it happens the way it does ...” qualitative research is the most appropriate research method as it is designed “...to understand, and also explain in argument, by using evidence from data and from the literature, what the phenomenon or phenomena that we are studying is about. We do not want to place this understanding within the boundaries of an instrument beforehand because this will limit the data to those very boundaries” (Henning, 2004, p 3).

The research method accordingly adopted was face-to-face interviews. The face-to-face interviews were preceded by a pilot study where the feasibility of an

interview schedule (see Appendix 1) and a questionnaire (see Appendix 2) were tested.

#### **4.2.1 The face-to-face interview**

Due to the exploratory nature of the area researched an interview schedule was used in face-to-face interviews, as it "...allows the interviewer to use probes with a view to clear up vague responses or to ask for elaboration of incomplete answers" (Wellman and Kruger, 2005, p. 161). This approach is also supported by Henning (2004, p 52) since the aim of interview data is "...to bring to our attention what individuals think, feel and do and what they have to say about it in an interview, giving us their subjective reality in a 'formatted' discussion." Each interview commenced with a discussion guided by the interview schedule and was concluded with the completion of the questionnaire which was immediately returned to the researcher. The collected data was analysed through a combination of content analysis and frequency distribution analysis.

#### **4.2.2 The questionnaire**

According to Patton (2002) absolute allegiance to a particular methodology is not ideal however and a combination of qualitative and quantitative methods can contribute to methodological rigor. This study accordingly also made use of a questionnaire (Appendix 2), which had the added advantage of measuring the reactions of a group of people to a limited set of statements "...thus facilitating comparison and statistical aggregation of data" (Patton, 2002, p 14).

### **4.3 Design of data gathering tools**

#### **4.3.1 The interview schedule**

The interview schedule consisted of five questions that were aimed at addressing the research questions. The open-ended questions further addressed four variables identified in the literature as critical to regulation namely the quality of regulation, the impact of regulatory compliance on executive decision-making processes, operational activities and strategic responses to regulation.

#### **4.5.2 The questionnaire**

Due to the exploratory nature of the research the open-ended questions in the interview schedule were designed to elicit responses that are not dealt with in the literature. The questionnaire accordingly aimed at addressing specific issues highlighted in the literature. The questionnaire consisted of twelve statements which respondents were asked to rate on a five point rating scale, between strongly agree and strongly disagree. These responses were in turn awarded nominal values between 1 (strongly disagree) and 5 (strongly agree) to enable the data to be subjected to a frequency distribution analysis.

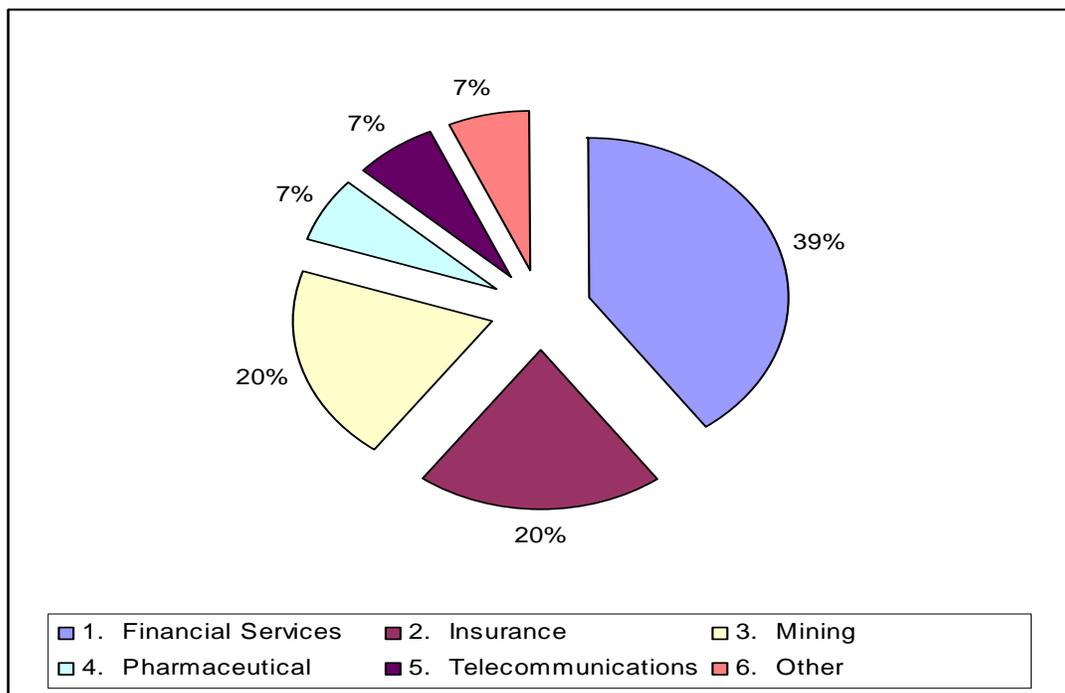
### **4.3 Population**

The population of relevance for this research consisted of companies listed on the JSE during 2006. Compliance officers employed in public companies were targeted for interviews, as they are the individuals within public companies that are tasked with managing regulatory risk and compliance. It was accordingly felt that compliance officers would have a clearer understanding of the impact of regulation on the companies they are employed in.

#### 4.4 Sampling

When the probability that any unit of analysis cannot be specified, due to the fact that certain members of the population may have no chance of being included in the sample, non-probability sampling is used (Welman *et al*, 2005). Snowball sampling, a type of non-probability sampling, was used for the selection of respondents, by seeking introductions through respondents that already formed part of the researcher's own network, and secondly the introduction to respondents through cohorts of the GIBS MBA 2005/2006 class, who work for public companies. The compliance officers of 15 companies were interviewed, a number recommended by Welman *et al* (2005) as the least number of units of analysis that should be included in a sample, as a general rule. Figure 2 below sets out a breakdown of the respondents interviewed per industry:

**Figure 2:** Breakdown of respondents per industry



A total of 18 respondents were approached with requests to participate in the study. Of these 15 (83.3%) agreed to participate in the study. Table 6 reflects a breakdown of respondents by industry.

**Table 6: Profile of respondents approached**

INDUSTRY	PARTICIPANTS APPROACHED	THOSE THAT PARTICIPATED	PERCENTAGE OF SAMPLE
Financial Services	6	6	40
Insurance	4	3	20
Mining	3	3	20
Pharmaceutical	2	1	6.66
Telecommunication	2	1	6.66
Other	1	1	6.66
<b>TOTAL</b>	<b>18</b>	<b>15</b>	<b>100</b>

One company in the insurance industry did not wish to participate in the research, as the respondent perceived the nature of the research as too sensitive. Two companies in the pharmaceutical- and telecommunications industries respectively, declined to participate for similar reasons. One company only participated on the express condition that the company and the industry in which it operates remained anonymous, due to the fact that the nature of the research was deemed too sensitive. This industry is reflected as “Other” in Table 6 above.

## **4.6 The pilot study**

A pilot study was conducted to pre-test the interview schedule and the questionnaire. For this purpose, a compliance officer in the financial services industry, who was not going to take part in the study, was selected.

### **4.6.1 Purpose**

The purpose of the pilot study was:

- To identify whether additional information was thought to be lacking by the compliance officer and needed to be included to develop a more accurate and relevant interview guide that would aid in the collection of data and improve the quality of the interviews.
- To establish whether the interview schedule was appropriately structured to obtain data that would address the research questions and whether the study to be undertaken was feasible. (Leedy and Ormrod, 2005)
- According to Merriam (1998, p. 82) a pilot-interview is also considered “...the best way to tell whether the order of your questions works or not...”.

## **4.7 Data gathering procedure**

Respondents that were identified through snowball sampling were contacted by the researcher and briefed regarding the study and its purpose. Appointments were arranged at respondents' place of employment where face-to-face interviews were conducted. Interview data was collected through a combination of audio tape recordings and field notes. Each interview concluded with

respondents completing the questionnaire and immediately returning the completed questionnaires to the researcher.

## **4.8 Data analysis**

The collected data was analysed through a combination of content and frequency distribution analysis described below.

### **4.8.1 Content analysis**

Content analysis is regarded as an appropriate tool for the analysis of responses to open-ended questions (Welman and Kruger, 2001). Content analysis involves the reduction of qualitative data, whilst articulating the data's most important themes and characteristics through the identification of core consistencies and meanings. Themes identified in the literature review assisted in the identification and clustering of common characteristics under each distinctive theme. The resulting themes are discussed in the results section.

### **4.8.2 Frequency distribution analysis**

The use of a Likert-type scale in evaluating the questionnaires enabled the data to be analysed using a frequency analysis. Responses were captured onto a Microsoft Excel 2003 spreadsheet that was used to generate figures that would help to identify patterns and trends in the data and to make comparisons between the responses from different industries.

## 5. Chapter 5: Results

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### 5.1 Introduction

This chapter presents the results from the 15 respondents' open-ended questions, and the questionnaire. Responses to the questions appearing in the interview schedule (Appendix 1) are outlined first and followed by responses to the questionnaire (Appendix 2).

### 5.2 Profile of respondents

The profile of participants in the study, in terms of their titles and tenure, are summarized in tables 7 and 8.

**Table 7: Breakdown of respondents according to tenure**

TENURE	FREQUENCY	PERCENTAGE OF SAMPLE
2-4 Years	7	46.6
4-6 Years	4	26.6
0-2 Years	3	20
6-8 Years	1	6.6
<b>Total</b>	<b>15</b>	<b>100</b>

Some companies do not assign the management of regulatory risk to compliance officers and in some isolated cases it was found that the internal legal advisor or legal manager was tasked with the management of regulatory compliance. Table 8 shows the spread across the sample in terms of position held by the respondent.

**Table 8: Breakdown of sample according to position held**

POSITION	FREQUENCY	PERCENTAGE OF SAMPLE
Compliance Officer	13	86.66
Legal Advisor/ Manager	2	13.33
<b>Total</b>	<b>15</b>	<b>100</b>

### 5.3 Responses to the open-ended questions

This section outlines responses to questions gleaned through dyadic interviews.

These were clustered into specific themes as described in the literature review.

Also new issues peculiar to this study are shown and discussed in Chapter 6.

#### 5.3.1 Does regulation stifle growth?

The literature revealed that regulation could stifle the growth of companies in a variety of ways. Four themes that encapsulate how growth could be stifled are:

sluggish decision-making of executives, regulatory quality, operational activities and strategic approaches that can be adopted to respond to regulation.

Responses have been clustered into these four themes as shown in Table 9.

The first open-ended question was intended to gauge respondents' perceptions, in general, on the impact that regulation has on public companies.

**Table 9: Does regulation stifles growth?**

Response	Frequency	Reason	Theme
Yes	6	Makes business cumbersome. Takes more time and effort to roll out products/services. Makes executives more cautious and even hesitant	Sluggish decision-making/ time
Yes	2	Not all stakeholders are treated equally or even considered in legislation. This results in ineffective regulation that not does not encourage growth	Regulatory Quality

Response	Frequency	Reason	Theme
Yes	1	Regulation that lacks quality results in playing field not being equal amongst competitors – this undermines growth	Regulatory Quality
<b>TOTAL</b>	<b>9</b>		
No	4	Poses challenges that can be overcome and in fact give companies a competitive advantage if the correct strategy is followed.	Strategic Issues
No	2	Poses challenges but can facilitate growth if it is managed correctly through appropriate structures and internal procedures	Operational Issues
<b>TOTAL</b>	<b>6</b>		

Table 9 above shows the responses broken down in terms of the four themes discussed previously. The detail of what was raised in each of the four themes is elaborated on below. Thereafter, interviewees' responses to the remaining questions in the interview schedule will be addressed.

### 5.3.1.1 Sluggish decision-making

Six respondents (40%) were of the opinion that regulation stifled growth because it slowed senior executives' decision-making. Simultaneously, the fact that regulatory compliance was a time consuming exercise was raised as the reason why regulation stifled growth. Of these six respondents four (26%) indicated that decision-making was sluggish as executives were more cautious and wanted decisions approved by the compliance department, before the decisions are acted on:

*"...it often seems that they [senior executives] know what they want to do...they are also concerned about doing something that will*

*cause the company harm or cause them embarrassment. The result is that Compliance is consulted before decisions are acted on – this can delay taking action as executives want to be assured that everything is OK...”*

Red tape was blamed by two respondents (13%) as slowing down executives as organisations are being forced to comply with a myriad of administrative procedures before, for example, licenses can be obtained to either enable companies to exploit new opportunities or to simply remain in business.

*“...a course of action was decided on, debated and everyone is hyped up and ready to go. Then you find that before the decision can be acted upon a whole lot of administrative requirements must be dealt with before you can move forward...its like playing snakes and ladders...”*

### **5.3.1.2 Strategic Issues**

Six respondents (40%) disagreed that regulation stifled growth. Of this group four respondents (26.6%) felt that regulatory compliance could facilitate growth and in fact give organisations a competitive advantage over rivals in their industries, if the correct strategic approach to regulatory compliance is adopted. The particular comments made in this regard were:

- *“...with the right strategy the problems posed by regulatory compliance can be overcome...it can give you the edge over competitors.”*
- *“...it depends on your relationship with the regulator. If you maintain a transparent and co-operative relationship with your regulator regulatory compliance does not affect growth...it gives you an advantage...”*
- *“...if executives align business processes with [regulatory] compliance to ensure that everyone is on the same page regulation should not impact on the company’s growth...”*
- *“... not if you have the right corporate culture. If the CEO and the EXCO take compliance seriously, drive regulatory compliance and demonstrate that its important to them you’ll create a culture of compliance. With the right culture regulation does not stifle growth ...it [the right culture] can give you an advantage over competitors with weaker cultures ”*

### **5.3.1.3 Regulatory quality**

Of the nine respondents (60%) that perceived regulation to stifle the growth of companies, three respondents (20%) felt that the quality of regulation was responsible for stifling growth.

These respondents made specific reference to the processes of regulation, as opposed to regulatory outcomes (the second criterion for measuring regulatory

quality) as the main reason as to why regulation stifles growth. The particular comments made in this regard were that:

- *“...badly drafted legislation is a problem. When it is so badly drafted that you have to guess what the regulator was trying to achieve, it slows down the development of new products or services. Everyone waits for Compliance to give the green light...”*
- *“...sometimes the focus is on the protection of consumers or investors. Not all stakeholders are treated equally. You spend all your time on putting in place compliance measures that only costs the company money. It certainly does not encourage growth...”*
- *“...they [regulators] do not appear to have the faintest idea of how our industry will be impacted. They implement measures [regulation] that frankly does not work – all it does is cost us money...”*

#### **5.3.1.4 Operational activities**

The least referred to theme that emerged in response to the question whether regulation stifles growth was operational activities.

Of the nine respondents that did not believe that regulation stifles growth, two (13%) raised issues relating to operational activities in explaining how operational activities could be leveraged to facilitate the growth of public companies, alternatively that regulation only tended to stifle growth if the correct operational

activities were not adopted by corporations. The particular comments made in this regard were that:

- *“...if you have the right rules and procedures in place and everyone is trained well and knows how it [the rules and procedures] works and what is required of them the company can just get on with business. If your competitors do not have the same type of mechanisms in place, you can move faster than they can...”*;
- *“...it [operational activities] establishes the rules of the game, provides transparency and security for stakeholders...all your resources start pursuing the same goal...”*;
- *“...Strong compliance procedures provide a solid foundation. It gives the company a point of departure from which new products or services can be launched...without it they [employees or resources] don’t know whether the projects that are worked on is worth the effort”*;
- *“... compliance policies establish boundaries within which the company must operate. This gives shareholders and directors the peace of mind that monetary- and reputational losses are mitigated...”*

The discussion of responses outlined in paragraph 5.3.1 above provides a general view of respondents’ perception *vis-à-vis* the impact that regulation has on public companies. What follows is a discussion of respondents’ responses to the remaining questions in the interview schedule (Appendix 1).

### 5.3.2 Regulation’s impact on executives’ decision-making processes

Question 3 of the interview schedule addressed the impact that regulation has on the decision-making processes of executives. Nine respondents (60%) did not perceive regulation to result in sluggish decision-making by company executives, whilst six respondents (40%) did perceive regulation to slow down executives’ decision-making. Table 10 ranks in order of frequency interviewees’ reasons for believing or not believing that regulation results in sluggish decision-making on the part of executives.

**Table 10: Does regulation slow down executives’ decision-making process?**

Yes/No	RESPONSE	FREQUENCY
No	With the <u>correct systems and procedures</u> in place decision-making should not be slowed down. Considering regulation becomes <u>just another aspect of everyday business</u> . The problem lies in the <u>implementation of decisions</u> and particularly the administrative hoops one has to jump through.	5
No	Considering regulation is <u>just another part of everyday business</u> . Internal controls ensure decisions are not sluggish. Regulation rather <u>has a knock-on effect</u> down the line in that it delays decision implementation.	2
No	The <u>potential personal liability</u> has resulted in a more cautious approach with more internal rules and procedures but it has not really slowed down decision-making. It rather results in the <u>business processes down the line</u> being slowed down	1
No	It <u>depends on whether it is new</u> regulation or not. If it’s new and badly drafted it takes time for everyone to get used to it. After everyone has <u>acclimatized</u> to the new regulation it becomes just another part of everyday business. <u>Executing decisions is slowed down</u> by rules and procedures though.	1
	<b>TOTAL</b>	<b>9</b>
Yes	Regulation has a major impact. Particularly ambiguous regulation results in <u>considerable deliberation before decisions are made</u>	2
Yes	The <u>potential personal liability</u> of executives results in a drive that everything must be done by the book. There is almost an obsession that a <u>paper trial</u> of every decision must exist	2
Yes	But is <u>industry specific</u> . One cannot generalize. The perception is that it slows down executives especially in financial services	1
Yes	It does slow down decision making but if it means that the company will toe the line its good for all the stakeholders	1
	<b>TOTAL</b>	<b>6</b>

The responses were as follows:

- Firstly, the majority of respondents (60%) did not perceive regulation to slow down the decision-making process with five respondents (33%) believing that well-designed operational activities and systems remove any stumbling blocks in the decision-making process. As one of the respondents commented:

*“...if you have a robust risk management system in place [regulatory] compliance becomes just another part of everyday business. Executives demand immediate answers as and when questions arise. The problems actually arise later, when you want to put into practice what was decided on. Very often you find that an administrative obstacle course must be navigated to give effect to decisions...”.*

- Secondly, of those respondents that perceived regulation not to slow down the decision-making processes of executives, eight respondents (53%) perceived the impact that regulation has on decision-making processes to be just another part of everyday business. One respondent (6%) raised the point that regulation may be cumbersome initially but once everyone becomes accustomed to it and what is required in terms

of new regulation, it has a negligible impact on decision-making;. This respondent commented that:

*“It takes time to get to grips with new regulations. However, once you become used to it [the new regulation] it becomes just another part of the everyday business process. I would say everyone goes through a process of acclimatizing to new regulation. You become familiar with regulation fairly quickly – the business demands it-and there is no slow down...they [senior executives] don’t wait for you...”.*

- Thirdly, of the six (40%) respondents that perceived regulation to slow down decision-making, the potential personal liability of executives and the quality of regulation stood out as the major reasons as to why regulation was perceived to slow down executives’ decision-making. A comment made in this regard was:

*“There is definitely a more cautious approach to running the business. Senior executives are very conscious of the fact that they can’t behave like cowboys – they often say that it’s in shareholders’ interests that the company toes the line and practice good governance. I think that the threat of personal liability is what really causes them to slow down, dot the i’s and cross the t’s...”*

In so far as the quality of regulation is concerned it was said that:

*“Some regulations just don’t make sense. In some cases it’s so badly drafted that you have to start reading between the lines. This slows down executives because they seek assurances that what they plan is “by the book”. If it means that they have to obtain more than one opinion, they’ll wait for it... Of course this will slow them down...”*

Question 2 of the semi-structured interview addressed the impact that regulation has on the customary tasks of executives. All respondents made reference to King II and how corporate governance has affected the customary tasks of executives. The responses to question 2 were that:

- Seven respondents (46.6%) believed that regulation has resulted in more “buy-in” being expressed for the compliance function, by directors, and that directors are more frequently in contact with the compliance function, as a result of regulation. One respondent commented:

*“...I would not say that compliance has changed what they do on a day-to-day basis. [Company name] has always been a good corporate citizen. The focus in recent years on corporate*

*governance has simply emphasized what companies should always have been doing...with King II corporate governance has been elevated to a new level and the senior guys pay a lot more attention to it... there is more contact with Compliance, more buy-in for compliance procedures. They want to be sure that there are no transgressions while they are steering the ship...that everything was done “by the book”*

- Four respondents (26.6%) indicated that the increasing focus on the potential personal liability of directors has resulted in senior executives adopting a far more open and transparent decision-making process:

*“...there is a paper trail of every important decision. I suppose its made business a bit more formal but its good. When something is considered they are more likely to convene a meeting to debate whether the course of action that is being considered would be appropriate...that it [decisions] could later be defended. Directors are obviously concerned about the possibility that they can be held liable and they want to ensure that it does not happen...”*

Responses to question 2 are outlined in Table 11 below and ranked in order of the frequency of how respondents perceived regulation to have affected the customary tasks of directors and the EXCO.

**Table 11: How has regulation affected the customary tasks of directors/the EXCO?**

COMMENTS MADE	FREQUENCY
King Code II has dramatically altered directors' mindsets – they are far more vigilant and there is far more “buy-in” for the compliance function, which has to “sell” and drive compliance in the organisation. Directors seek confirmation that everything is done “by the book” before decisions are executed.	7
The King Code II on governance had a drastic impact of the traditional tasks of especially directors. There is now <u>greater emphasis the personal accountability</u> of directors. This has resulted in directors being more mindful of the fact that they have to demonstrate that decisions are arrived at within the boundaries of regulation, before decisions are implemented.	4
It has thrown the board into the spotlight. It is now part of the JSE's listing requirements that King II be complied with and that compliance is demonstrated. Whether a company follows King II affects the confidence the public has in the company. Directors accordingly <u>act far more openly</u> – decision-making is far more transparent	3
There are <u>no major changes</u> as a result of regulation or King Code II. King Code simply fosters good business practices that were always followed by the board and EXCO in any event. These good business practices have now simply been elevated to regulatory status.	1

### 5.3.3 How the quality of regulation affects the growth of companies

Question 4 of the interview schedule addressed the issue of regulatory quality and its impact on the growth of companies. Interviewees' responses to Question 1 (in so far as it related to regulatory quality) have been summarized in Table 9 above. Table 12 below outlines whether the aspect of regulatory quality relates to the process of regulation or the outcome thereof.

**Table 12: The impact of regulatory quality on companies' growth**

COMMENTS MADE	ASPECT OF REGULATORY QUALITY ADDRESSED	FREQUENCY
Not enough prior consultation with industry during drafting of legislation, which results in ambiguous, unclear legislation, that is costly to comply with.	REGULATORY PROCESS	7

COMMENTS MADE	ASPECT OF REGULATORY QUALITY ADDRESSED	FREQUENCY
Too much regulation is passed through Parliament too quickly without assessing first its impact through RIAs	REGULATORY PROCESS	4
Too much regulation is passed without any capacity or resources to actually monitor and police compliance – this creates advantages for companies that are prepared to push boundaries of regulation	REGULATORY PROCESS	2
Ambiguous regulation creates complexities that slow down product/service innovation and results in additional costs being incurred for professional advice.	REGULATORY OUTCOME	2

Table 12 shows that most interviewees felt that the process of regulation rather than regulatory outcomes stifled the growth of companies and indicated that a lack of consultation by regulatory bodies, when legislation was being drafted, resulted in the quality of regulation being compromised.

Seven respondents (46.6%) commented on the fact that a common problem appeared to be the lack of insight in a particular industry, by the regulator:

*“Sometimes its very frustrating... You can see what it [regulation] aimed at but because the regulator does not know how the industry works, the regulation actually becomes meaningless. Its as if there*

*was some urgency to get regulation passed into law, before checking whether it would actually achieve what its supposed to achieve...without ascertaining first how it will impact on the industry.”*

Four respondents (26.6%) raised the fact that the absence of RIA's was responsible for unintended consequences. These respondents felt that an *ex ante* appraisal of the costs and benefits related to regulation would go a long way in overcoming the current obstacles to growth that regulation pose:

*“...it would be great if they [the regulator] could communicate exactly how the new regulations are going to work, before it is actually implemented. Its one thing to publish new laws for comment...but the implementation is a different story. Often the practical implementation is not what was expected at all...that's when you really start seeing the implications and the cost of it...”*

Table 12 above shows that the majority of respondents believed that the preceding regulatory process directly affected regulatory outcomes and that any flaws in the regulatory process compromised the quality of regulatory outcomes.

As one respondent commented:

*“...by the time its passed as a law its too late to fix it – the damage is done....Yes, it can be fixed with amendments but it takes time. If problems are not resolved before regulations are promulgated you end up with regulations that are problematic ... its not that it [regulation] does not work but it could have been far more effective...”*

One respondent in the banking industry however felt that the lack of consultation could not be attributed to the regulator. According to this respondent the lack of collaboration could rather be attributed to the industry itself. In this regard the respondent felt that the banking industry was characterized by a measure of apathy when it came to engaging with the regulator on particularly potential regulatory changes:

*“...its not all the regulator’s fault...I think that the industry tends to be a bit arrogant. There sometimes seems to be an attitude that it’s the regulators duty to talk to the industry, and not the other way around...”*

#### **5.3.4 Strategies that are pursued to enable companies to thrive within the regulatory environment**

Question 5 of the interview schedule addressed research question 3 and asked interviewees what they would describe as the ideal strategic response for organisations to survive and prosper within the regulatory environment.

Seven respondents (46.6%) believed that well-designed operational activities, combined with support from the board of directors and the EXCO represented the ideal strategy to pursue in the regulatory environment. These respondents added that support from the board of directors and the EXCO must be demonstrated in such a manner so as to eventually result in a culture of compliance being instilled in the organisation. As one compliance officer in the banking industry commented:

*“...you must have a robust risk management system and the right attitude to risk management. It should be seen as a necessary part of doing business by senior executives – they have to support it and drive it...If your systems and controls work and work well, and you have visible support from the top, compliance really should not be a problem...the whole company will follow...”*

Three respondents (20%) described the ideal strategy as a process in terms of which regulation is ranked in accordance with the potential risk posed to the organisation. Compliance officers should then be assigned to managing the various regulations according to their seniority and experience. One of these respondents said that:

*“...you need the right people...find out where the big risks to the business lie and appoint the more senior and experienced people*

*to look after that risk... as the risk reduces, the people managing that particular risk should be those that are less experienced...”*

Table 13 below reflects interviewees’ perceptions of the ideal strategic response and ranked in terms of those most frequently mentioned.

**Table 13: Ideal strategies to pursue to enable companies to thrive in the regulatory environment**

COMMENTS MADE	FREQUENCY
Organisations should implement <u>well-designed operational activities</u> that enjoy <u>support from the CEO/Board/EXCO</u> who demonstrate their support for the regulatory compliance function in such manner as to eventually bring about a <u>corporate culture of compliance</u> .	7
Legislation should be assessed for applicability to the business’ operations and then <u>ranked in accordance with the potential risk posed</u> . Compliance officers are then assigned between high risk and lower risk legislation according to seniority and <u>experience levels to manage compliance risk</u> .	3
Organisations should focus on <u>operational activities alone</u> and ensure that they are well designed and run by competent staff. Someone who has <u>political power in the organisation</u> i.e. who either sits on the EXCO or who has influence within the organisation and the visible support of the EXCO should then head the compliance function.	3
Organisations must be pro-active and <u>anticipate and influence regulatory changes</u> . An effective monitoring system is required in terms of which regulatory risk is assessed, monitored and managed through the <u>appropriate operational procedures</u> . Finally, a <u>culture of buy-in</u> for regulatory compliance must be fostered through visible support from the CEO	2

#### 5.4 Questionnaire results

The 4 themes that were identified in the literature review, and discussed previously were the impact of regulation on executives’ decision-making processes, strategic issues, regulatory quality and operational issues. The responses to the questionnaire are clustered into these themes, and some of the other themes that emerged from the literature, and discussed below.

### 5.4.1 Strategies to respond to the regulatory environment

Three statements in the questionnaire (Appendix 2), statements 10, 11 and 12, related to strategic issues. Statement 10 asked respondents to respond to the statement that regulation is incorporated a core element of their organisations' corporate strategy.

**Figure 3: Regulation is incorporated as a core element of corporate strategy**

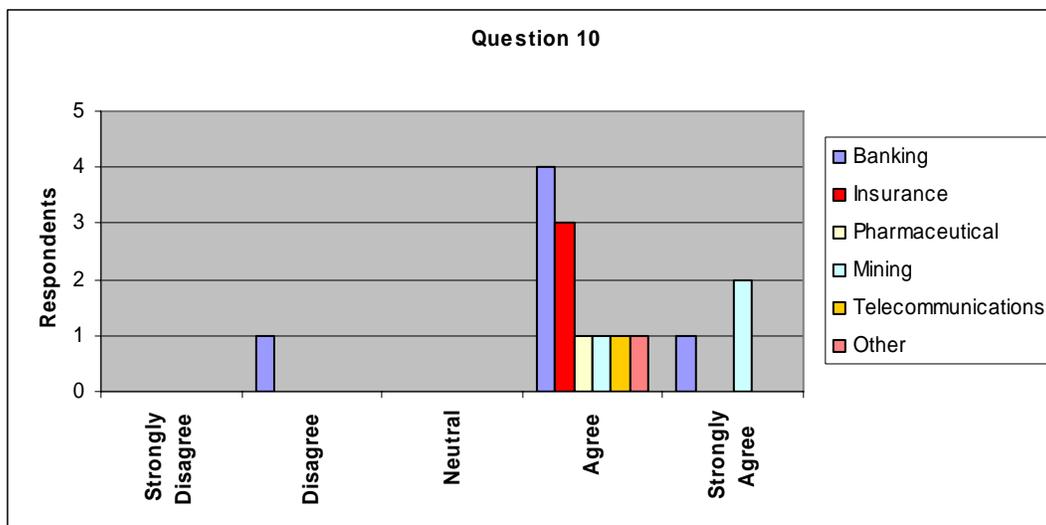
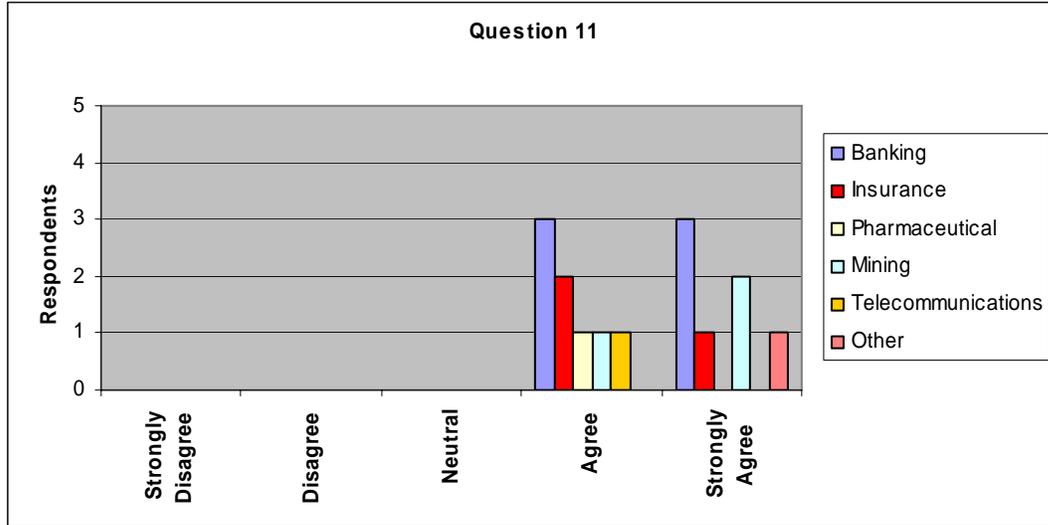


Figure 3 shows that most respondents agreed (one respondent in the banking industry disagreed) with the statement that regulation was incorporated as a core element of their organisations' corporate strategy. Most of the respondents in the mining industry (66%) strongly agreed that regulation was incorporated as a core element of corporate strategy.

Statement 11 addressed the extent to which respondents perceived regulation to be supported by the board and driven by the CEO of their organisations. Figure

4 indicates that all respondents share the perception that regulation is supported by the board and driven by the CEO.

**Figure 4: Regulation is supported by the board and driven by the CEO**



Statement 12 asked respondents to respond to the statement that direct dialogue with the regulator is the way to influence regulatory changes. Figure 5 shows that all respondents reacted positively to this statement, with most respondents (73%) strongly agreeing with the statement.

**Figure 5: The way to influence regulatory change is through direct dialogue with the regulator**

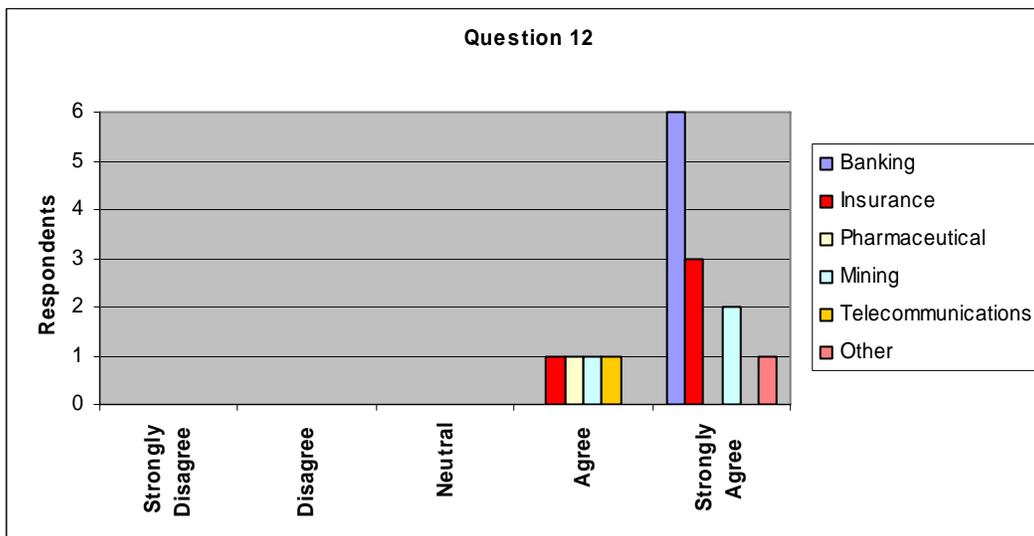


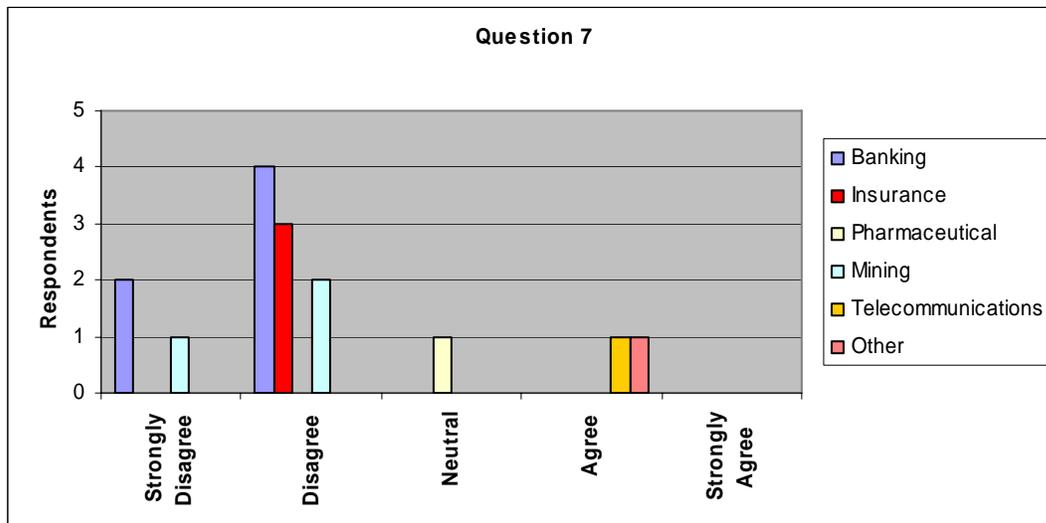
Figure 5 above shows that all banks strongly agreed with the statement whilst most of the insurance – and mining companies also agreed strongly with the statement.

#### 5.4.2 The impact of regulation on innovation

Statement 7 of the questionnaire asked respondents to respond to the statement that regulation stifles either product or service innovation in their organisations.

Figure 6 shows that nine respondents (60%) disagreed and three respondents (20%) strongly disagreed that regulation stifled either product or service innovation. A company in the telecommunications sector (and the “other” company) however agreed with the statement that regulation stifles product or service innovation.

**Figure 6: Regulatory compliance stifles innovation**



Statement 4 of the questionnaire tested perceptions as to whether respondents believed regulatory compliance to add value to shareholders.

**Figure 7: Shareholders derive value from regulatory compliance**

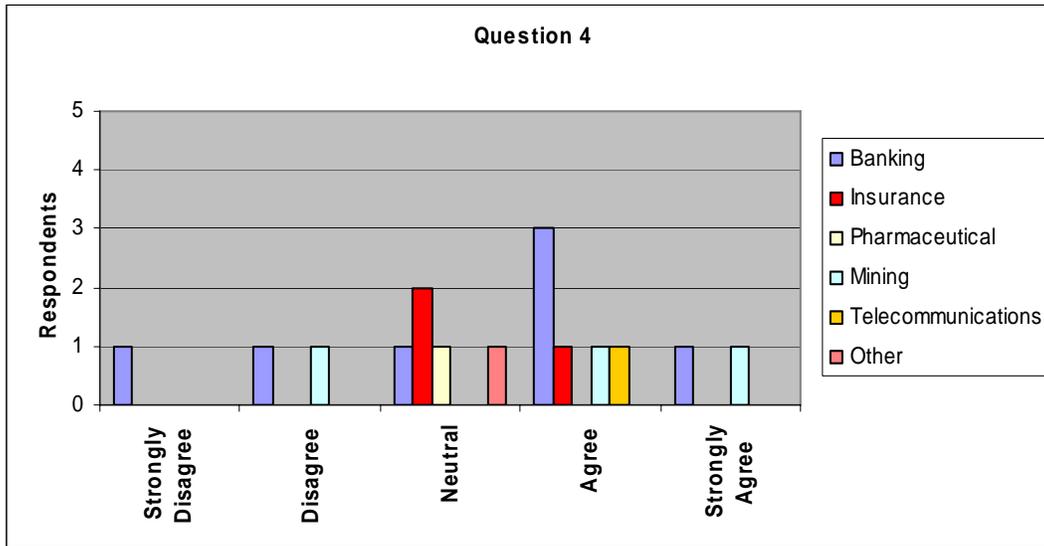


Figure 7 shows that two of the banks surveyed did not agree with the statement that shareholders derive value from regulatory compliance. Most of the insurance companies (66%) were neutral as to whether regulatory compliance added value. Six respondents (40%) however agreed and two respondents (13%) strongly agreed that regulatory compliance adds value for shareholders.

#### 5.4.3 The impact of regulation on the decision-making processes of executives

Statements 5 and 6 of the questionnaire tested respondents' perceptions with regard to the impact that regulatory compliance has on the decision-making processes and efficiency of executives. Statement 5 of the questionnaire asked respondents to respond to the statement that regulatory compliance has resulted

in sluggish decision-making on the part of executives in that more meetings are held and that meetings are characterized by increased indecisiveness.

**Figure 8: Regulatory compliance results in sluggish decision-making on the part of executives**

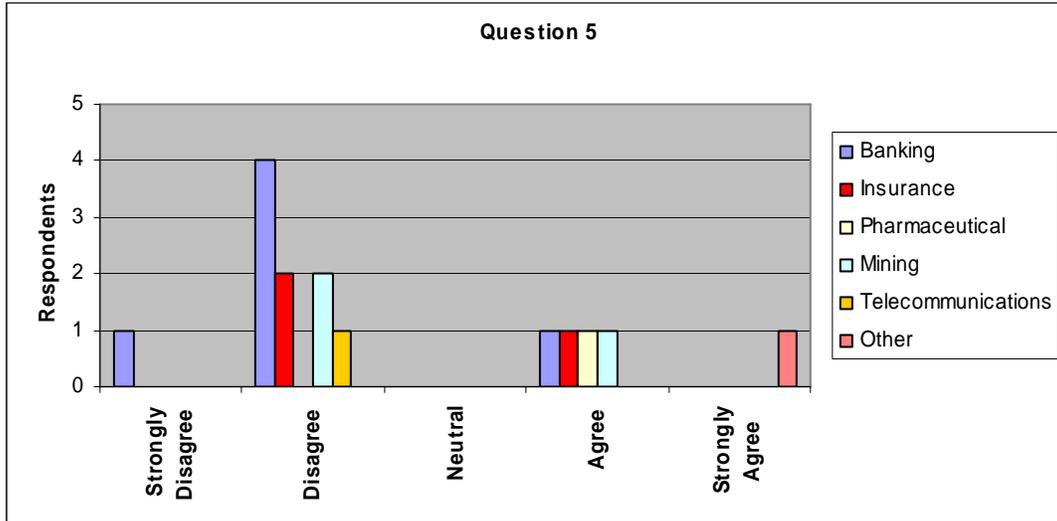
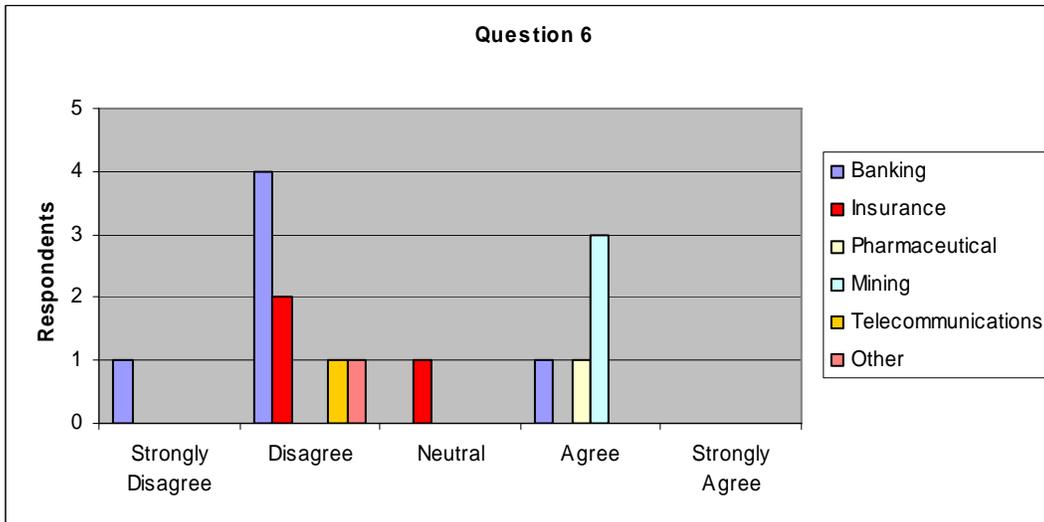


Figure 8 shows that ten respondents (66%) did not perceive any negative impact on the decision-making processes of executives, as a result of regulatory compliance. Notably the “other” respondent strongly agreed that regulatory compliance slows down executives whilst the respondent from the pharmaceutical industry agreed that regulatory compliance slows down executives. However, most banks (33%), insurance companies (13%) and mining companies (13%) disagreed that regulation resulted in sluggish decision-making on the part of their executives.

Statement 6 of the questionnaire asked respondents to respond to the statement that regulatory compliance results in respondents’ board of directors or EXCOs being more inefficient.

Notably, all respondents in the mining industry (20%) agreed with the statement whilst most of the banks (33%) disagreed with the statement. Figure 9 reveals that in total nine respondents (60%) disagreed with the statement.

**Figure 9: Regulatory compliance results in inefficiency of the board/EXCO**



#### 5.4.4 The impact of the quality of regulation on public companies

Statement 1 asked respondents to respond to the statement that the regulation achieved the goals set down by Parliament.

**Figure 10: Regulation achieves the goals set down by Parliament**

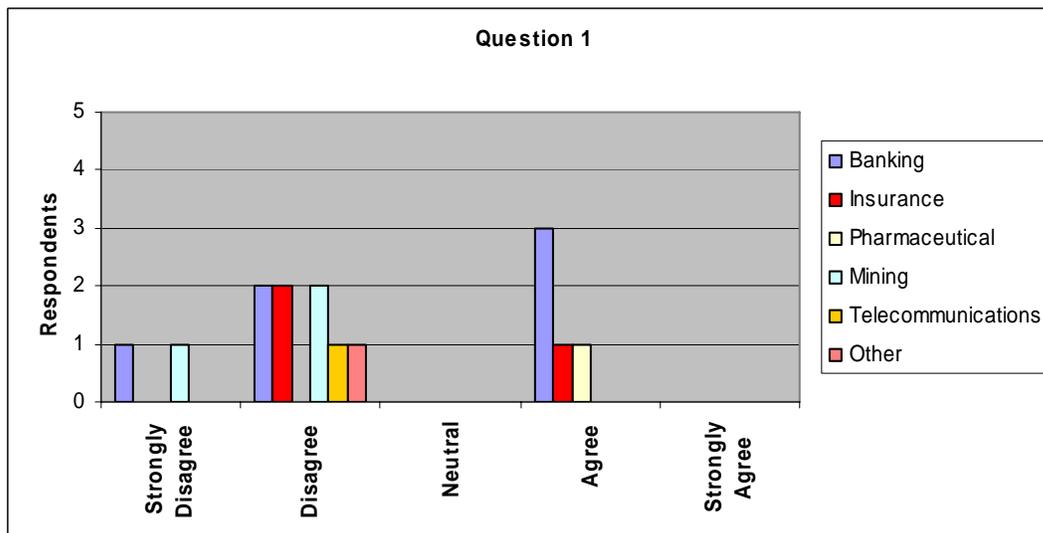
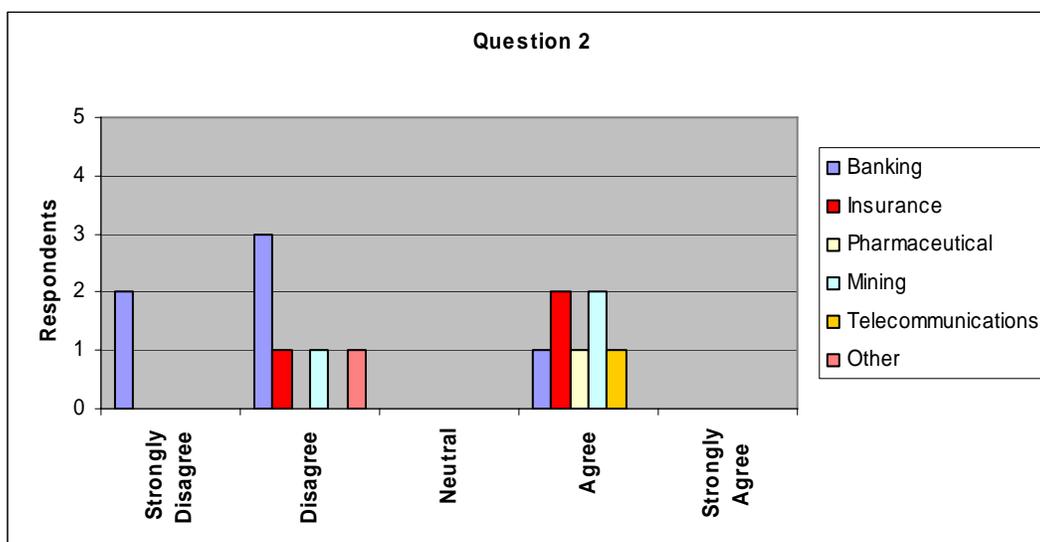


Figure 10 above shows ten respondents (66%) disagreed with the statement. Notably, half of the respondents in the banking industry disagreed that regulation applicable to their organisation achieved the goals aimed at by Parliament whilst most insurance companies and all of the mining companies disagreed with the statement.

Statement 2 of the questionnaire asked respondents to respond to the statement that industry regulators engage in proper consultation when arriving at decisions. Figure 11 below reveals that only seven respondents (46.6%) agreed with the statement that there was proper consultation by the regulator. Five out of the six banks however disagreed with the statement. Most of the respondents in the mining industry (13%) and the insurance industry (13%) felt that there was proper consultation by the regulator when arriving at decisions.

**Figure 11: Industry regulators engage in proper consultation when arriving at decisions**



Statement 3 of the questionnaire asked respondents to respond to the statement that regulators seek to balance the interests of all stakeholders when enforcing and monitoring compliance with regulation.

**Figure 12: Industry regulators seek to balance the interests of all stakeholders when enforcing and monitoring compliance**

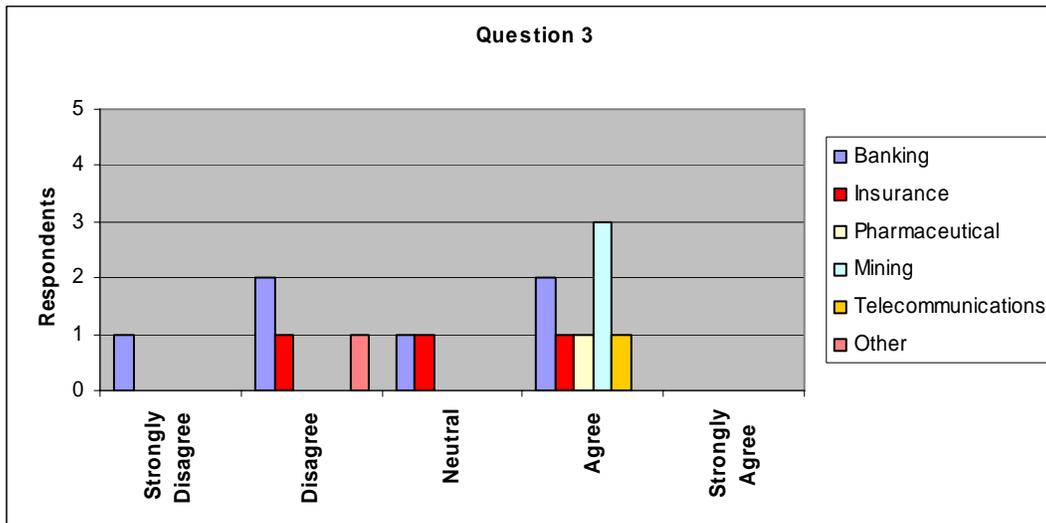


Figure 12 above shows that eight respondents (53.3%) agreed with the statement with the mining industry comprising nearly half of those that agreed. Notably, the banking and insurance industries appears to be divided on the issue with only 33% of the banks and 33% of insurance companies agreeing with the statement.

Statement 8 of the questionnaire asked respondents to respond to the statement that the quality of regulation, in so far as outcomes are concerned, enables companies to grow.

**Figure 13: The quality of regulation, in so far as outcomes are concerned, enables companies to grow**

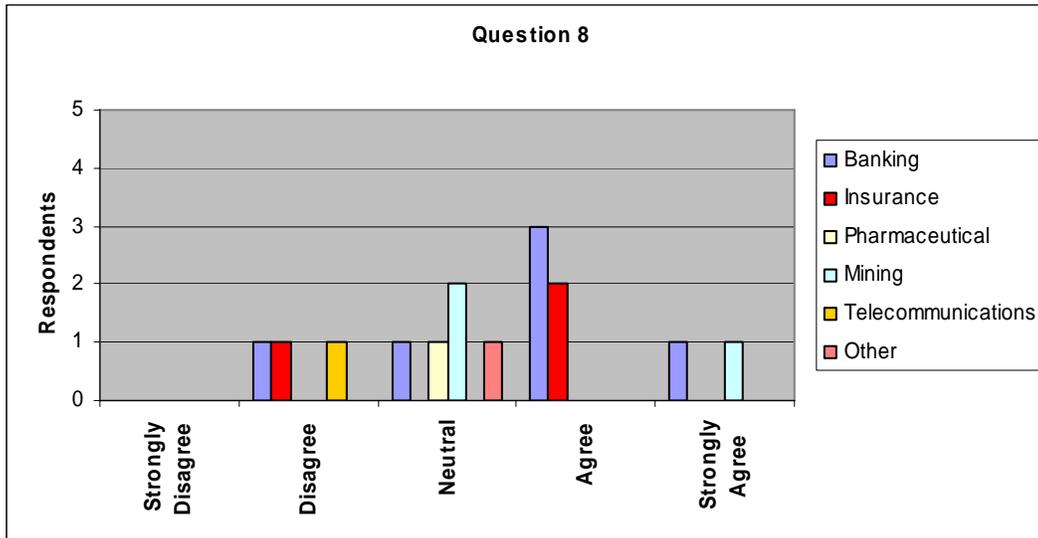
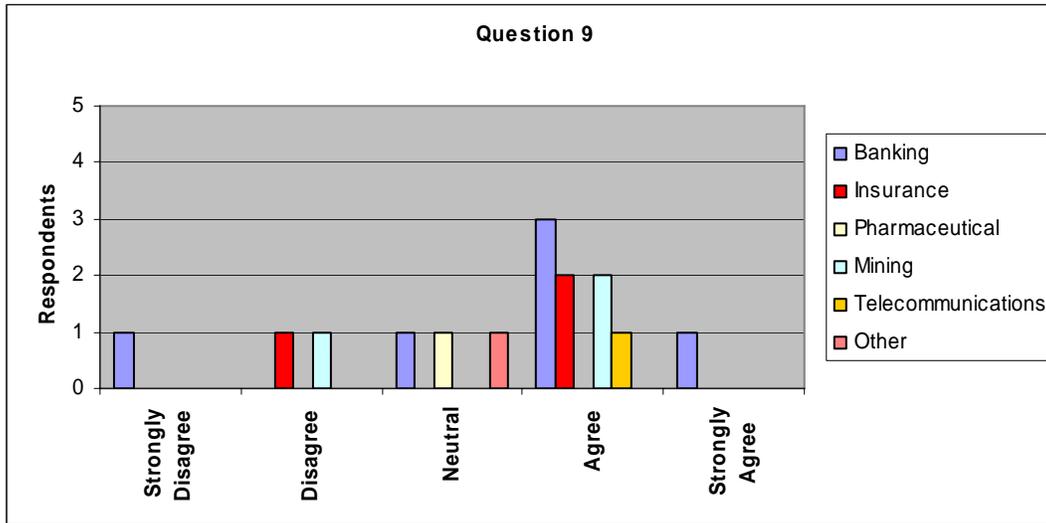


Figure 13 shows that, with regard to regulatory outcomes, only seven respondents (46.6%) agreed that the quality of regulation, in so far as its outcomes are concerned, enabled companies to grow. Most of the banks and the insurance companies agreed with the statement whilst the pharmaceutical company, most of the mining companies and the “other” company neither agreed nor disagreed.

Statement 9 of the questionnaire stated that the quality of regulation, in so far as processes are concerned, enable companies to grow. Figure 14 below reveals that nine respondents (60%) believe that regulatory processes enable companies to grow.

**Figure 14: The quality of regulation, in so far as processes are concerned, enables companies to grow**



Notably, the telecommunications company and most of the mining companies appear to perceive regulatory processes to be conducive to growth but do not believe regulatory outcomes enable them to grow.

## 5.5 Summary

The objective of this research is to establish how regulation impacts on the decision-making processes of executives in listed companies and to ascertain whether public companies favour particular strategies in managing regulatory risk. The results of the study outlined in this chapter reveal that support for the contention that regulation slows down the decision-making processes of executives is not as strong as Durden and Pech (2006) or the results of the SBP-survey (Paton, 2005) might indicate. Responses revealed that most respondents perceive regulation *per se* not to slow down decision-making. Rather respondents perceive the rules and procedures that have been designed in

response to regulatory compliance to slow down the implementation of decisions further down the line in the business process.

The importance of CEO support, as an element of the integration of regulation as a core element of strategy, was recognized. However, respondents perceived visible CEO support as a separate and distinct factor that was critical to the success of a strategic response to the regulatory environment. According to respondents, the integration of regulation as a core element of strategy in itself is not enough to enable companies to overcome the negative impact of regulation.

Strong views were expressed regarding how the quality of regulation stifled growth. In this regard the results revealed that the regulatory processes are the root cause for regulation not achieving the goals aimed at by Parliament. Flawed regulatory processes appear to result in regulatory outcomes being flawed and ultimately stifle growth.

Respondents generally felt that the ideal strategic response to the regulatory environment hinged on leadership (CEO support) and well-designed operational activities although some respondents articulated the added requirement of an alignment being required between corporate strategy and the external environment. Chapter 6 will focus on a discussion of the results of this study and these will be integrated with the theory base.

## 6. Chapter 6: Discussion of Results

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### 6.1 Introduction

This chapter provides a discussion of the results of the study. The research questions are discussed by first outlining the results and introducing key insights that that arose from the study. These are then evaluated against the literature reviewed. The key findings are then summarized at the end of each research question's discussion.

### 6.2 Research Question 1: How does regulation impact on executive decision-making processes?

The study could not confirm that regulation *per se* led to sluggish decision-making, in the manner described by Durden and Pech (2006). Table 10 shows that 60% of respondents in fact perceived regulation not to slow down the decision-making process. Figure 8 further confirmed that 66% of respondents disagree that regulation slows down executives' decision-making. Rather, respondents perceived decision-execution to be stifled. An analysis of responses in Table 10 revealed that respondents rather perceived red tape to hamper decision-execution. Observations regarding the impact of red tape and corporate governance respectively are dealt with in more detail below.

#### 6.2.1 The impact of red tape on decision execution

Although Table 10 shows that 40% of respondents perceive regulation to slow down executive decision-making, a probing of respondents' responses in Table

10 revealed that red tape, and not regulation, slows down the execution of executives' decisions. These respondents confirmed what Buchanan (1975) says regarding red tape namely that an emphasis on rules and regulations (mostly initiated by regulators) results in a ponderous and ineffective administrative style.

Often decisions are discussed, debated and finally decided on but execution is delayed by "...guidelines, procedures, forms and.... interventions that [are] perceived as excessive, unwieldy, or pointless in relationship to decision-making" (Rosenfeld, 1990 as referred to in Pandey and Scott, 2002, p.557). The evidence emerging from the study (Table 10) could accordingly not confirm that executives' decision-making process was slowed down by regulation in the manner described by Durden and Pech (2006).

### **6.2.2 The impact of corporate governance on the decision-making process**

Table 11 of the study shows that 73% of respondents believe directors to have become increasingly concerned with their potential personal liability for transgressions of corporate governance. These respondents expressed the view that King II results in an increased focus on the need for directors to adopt a more consultative and collaborative approach to managing corporations. This view is supported by Tricker (in Wixley and Everingham, 2002) who describes how King II results in an increased monitoring of management activities and internal rules and procedures being implemented to ensure the accountability of management.

Table 10 shows that 13% of respondents perceive an emphasis by directors and the EXCO on internal rules and procedures being adopted. A “paper trial” on decision-making is perceived as being very important. Table 10 further shows that 33% of respondents commented on how the absence of well-designed rules and procedures can result in the same ineffective administrative procedures mentioned by Buchanan (1975, as referred to in Pandey and Scott, 2002), in describing the effects of red tape.

Table 11 further shows that 20% of respondents believe that an awareness of the need to foster transparency in organisations and being able to justify decisions to shareholders and other stakeholders results in an increase on reporting procedures. Two further observations that emerged from the study were that:

- Executives rely more on the compliance function to participate in and approve decision-making, from a regulatory perspective. However, instead of a reactive approach being adopted, where the compliance function is consulted after decisions had been made, King II has results in directors now collaborating more with the compliance function during the decision-making process (Table 11).
- The board and EXCO expect the compliance function to be *au fait* with regulatory issues and to be in a position to provide answers to queries as the decision-making process is underway. Respondents further revealed

that the board expects the compliance function to drive operational activities to ensure enterprise wide compliance (Table 11).

### **6.2.3 The impact of regulation on the efficiency of the board**

Story (2002) notes how shifts in board composition can result in a more adversarial and less cohesive boardroom that restricts the effectiveness of boards of directors. Durden and Pech (2006) further argue that an increasing focus on regulatory compliance distracts boards of directors in that directors become more actively involved in the customary tasks and decision-making of senior management. The study could not confirm either of these arguments, as is indicated below.

Table 11 shows that the increased focus on corporate governance and in particular the potential personal liability of directors results in them being far more open in their decision-making processes. This results in increased “buy-in” for the regulatory compliance function. Beardsley *et al* (2005) note that companies will only be able to manage the downside risks and create opportunities if regulation is considered a core element of strategy. It however appears that the increased focus on corporate governance may bring about the integration of regulation as a core element of strategy as increased buy-in for the compliance function appears to result in a deeper understanding of regulatory scenarios and stakeholders’ interests. In so far as the efficiency of directors is concerned, figure 9 shows that 60% of respondents perceive regulatory compliance not to affect the efficiency of directors.

#### **6.2.4 Research Question 1: Summary**

In summary it appears that regulation *per se* does not slow down executives' decision-making process. The increased focus on corporate governance has resulted in greater buy-in for the compliance function that results in compliance issues being dealt with by executives as and when the decision-making process is underway. Internal rules and procedures ensure that a "paper trail" exists in respect of decisions, that there is an emphasis on accountability and that decision-making is transparent. In the absence of well-designed operational activities these internal rules and procedures can have the same effect as red tape and result in executives' decisions being executed. Red tape was shown to slow down the execution of executives' decisions.

#### **6.3 Research Question 2: How does the quality of regulation stifle the growth of public companies?**

Table 12 shows that 86% of respondents perceive the regulatory processes to be flawed. The study confirmed what Parker (1999) and Kirkpatrick (2005) say regarding the lack of quality in regulatory processes namely that it impacts directly on the quality of regulatory outcomes: 46.6% of respondents perceive a lack of consultation between regulators and the relevant industry to result in ambiguous legislation being promulgated that does not necessarily achieve the goals aimed at by Parliament (Table12).

This view is supported by Kay and Vickers (1988) and Parker (1999) who attribute a lack of accountability (the observance by regulatory agencies of the rules of due process and engaging in proper consultation when arriving at decisions) as the main reason why regulation fails to achieve the goals set down for it by Parliament. The distinction that Jalilian *et al* (2003) seeks to make between the quality of the process and the outcome of regulation may therefore be artificial, as there is seldom a complaint regarding the quality of regulatory outcomes if the regulatory process is characterized by a presence of accountability, transparency and consistent behaviour on the part of regulatory agencies. These insights are elaborated on below.

### **6.3.1 Regulatory processes increase product development costs**

Table 12 shows that 86% of respondents perceive regulatory processes to stifle growth. Respondents' indicated that a flawed regulatory process results in a lack of effectiveness of regulation as it constrains management and increases the cost of compliance. This view is supported by Jalilian *et al* (2003) who submit that the effectiveness of regulation depends on the quality of the regulatory process.

Table 12 further shows that 46.6% of respondents perceive a lack of prior consultation as being the cause of ambiguous regulation. This view is supported by Kirkpatrick *et al* (2005) who argue that problems with the quality of regulation can often be traced back to information asymmetries i.e. a lack of information by the regulator that results in flawed regulation being drafted. These respondents

believe that ambiguous regulation is difficult to interpret and costly to comply with. It also complicates product and service development and results not only in increased development costs but also in delayed product - or service delivery to the market. This results in lost opportunities, lost revenue and accordingly stifled growth.

### **6.3.2 Regulatory processes result in uneven playing fields**

An important observation that arose from Table 12 was that industry players interpret ambiguous legislation differently. Two respondents (13.3%) believe that different interpretations of the same regulation result in an uneven playing fields. According to these respondents some organisations adopt a less restrictive interpretation of regulation than others. Organisations adopting a more conservative approach inevitably pay the penalty of either increased cost in attempting to comply with the letter of the law or by losing the “first mover” advantage. Kay and Vickers (1988) note that inconsistency undermines public confidence in the regulatory system and creates uncertainty for investors. Evidence emerging from the study confirmed that inconsistent and opaque regulation stifled growth as it stymied the development of competition.

### **6.3.3 Lack of regulatory capacity stifles growth**

Within the context of an uneven playing field being created by a flawed regulatory process, 13.3% of respondents raised the issue of regulatory capacity as stifling growth. It emerged that some regulations are promulgated without the necessary regulatory capacity to monitor and enforce compliance. In cases where regulations are ambiguous and difficult to interpret and implement, this results in

some rivals adopting a less conservative approach to compliance as there is little risk in strict compliance being enforced. This results in increased compliance costs for the more principled organisation and in some cases lost opportunities.

This undesirable state of affairs is further aggravated when there is a lack of regulatory capacity to effectively monitor and enforce regulation. Unscrupulous organisations continue pushing the boundaries of regulation, often eroding the revenue base of the more principled companies. As one respondent in the pharmaceutical industry commented:

*“In our industry we have regulations that, for example, prescribe the extent to which incentives or gifts may be given to medical practitioners and hospitals. For example, companies can only give a certain quantity and value of a new product to a doctor as a sample. There is however no regulatory body that actively monitors and enforces these guidelines. The result is that you get some companies that will go to a doctor and exceed these prescribed guidelines. Their product is punted by the doctor because he earns revenue on a product he paid nothing for while the honest companies have to grow their market in the prescribed way. You lose revenue and this stifles the growth of the company.”* (Interview with compliance officer, 2006).

This view is supported by Jalilian *et al* (2003) who argue that the effectiveness of regulation depends on the quality of supporting regulatory institutions. Kirkpatrick *et al* (2005, p.374) too argues that if the state wishes to promote economic and social welfare it needs to promulgate regulation that is both effective and efficient: "...effective in the sense of achieving its planned goals and efficient in the sense of achieving these goals at minimum cost". This highlights the imperative for organisations to adopt the appropriate strategic response that will enable them to influence regulatory outcomes. According to Thompson *et al* (2005) this requires that managers must be able to perceptively diagnose a company's external and internal environments to succeed in crafting a strategy that is an excellent fit with the company's situation.

Cummings and Worley (2005) notes that only by fully understanding the nature of the external environment will companies be able to align business strategy and organisational design to outperform rivals.

#### **6.3.4 Research Question 2: Summary**

It accordingly emerged from the study that a lack of regulatory quality is caused by the lack of communication between regulators and industry players. The lack of communication results in ambiguous and ineffective legislation that is difficult to interpret and costly to comply with. Companies' growth is further stifled in that less principled organisations tend to push the boundaries of regulation, especially where the regulatory capacity to monitor and enforce the relevant regulation is absent.

#### **6.4 Research Question 3: Does the integration of regulation as a core element of strategy and executive support enable public companies to grow?**

Table 13 shows that 80% of respondents do not perceive company growth as being dependent on the integration of regulation as a core element of strategy. A striking observation that emerged from the study however was that respondents perceive CEO support to be a separate issue from the integration of regulation as a core element of strategy. Notwithstanding the fact that Beardsley *et al* (2005) describes CEO support as one of the crucial elements in integrating regulation as a core element of strategy, respondents perceive CEO support as a separate and distinct success factor that is required for the successful implementation of any strategic response. These findings are dealt with in more detail below.

##### **6.4.1 Leadership endorsement of regulatory compliance drives successful strategies to manage regulatory risk**

Evidence emerging from the study (Table 13) supports what Thompson *et al* (2005, p.400) says about the importance of "...reiterated management endorsements..." namely that for any initiative to succeed, buy-in from the leadership of the organisation is required. Respondents perceive the integration of regulation as a core element of strategy to amount to little more than a mission statement. Visible CEO support for the regulatory compliance function is however perceived by 80% of respondents as being a critical success factor that enables companies to grow. In this regard respondents distinguish between express CEO support and visible CEO support:

- A number of respondents commented that it was crucial for the CEO “to walk the talk” as the CEO’s visible support places regulatory compliance at the “top of the board agenda and sets the tone for the whole organisation”. As one respondent commented:

*“... any initiative regarding the compliance function would succeed if your CEO openly supports the compliance function...”*

This confirms what Cummings and Worley (2005) says regarding a leader’s willingness and commitment being crucial as a first step in bringing about a realignment between a company’s environment and resources in order to improve performance and effectiveness.

- Respondents further perceive visible CEO support to entail steps that Beardsley *et al* (2005) describes as regulation being integrated as a core element of strategy. Respondents perceive the development of a thorough understanding of regulatory scenarios and the understanding of stakeholder interests to be elements representing visible CEO support whilst express CEO support is seen as the act of incorporating regulation as a core element of corporate strategy.

#### **6.4.2 CEO support and operational activities enable companies to grow**

More than 60% of respondents believe that CEO support, either alone or in combination with certain operational activities is necessary to enable companies to thrive in today’s business environment (Table 13). In discussing the most

appropriate strategy for companies to adopt regarding regulatory compliance, more respondents (80%) believe that support from the CEO and the board is a crucial element in any strategic response.

A further observation emerging from the study is that despite the fact that all respondents perceived regulation to be supported by the CEO (Figure 3), 60% of respondents still believe that regulation stifled growth. This evidence may confirm what Cummings and Worley (2005) say about the need for companies to achieve an alignment between company resources, the task and the general environment and the corporate strategy. To integrate regulation as a core element of strategy will in itself not help companies grow, but the success of any strategic response appears to pivot on this support from companies' leadership.

#### **6.4.3 Research Question 3: Summary**

In summary, the integration of regulation as a core element of corporate strategy in itself does not appear to enable companies to grow. It appears from the study however that visible CEO support, or reiterated leadership endorsement as described by Thompson *et al* (2005), of the regulatory compliance function, together with well-designed operational activities enable companies to grow.

#### **6.5 Research Question 4: What strategies are pursued to enable public companies to survive and prosper?**

The study confirmed what Porter (1996) says about companies' strategic approach to managing regulatory risk namely that companies fall into the trap of

becoming preoccupied with operational activities, in order to achieve operational effectiveness. A review of Table 13 confirms that operational activities (such as those recommended by Pocker, 2005; Britt, 2005 and Foster, 2005) feature prominently in most strategic responses described by respondents. The different strategic responses that emerged from the research are discussed below.

### **6.5.1 The trap of focusing on operational activities**

An important observation that emerged from the study was that only 26.6% of respondents (see paragraph 5.3.1.2) made any reference to the need for an alignment between operational strategy, corporate strategy and the external environment as outlined by Cummings and Worley (2005). Thompson *et al* (2005) argue that companies must be able to perceptively diagnose a company's external and internal environments to succeed.

Table 13 revealed that 86% of respondents relied on essentially operational strategies alone to respond to the challenges posed by regulation. In this regard respondents described how the attitude of most organisations was that the compliance department should drive the operational activities and that it was the compliance department's function to "sell" compliance related activities to other business units throughout organisations. Compliance officers perceived their function to entail a balancing act between minimizing risk and maintaining operational efficiency.

### 6.5.2 The perceived absence of potential NGO partners

An important observation that emerged from the study was the fact that, aside from the mining industry, respondents perceived almost no NGOs or other non-rival organisations that existed with which organisations could form alliances to assist organisations in their strategic positioning *vis-à-vis* regulatory compliance. Only respondents from the mining industry perceive NGOs as useful alliances to lobby and influence regulatory changes. Although industry associations (such as the Banking Association) are present in most industries, most respondents are not very flattering about the role played by industry associations. As one interviewee commented:

*“You must remember that the industry is very competitive and people are concerned about their organisations’ reputations. I find that meetings [arranged by the industry association] are nothing more than dog and pony shows. No one is prepared to stand up and say: “Listen, we are experiencing these difficulties, how do you guys deal with it?” There is a role to be played by these forums but I think that generally people do not see it as a place where you gain support to try and get the regulator to agree to changes...”* (Interview with compliance officer, 2006).

Some respondent’s refer to NGOs as “pressure groups” or “letter production machines”, indicating that NGOs are perceived by respondents to exist mostly to fulfill a confrontational role. Notably, the process of regulation is the one area

where respondents can influence change, if the correct strategy is adopted (Yaziji, 2004). As one interviewee in the banking industry commented:

*“There is a major problem with the regulatory process. Legislative initiatives appear to be driven by international events. The regulator takes legislation from a foreign jurisdiction and then implements it in South Africa without really having an understanding of the South African industry’s unique circumstances. This often results in very poor regulation that does not work, as it should. There is an invitation to participate but participation is weak. On the one hand there is a certain complacency in the industry. On the other hand there is the impression that we are negotiating from a point of weakness – we do not have a lot of negotiating power to persuade the regulator to accommodate our requests”* (Interview with compliance officer, 2006).

### **6.5.3 Advantages of partnering with NGOs in the mining industry**

By contrast, some players in the mining industry leverage considerably off the strengths of NGOs. As one interviewee commented:

*“With the change in minerals legislation mines have to obtain a license in respect of a particular site before they can start mining. The license is reviewed annually by the DME and you have to satisfy them that the undertakings that were given in the license application are being met.*

*NGOs are very useful. We arrange...with them to submit the environmental impact reports and Unions to submit reports on OHSA. By including reports from independent parties the whole process is far more credible. On the other hand both parties win as the NGOs want to ensure that their interests are also satisfied – there is a lot of co-operation”.*  
(Interview with compliance officer in mining industry, 2006).

It is not surprising that respondents from the mining industry are far more positive about the quality of the regulatory system and how the quality of regulation, in so far as processes are concerned, enabled companies to grow. The evidence emerging from responses from the mining industry accordingly confirms what Yaziji (2004) says collaboration with NGOs namely that alliances with NGOs are the ideal way to influence the external environment

#### **6.5.4 An absence of strategic alignment**

The study revealed that public companies’ response to regulation contain some of the elements that have been identified through the literature review as being critical in a strategic response to the regulatory environment. Some of these critical elements are CEO support and well-designed operational activities. Despite the fact that regulation does not appear to impact SA public companies as negatively as authors such as Durden and Pech (2006) and Davis (2004) warn it would, table 9 shows that 60% of respondents still perceive regulation to stifle organisations’ growth.

The study identified the execution of executives' decisions to be a problem currently experienced by companies. This problem appears to stem from an absence of a strategic alignment between operational strategy, business strategy and the external environment. Only 26.6% of respondents recognized the need for an alignment between business processes with regulatory compliance. It is accordingly appears that a gap exists in the strategic thinking of organisations on how to approach regulation in a manner that will enable companies thrive within the regulatory environment.

#### **6.5.5 Research Question 4: Summary**

The findings were accordingly consistent with the literature in that it confirmed that companies tend to favour well-designed operational activities, combined with CEO support, in responding to the regulatory environment. The study further highlighted the fact that, save for the mining industry, companies do not perceive collaboration with NGOs as viable in their strategic response to the regulatory environment. The well-designed operational activities appear to keep executives' decision-making streamlined but an absence of alignment between business processes and the regulatory environment results in decision execution being slowed down.

#### **6.6 Research Question 5: Are public companies inclined to grow or not to grow as a result of regulatory compliance?**

A number of factors need to be considered in answering this research question. Whilst results of surveys such as the SBP survey indicate that SMEs might not

be inclined to grow, it should also be borne in mind that SMEs have limited resources in managing regulatory risk. Public companies however boast entire compliance departments that are staffed by professionals whose sole function it is to manage regulatory risk by driving operational activities recommended by Britt (2005), Foster (2005) and Pocker (2005).

This research question will be addressed by considering the impact of regulation on those aspects that featured in the discussion of earlier research questions. The impact that regulation has on the different facets of organisations will then be considered as a whole in order to gauge whether SA public companies are inclined to grow or not as a result of regulation.

#### **6.6.1 The integration of regulation as a core element of strategy**

The literature reveals that leadership endorsement is a critical success factor to a successful strategic response to regulation. Whilst Beardsley *et al* (2005) describe leadership support as one of three steps to be taken by companies in integrating regulation as a core element of strategy; the study revealed that respondents perceive visible leadership support as a separate and distinct success factor. The study further confirmed what Thompson *et al* (2005) says regarding successful strategy execution namely that it depends on adept managerial leadership to convincingly communicate the strategy.

It is accordingly possible that CEO support in itself is sufficient to ensure the success of a strategic response to the regulatory environment. Kotter (1995) too

notes that leadership is the first step in bringing about a cultural change in organisations after communicating the need for change. It emerges that the other elements that Beardsley *et al* (2005) raise as elements representing an integration of regulation as a core element of strategy naturally follows if CEO support exists.

Cummings and Worley (2005) argue that company resources' actions should accurately reflect the company's general and task environment. Adept managerial leadership is required to ensure that the enacted environment is aligned with the task and general environment. This alignment depends on leadership and processes such as ISC where a committed leadership is required to achieve and alignment between organisational design and corporate strategy.

Most respondents (Figure 4) indicated that regulatory compliance was supported by their directors and driven by the CEO. This indicates that most respondents perceived visible CEO support to be present in their organisations. It also emerged that the introduction of King II results in boards of directors being more aware of and concerned about regulatory compliance. This increased prominence that regulatory compliance enjoys appears to result in regulatory compliance being on most boards' agendas and to naturally result in organisations' leadership supporting regulatory compliance.

Although this is a good starting point for organisations grow, Cummings and Worley (2005) indicate organisations have to take additional steps to achieve an alignment between corporate strategies and the external environment if this growth is to be sustained.

### **6.6.2 The impact of regulation on innovation**

It emerged from the study, and particularly responses to question 7 of the questionnaire, that 80% of respondents do not perceive regulation to impact negatively on innovation (Figure 6). During the interviews, when asked whether regulation stifles growth, none of the respondents raised innovation as a factor that is impacted on by regulation.

Most respondents indicate that they perceive the NGOs that are active in their respective industries to be confrontational. However, the study did not confirm what Yaziji (2004) says regarding the impact that NGOs have on innovation namely that companies are forced to be more innovative in order to address concerns that are raised by NGOs. Furthermore, none of the respondents confirm what Story (2002) says regarding how regulation results in a less cohesive board that is less innovative.

The fact that the innovative abilities of SA companies appear to be largely unaffected by regulation bodes well for the potential of organisations to grow, provided that companies' leadership visibly supports regulatory compliance and

take such further steps as outlined by Beardsley *et al* (2005) that would be representative of an integration of regulation as a core element of strategy.

### **6.6.3 Sluggish decision-making**

At first blush there appears to be a conflict between responses to question 1 and question 3 of the interview schedule. More responses to question 1 raised how regulation has made conducting business cumbersome. Responses to question 3 however revealed that the majority of respondents did not perceive regulation to slow down decision-making in the manner described in the theory base.

Probing however revealed that the decision-making processes of executives have not been adversely affected by regulation. King II has raised the prominence of regulation on the agenda of CEOs and the board but their decision-making processes have remained largely unaffected. Rather, the decision execution process seems to have been slowed down. In this regard red tape has been blamed as slowing down the implementation and execution of strategies and decisions.

Whilst it is positive that the effectiveness of executives does not appear to be impacted negatively by regulation, the growth and competitiveness of organisations still depend on successful strategy execution. To the extent that the implementation of decisions is delayed, the growth of organisations may be stifled. As Porter (1988) notes: competitive strategy entails taking action, whether it is offensive or defensive. This points to the imperative for companies

to adopt the appropriate strategic response to ensure that the execution of decisions is not hampered.

#### **6.6.4 Interaction with regulator**

It emerged from the study that SA public companies operate in an economy that lacks a well-functioning regulatory system. An analysis of the data indicates that information asymmetries are to a large extent to be blamed for problems experienced in the quality of regulation. In general, most respondents raised the lack of regulatory quality as a factor stifling companies' growth. In particular it emerged from the study that the SA regulatory process is flawed because respondents perceive there to be a lack of collaboration (and accordingly a lack of exchange of information) between industries and the relevant regulators during the drafting of regulation. This lack of communication results in a host of problems that stifle organisations' growth:

- Ambiguous regulation that is both difficult to interpret and costly to comply with; and
- Regulation that simply does not achieve the goals aimed at by Parliament because there is a lack of understanding on how particular industries operate.

In the absence of a strategic response to overcome the obstacles posed by information asymmetries, regulatory processes will remain flawed and continue stifling growth. Companies can overcome this obstacle by adopting the appropriate strategy to influence regulatory changes.

### **6.6.5 Strategic Responses**

An overview of the study reveals that whilst the impact that regulation has on SA public companies is not as negative as the theory base suggests, regulation does impact negatively on the execution of executives' decisions. In addition there appears to be a problem with badly drafted regulation in that it is costly to comply with, fails to achieve the goals aimed at by Parliament and stymies product and service development.

Whilst the increased focus on corporate governance and King II in particular results in leadership support for regulatory compliance, it appears that the majority of companies' strategic response pivot's on operational activities. Most companies tend to focus on achieving operational excellence by managing regulatory risk through internal rules and procedures.

Aside from companies in the mining industry, respondents are not positive about alliances with NGOs. It further emerged that companies that appreciate the benefit and the need to align corporate strategy with the external environment are in the minority. In the absence of an appropriate strategic response to regulation, companies will not be able to thrive in the regulatory environment.

### **6.6.6 Research Question 5: Summary**

Overall the evidence emerging from the study suggests that the results of the SBP survey, in respect of SMEs, are not mirrored in public companies. When the factors that are impacted on by regulation are considered, one can not

unequivocally conclude that public companies are not inclined to grow as a result of regulatory compliance as:

- there appears to exist broad support from CEOs for regulatory compliance as is recommended by Thompson *et al* (2005). Whilst this support is not necessarily expressed by respondents as part of an intentional integration of regulation as a core element of strategy, visible CEO support in itself appears to achieve, in practice, the same outcomes as an integration of regulation as a core element of strategy would;
- Regulatory compliance does not appear to have a significant impact on product and service innovation within public companies, as Story (2002) warns it would;
- The study revealed that regulatory compliance does not slow down executives' decision-making in the manner that Durden and Pech (2006) warns it would. Regulation does appear to slow down strategy execution though, largely because of uncertainty that surrounds the interpretation of regulation.

One can accordingly conclude that companies would probably be inclined to grow. In the absence of the appropriate strategic response companies' growth will however be stifled by the negative side effects of regulation, such as the delay in strategy execution. The delay in strategy execution can be overcome if companies adopt an appropriate strategic response.

The possibility of designing an ideal strategic response to the regulatory environment was introduced at the end of the literature review. The study has confirmed the effectiveness of some of the approaches that makes the design of an ideal strategic response to the regulatory environment possible. It is accordingly submitted that the ideal strategic response consists of:

The following steps to be taken within the enacted environment:

- Step 1: Visible CEO endorsement of regulatory compliance as recommended by Thompson *et al* (2005) and Kotter (1995);
- Step 2: An executive decision-making process that runs parallel to the operational activities recommended by Pocker (2005) and described in Table 5;
- Step 3: A two pronged strategic positioning aimed at both competitive and collaborative strategies as recommended by Cummings and Worley (2005) and Yaziji (2004);
- Step 4: ISC to bring about an alignment between the organisation's design and the company's corporate strategy. A simultaneous assessment of the environmental turbulence (on a scale between dynamic and static) as recommended by Adonisi (2005) to ensure that organisational resources, business – and corporate level strategy is aligned to the turbulence in the general environment;

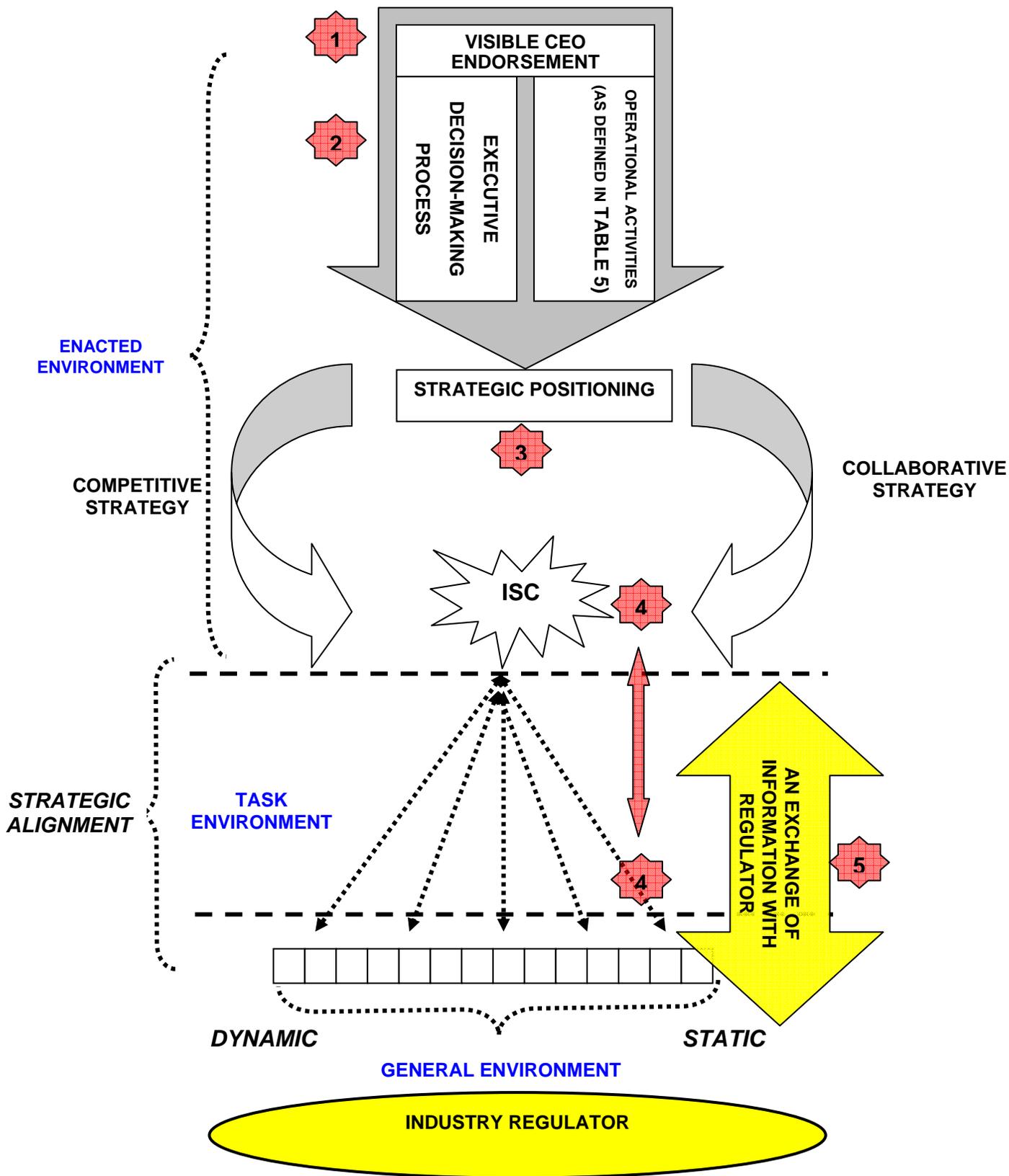
Within the task environment:

- Step 5: A number of activities that should be pursued by companies:
  - An assessment of the strengths and weaknesses of rivals (Porter, 1998);
  - A decision on what activities to pursue that are different from the activities performed by rivals as outlined by Porter (1996);
  - Forming alliances that can assist in influencing regulatory change as recommended by Yaziji (2004);
  - Engaging regulatory agencies in dialogue, preferably through strategic alliances as recommended by Yaziji (2004);

This ideal strategic response, with the required steps that should be taken, can be depicted in Figure 15 below. Companies can overcome the negative side effects of regulation and in particular the problems currently experienced with the execution of executives' decisions by following the steps outlined above. By adopting this strategic approach companies should not only be able to cope better with the challenges posed by the regulatory environment – they should also be able to thrive in a regulatory environment where other companies without the appropriate strategic response are slowed down.



Figure 15: Ideal strategic response to the regulatory environment



## 7. Chapter 7: Conclusion and Recommendations

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### 7.1 Introduction

This chapter highlights the main findings of the research and provides a synthesis of the theory base and research results to produce a set of recommendations for both the regulated and regulators.

### 7.2 Main findings of the research

The main findings of the research can be summarized as follows:

- More than half of the public companies surveyed perceive regulation to stifle growth;
- Corporate governance has resulted in an increased awareness and support for regulatory compliance but red tape appears to slow down strategy execution and not the executive decision-making process;
- Companies tend to overcome the negative side effects of regulatory compliance through well-designed operational activities;
- A lack of regulatory quality stifles the growth of public companies. A flawed regulatory process that is characterized by a lack of collaboration and an exchange of information between regulators and the regulated results in ambiguous regulation that stifles growth. A lack of regulatory capacity to monitor and enforce compliance aggravates these negative outcomes.
- The integration of regulation as a core element of corporate strategy is, in itself, not sufficient for companies to overcome obstacles to growth.

Visible CEO endorsement of the regulatory compliance function is required for a successful strategic response to the regulatory environment.

- Companies perceive the ideal strategic response to the regulatory environment to consist of a combination of visible CEO support and well-designed operational activities;
- Regulation does not impact negatively on innovation;
- Despite the negative side effects that regulation appears to result in, public companies are probably inclined to continue displaying growth, albeit at less than the potential rates that could be achieved as:
  - Executives' decision-making speed and efficiency does not appear to be affected negatively by regulatory compliance;
  - Regulation does not appear to impact on innovation;
  - Regulation is incorporated as a core element of corporate strategy, supported by the board and driven by the CEO in all public companies;
  - All respondents appear to perceive direct dialogue with the regulator as the way to influence regulatory changes.

The study reveals that companies rely largely on operational activities (that are supported by the board and driven by the CEO) to obtain competitive advantages over rivals. These activities assist in keeping executives' decision-making

processes streamlined and in the absence of any significant impact on innovation and the efficiency of directors, it is likely that companies will continue to grow.

It emerged from the study however that significant problems are experienced with the quality of regulation, particularly regulatory processes, that results in growth being stifled. This points to the absence of important factors in companies' strategic responses to regulation. Similarly, from the regulator's perspective, it emerged that despite the positive sentiment that exists amongst companies in so far as communication with regulators are concerned, regulation appears to miss the mark in achieving the goals set down by Parliament. This problem is aggravated when regulators lack the necessary capacity to monitor and enforce compliance. Recommendations for both companies and regulators are accordingly advanced.

### **7.3 Recommendations to regulators**

Table 12 indicates that the main problem experienced in respect regulatory quality relates to the regulatory process. The study further reveals that regulation stifles the growth of companies (Table 9). Ironically, regulation does not appear to achieve the goals set down by Parliament (Figure 10). It is therefore a case of both the regulator and the regulated losing. The research therefore confirms Kay and Vickers' (1988) argument that a strong causal link exists between regulatory quality and economic performance.

The following recommendations to regulators can improve the quality of the regulatory processes and can, hopefully, result in improved economic performance:

- Regulators should follow the steps outlined by Beardsley *et al* (2005) as part of stakeholder management namely stakeholder analysis, managing trade-offs and communicating regulators' objectives. This approach can improve lines of communication between regulators and industries and result in a better understanding of all stakeholders' agendas.
- As part of the RIA process regulators should establish a forum where industries are required to attend discussions of proposed regulation and the goals Parliament aims to achieve, and how those goals can be achieved. This approach should result in a balance of all stakeholders' interests being achieved. Simultaneously a better understanding can be gained of how Parliament's goals can be achieved through an improved design of regulation. This process will also ensure that regulation is not passed through Parliament too quickly.
- Regulators should give serious consideration to the incorporation of measures in proposed regulation that will encourage self-regulation as outlined by McAleese (2004). This approach should overcome the problem of a lack of regulatory capacity in enforcing and monitoring

compliance, which results in uneven playing fields. By improving the preceding process of regulatory design, regulators will also be able to ensure that the incentives for self-regulation encourage the achievement of goals aimed at by Parliament.

These recommendations directly address the problems that respondents perceive with regulatory quality (as outlined in Table 12). The introduction of RIAs by government is a step in the right direction but it appears from the study that companies still perceive an absence of the appropriate channels and transparency through which all stakeholder interests can be ventilated and incorporated in the regulatory process. Improved transparency, surrounding the RIA process, and the creation of a forum where stakeholders are required to participate in discussions in respect of proposed regulation should eliminate the problems currently perceived with the regulatory process.

#### **7.4 Recommendations for companies**

It emerged from the study that the problem SA public companies are faced with lies in strategy execution and overcoming the hurdles to growth that is presented by a weak regulatory process. The study could not confirm evidence of other problems warned of by Durden and Pech (2006), Davis, and Story (2002), as outlined in the literature. The recommendations that follow accordingly only address the problems that the study confirmed exists with the regulatory process, and as outlined in Table 12.

The ideal strategic response (Figure 15) that was developed through the literature and the study can provide companies with an action plan to overcome the problems outlined above:

- Firstly, companies should be mindful of the fact that the success of their strategic response to the regulatory environment pivots on express endorsement and support for the role fulfilled by the compliance function, as described by Thompson *et al* (2005). Table 13 indicates that 80% of respondents considered express, visible CEO support, alternatively the support of someone with political power within the organisation as a key element in the ideal strategic response;
- Secondly, companies should actively investigate and pursue collaborative strategies with NGOs, as recommended by Yaziji (2004), simultaneously with their competitive strategies. The study confirmed what Porter (1998) says about how companies fall into the trap of becoming too focused on operational activities to obtain a competitive advantage over rivals. Table 13 confirms that operational activities play a central role in companies' response to the regulatory environment. Companies do not appear to appreciate the potential benefits that can be gained from collaborative partnerships with NGOs, as highlighted by Yaziji (2004). The success of strategic alliances between mining companies and NGOs, as outlined in paragraph 6.5.2 and 6.5.3 confirms the feasibility of a pursuit of collaborative strategies with NGOs.

- Thirdly, companies should undertake a “...deliberate coordinated process...” of ISC as described by Cummings and Worley (2005) to realign companies’ strategic orientation with the external, regulatory, environment. Figures 3, 4 and 5 shows that regulation is incorporated a core element of companies’ corporate strategies, supported and driven by companies’ leadership and that companies are positive about open communication with regulators.

Despite the fact that innovation is apparently not affected by regulation (Figure 6), Table 9 reveals that most respondents perceive regulation to stifle growth. Aside from the difficulties experienced with regulatory quality, this disconnect may be explained by a lack of the strategic alignment between companies’ strategic orientation and the regulatory environment. This process (ISC) can not be pursued however unless the first recommendation above has been followed. As argued by Kotter (1995), the success of any change plan depends on the leadership championing the change.

- Finally, companies should take steps to improve lines of communication with regulators. Figure 5 indicates overwhelmingly that companies agree that direct communication with regulators is the way to influence regulatory change.

Even if companies perceive an absence of NGOs with whom collaborative alliances can be formed, companies should grasp every available opportunity to interact directly with regulators to improve the exchange of information. The implementation of RIAs by government should be seen as a positive step. Companies should take every possible opportunity presented during the RIA process to communicate their interests to government if they want to ensure that the operation of industries are better understood before new regulations are passed through Parliament.

It is hoped that by following these recommendations the regulatory process will be improved and result in more efficient regulation being implemented that will meet the goals aimed at by Parliament, but at minimum economic cost to the affected stakeholders.

## **7.5 Potential research limitations**

The following research limitations were identified:

- Face-to-face interviews with individuals are prone to reveal the subjective views of the relevant interviewee and may not necessarily represent the view of the particular organization, particularly large multinational corporations that employ thousands of employees, where views are expressed.
- In so far as factual information is revealed (such as whether or not express executive support for the compliance function exists) or where a particular firm's response to regulation is discussed, the approach adopted

by a firm and the way regulation impacts on the organisation's growth will not necessarily be representative of the particular sector of the JSE or public companies in general.

- Snowball sampling resulted in more respondents in the financial services and insurance sectors being interviewed and accordingly the interview data would be skewed towards these industry sectors.
- As snowball sampling was used, generalization of the findings to the whole population would be inappropriate. The implementation of the ideal strategic framework would have to be tested, particularly by companies falling outside the financial services and insurance sectors of the JSE, to verify the validity of the ideal strategic response that was developed (Figure 15), in other sectors of the JSE.
- Public companies have more than one compliance department. Most public companies in financial services would, for example, have a compliance department (Treasury) and a compliance department (Retail) or, alternatively, a central Legal department (which would incorporate regulatory compliance) and several subordinate compliance departments at each business unit level. This further limits the generalization of findings.
- Some respondents were multinational corporations with operations on various continents worldwide. Röller's (in Koedijk and Kremers, 1996) warning in paragraph 1.1.1 above should accordingly be heeded that

these respondents may not be affected as much by regulation, in a SA context, as national companies may be affected.

According to Kumar (2005) an additional limitation to research by way of an interview lies in the quality of the interaction between interviewer and interviewee. The quality of the interaction is likely to affect the quality of the information obtained. Furthermore, as the interaction in each interview is unique, the quality of information obtained from different interviews may differ significantly (Kumar, 2005).

## **7.6 Future research**

This research was exploratory in nature, and can accordingly serve as a precursor to future research. The findings of this research have highlighted several areas that could be the subject of further research:

- It is possible that the study reflects the subjective views of the interviewees. Future research could be undertaken by adopting a quantitative methodology where the growth of companies in less regulated industries is compared to the growth companies in industries that are characterized by high quantities of regulation.
- The research represents a snapshot of a broad sample of companies listed on the JSE. Future research could be focused on specific industries.

- It would further be interesting to undertake future research by comparing multinational corporations' strategies *vis-à-vis* regulatory compliance with those of national corporations.
- A case study of mining companies could be undertaken to extract lessons of exactly how collaborative alliances with NGOs are established and sustained to gain a competitive edge in the regulatory environment.

## 7.7 Conclusion

The objective of this exploratory research was to establish:

- How regulation affects the growth of public companies. In particular the research sought to ascertain how regulation affected the decision-making processes of executives.
- The research further set out to explore how the quality of regulation impacted on companies' growth and whether regulation had any impact on innovation
- The research also aimed to establish whether an ideal strategy to regulatory compliance could be identified that would enable companies to overcome challenges and thrive and prosper in the regulatory environment.

The research could neither confirm that regulation slows down executive decision-making, nor that it has any impact on innovation. It was found however that a lack of regulatory quality and in particular a flawed regulatory process stifles growth and that companies rely largely on well-designed operational

activities to keep executives' decision-making processes streamlined. Visible leadership of the compliance function was found to be a critical element of any strategic response to the regulatory environment and in particular of an ideal strategic response. It is hoped that the ideal strategic response that was developed (Figure 15) will enable companies to thrive and prosper within the regulatory environment.

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## APPENDIX 1 INTERVIEW SCHEDULE

### QUESTIONS POSED TO COMPLIANCE OFFICER/ LEGAL ADVISOR/MANAGER

Researcher introduces himself and thanks the interviewee for making time available to meet with the researcher. Brief explanation of the research topic is provided and the purpose of the interview and questionnaire (Appendix 2) is explained.

1. Does regulation stifle growth? Why?
2. Has regulation affected the customary tasks performed by your board/EXCO? Why/How?
3. How has regulatory compliance affected the decision-making processes of your board/EXCO?
4. How has the quality of regulation affected your organisation. Why/How?
5. What would you describe as the ideal strategy / practice/approach for organisations to survive and prosper within the current regulatory environment?

The interviewee is informed that there are no further questions and is invited to raise any issue pertinent to the research topic that the respondent feels was not discussed. In the absence of any additional issues, the interviewee is asked to complete the questionnaire (Appendix 2).



## APPENDIX 2



GORDON INSTITUTE  
OF BUSINESS SCIENCE

University of Pretoria

### Regulatory Impact Questionnaire

Dear respondent,

Thank you for taking the time to participate in this research project. Please spare a few minutes to complete this questionnaire. The information disclosed by you will remain **strictly private and confidential** and will only be used for **academic purposes**. You (and your organisation) will remain completely anonymous.

PLEASE INDICATE THE EXTENT OF YOUR AGREEMENT WITH THE FOLLOWING STATEMENTS

	Strongly Disagree	Disagree	Neutral	Agree	Strongly agree
1. The regulation applicable to my organisation achieves the goals set down by Parliament.	<input type="checkbox"/>				
2. The industry regulator engages in proper consultation with the industry when arriving at decisions	<input type="checkbox"/>				
3. In enforcing/monitoring regulation the industry regulator seeks to balance the interests of all stakeholders, including my organisation.	<input type="checkbox"/>				
4. Shareholders derive value from regulatory measures implemented by my organisation i.e. share price/ growth increases	<input type="checkbox"/>				
5. Regulatory compliance has resulted in sluggish-decision making on the part of my organisation's executives (more meetings and meetings characterized by increasing indecisiveness)	<input type="checkbox"/>				
6. Regulatory compliance makes the board/EXCO more inefficient	<input type="checkbox"/>				
7. Regulatory compliance stifles product/ service innovation in my organisation	<input type="checkbox"/>				
8. The quality of regulation in my industry, in so far as its outcomes are concerned, enables the organisation to grow	<input type="checkbox"/>				



	Strongly Disagree	Disagree	Neutral	Agree	Strongly agree
9. The quality of regulation in my industry, in so far as its processes are concerned, enables the organisation to grow	<input type="checkbox"/>				
10. Regulation is integrated as a core element of my organisation's corporate strategy	<input type="checkbox"/>				
11. Regulatory compliance is supported by my board and driven by the CEO	<input type="checkbox"/>				
12. The way to influence regulatory changes is through direct dialogue with the regulator, before changes are implemented	<input type="checkbox"/>				

**DEMOGRAPHIC INFORMATION:**

Position held:

Industry represented (eg. Banking, Insurance, Mining) \_\_\_\_\_

Tenure with your organisation (in your capacity as compliance officer/legal adviser)

Copy of dissertation required?

Your contact details (if a copy of the dissertation is required)

\_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_