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Gordon Institute of Business Science
University of Pretoria

SMEs' corporate governance systems: status and effect on continuity

Malusi Shezi

12375081

A research project submitted to the Gordon Institute of Business Science, University of Pretoria, in partial fulfilment of the requirements for the degree of Master of Business Administration.

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Abstract

Corporate governance (CG) is recognised as a key driver of company performance, improves the decision-making and strategic vision of the business, thereby making it easier to monitor and manage risks as the business grows and matures (Bradley, 2010; Wellalage & Locke, 2011). Effective governance promotes continuity in small firms, allows for growth, maturity and succession beyond the founder. South Africa is recognised as having world class CG codes; however it has the highest SME failure rate amongst the developing world countries. No data existed on whether SMEs were using CG principles to improve performance, growth and continuity.

This study aimed to determine the extent CG principles in King III were implemented by SMEs; to understand the process followed by SMEs in entrenching ethical leadership and culture and to determine the context and content of a simplified code of CG for SMEs. Data was collected using exploratory qualitative method, through in-depth face-to-face interviews. A convenient sample of 11 SMEs was used to determine the state of King III implementation; challenges and benefits experienced by SMEs from adopting King III; and conclusions on ethics and agency problems in the SMEs. A CG expert specialising in SMEs was interviewed following a Delphi technique; on the need for SMEs to have a simplified code of CG.

The overall results from the study confirmed that CG in SMEs brought accountability, transparency, improved performance and could be used as a driver of growth. The study also found that agency problems existed in the South African SMEs; and that there was a need for a simplified code of CG for SMEs and the seven key elements of such code were identified.

The key words for this study were: corporate governance, King II Report and Code, SMEs and continuity.

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Keywords

Corporate governance

King III Report and Code

Small and medium enterprises (SMEs)

Continuity

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Declaration

I declare that this research project is my own work. It is submitted in partial fulfilment 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. I further declare that I have obtained the necessary authorisation and consent to carry out this research.

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Malusi William Shezi Date

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1. Introduction

1.1 Background

South Africa's Gini coefficient remains high with many people still living in poverty; the country's economy displays features of a low-growth, stagnant middle-income class, characterised by lack of competition and high unemployment (National Development Plan, 2012).The Gini coefficient (Gini) is a measure of the income distribution of a country's residents; it's numerical definition ranges between 0 and 1 and defines the gap between rich and poor (Investopedia, 2013). The rate of zero (0) represents perfect equality and one (1) represents perfect inequality: South Africa's Gini coefficient is 0.63 (Investopedia, 2013).

The National Development Plan (NDP) (2012) highlighted that 90 percent of jobs created between 1998 and 2005 were in small and medium enterprises (SMEs). However according to the Global Entrepreneurship Monitor (GEM) 2011 report (Herrington, Kew, Simrie & Turton, 2011) the total early-stage entrepreneurial activity (TEA) rate for South Africa was half of what was found in other developing countries. Entrepreneurship drives innovation, which drives identification of opportunities and creation of new businesses. South Africa's low TEA rate means that few new businesses are being created. This is a concern if the objectives of the NDP are to be achieved, as the NDP aims to create more than 24 million jobs through SMEs (NDP, 2012). The NDP is trying to do this in the context of low early stage entrepreneurial activity. According to the GEM report (Herrington et al., 2011), SMEs are recognised as playing a significant role in economic growth and providing employment opportunities in global economies.

Although South Africa's corporate landscape changed significantly after 1994, many SMEs are still not achieving sustainable continuity and growth to aid the economic growth imperatives(NDP, 2012). The South African Government is concerned by this non-achievement of continuity (failure rate). However there is a lack of robust data on SMEs, and so the reasons for this failure have not been properly diagnosed. This lack of robust data risks the SMEs' inability to increase employment becoming entrenched (NDP, 2012). This is because the lack of knowledge in regard to the failure of SMEs makes it difficult to implement solutions. Research by Rogerson (2008) and Urban and Naidoo (2012)found that most SME failures could be ascribed to owners and managers lacking management and leadership skills. This is exacerbated by the fact that most entrepreneurs often see little need for management and leadership skills training. Fatoki (2012) found that many SMEs were not granted access to finance owing to funders having concerns about ethical challenges and the inability of SME owners to repay the debt they incurred.

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Corporate governance (CG) principles have been recognised as playing a significant role in curbing business failures resulting from poor governance (Bradley, 2010). South Africa has benefitted from its listed companies following good governance principles and practices (Institute of Directors in Southern Africa (IoDSA), 2009a). This was evidenced by significant capital inflows into South Africa before 2008; following the implementation of the King II Committee Report (Institute of Directors Southern Africa (IoDSA), 2009).

South Africa's SME failure rate stands at 75% (Fatoki & Garwe, 2010), and this is the highest rate among developing countries. Inadequate accounting systems, lack of management skills and experience, lack of formal planning and an inability to cope with growth were identified as the causes of SME failure in the United Kingdom (UK) by Beaver and Jennings (2001), as cited in Davies, Hides & Powel (2002). Ethical issues and conflicts of interests also contribute to small businesses failing to achieve strategic objectives (Hamelin, 2011; and Rachagan & Satkunasingam, 2009). These weaknesses—as causes of SME failures—are matters that could be addressed through proper SME support and training (Mahembe, 2011). Since governance strengthens company performance and ensures continuity; its implementation might systematically address the root causes of SME failures at least to a minimum level and improve their continuity, thereby contributing to sustainable country-wide economic growth (Wellalage & Locke, 2011).

1.2 Research problem

Effective governance promotes continuity in small firms, allows for growth and maturity and succession beyond the founder (Wellalage & Locke, 2011). Per Wellalage and Locke (2011), good governance improves the decision-making and strategic vision of the business, thereby making it easier to monitor and manage risks as that business grows and matures. Governance is also a key driver of company performance (Bradley, 2010). However in South Africa the SME failure rate is too high (Fatoki & Garwe, 2010), this despite the presence of world class corporate governance (CG) codes and principles that should be assisting these companies in being run effectively and achieving continuity. The lack of proper business management skills by entrepreneurs, access to funding, cash flow management and growth strategy are the root causes of SME failures (Fatoki & Garwe, 2010). The contrasts between the benefits of good CG and SME failures leads to the question of whether South African SME failures are due to non-adoption of CG principles or whether it is the failure of governance systems to effectively influence their performance and continuity.

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SMEs are the most negatively affected during global crises and periods of economic instability (Theng & Boon, 1996; and Rowlatt, 2012), as most vanish during these times of financial crisis. The recent 2008 global financial crisis was attributed to weaknesses and failures within corporate governance structures, allowing excessive risk taking at many financial services companies, some of which were coupled with reporting fraud (Bradley, 2010). Investors lost a large amount of money and as a result are now looking for ways to prevent or at least deter this from happening again (Bradley, 2010). This investor concern also affects investors in the small businesses, such as the venture capitalists and private equity owners, in that they prefer to invest in companies with strong management teams and governance structures (Ahwireng-Obeng & Mwebi, 2012). Developing economies, as in South Africa, have as a result started recognising the need for good corporate governance as international investors are hesitant to lend money to, or buy shares in, companies that do not subscribe to these corporate governance principles (McGee, 2010). On the positive side, the implementation of corporate governance has been confirmed in that, as much as it does not guarantee automatic success, it does help entities avoid failure and achieve rapid growth (Abor & Adjasi, 2007; Wirtz, 2011).

The application of good governance is viewed as a valued feature of a well-run company (Rambajan, 2011). However, the literature linking corporate governance to company performance still shows inconsistent results. Bhagat and Bolton's (2008) study in the United States of America (USA) found no correlation between corporate governance and future company stock performance on the market. Studies by Bauer, Frijns, Otten, and Tourani-Rad (2008) and Rambajan (2011) found a positive relationship between CG implementation and company performance, as companies applying good CG principles outperformed those that were poorly governed.

CG codes in South Africa have evolved from King II—applicable to Johannesburg Stock Exchange (JSE) listed entities and state owned entities—to King III, which is applicable to all entities irrespective of size and incorporation. The release of the King III Report in 2009 was another milestone towards putting South Africa in the lead with respect to corporate governance (IoDSA, 2009b). King III is a self-regulation mechanism and its scope is regarded as being applicable to all entities. A study was performed recently by the Institute of Directors in Southern Africa (IoDSA) and the University of Pretoria (UP) on the perceptions and practices of King III in South Africa (Bouwer, 2013). This was undertaken to assess the progress and challenges experienced by businesses upon the implementation of King III. The study was criticised on the grounds that it generalised findings from the survey and interviews which focused on major JSE listed entities; it included only 12 SMEs and Non-Profit Organisations (NPOs) within a total sample of 183

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respondents who completed the questionnaire from among the IoDSA members (Jansen van Vuuren & Schulschenk, 2013).From the survey results, Jansen van Vuuren and Schulschenk (2013) identified the need for further research, including investigating the appropriate content for a separate set of codes specific to NPOs and small and medium enterprises. This would assist in determining how the King Report could be simplified and made more practical. Le Roux's (2010) study found that certain elements of King III could be applicable to all entities regardless of their size and form. However, the study by Le Roux (2010) lacked researched data to support conclusions reached therein.

Since SMEs are the engine of the economy and are expected to be the drivers of growth over the coming decades, it is concerning to note that little research (Le Roux, 2010; and McGee, 2010) has been done in South Africa to confirm the extent of corporate governance in the SME sector. The literature search in the South African SME context on corporate governance principles yielded only one result by Le Roux (2010). This indicated a gap in the study of the application of King III by SMEs and its impact in strengthening governance, increasing growth and business continuity in the SME sector. Studies on the application of, and benefits from, implementing CG principles in SMEs have been carried out in other economies such as in Australia, India, Malaysia, New Zealand and the UK (Abor & Adjasi, 2007; Brunninge, Nordqvist, & Wiklund, 2007; Gulzar & Wang, 2010; Henschel, Durst, & Crossan, 2010). These studies found that there were positive benefits for SMEs implementing CG principles.

SMEs, as highlighted in the preceding paragraphs, face multiple challenges. These include a lack of business management skills, low profitability, lack of access to funding due to ineffective corporate governance systems, ethical dilemmas and conflicts of interests. These issues lead to businesses failing to achieve their growth strategies. The SMEs' high failure rates and poor performance levels, plus the risks associated with starting businesses, resulted in most businesses failing during the early start-up stages (Herrington et al., 2011; Neneh & Van Zyl, 2012; and Nieman & Nieuwenhuizen, 2009). The lack of management, experience and leadership skills by entrepreneurs was a contributor to SME failure (Fatoki, 2012; and Wirtz, 2011), but beyond the start-up and survivalist stages of business, poor profitability and access to finance was a major challenge to SME growth (Ahwireng-Obeng & Mwebi, 2012; and Henschel et al., 2010). Conflicts of interest in small businesses were cited as a minor contributor to SME failure (Hamelin, 2011).

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The research problem therefore centres on the fact that the implementation of CG by SMEs in South Africa has not been clearly established. Even though King III is principles-based, with the intent of achieving a sense of responsibility, accountability, fairness and transparency, there is a risk that it could be viewed as merely another compliance burden (Bouwer, 2013).There is also risk that where misunderstanding arises about what the King III code sets out to achieve, there may consequently be a problem with implementation and interpretation (Bouwer, 2010). Currently no data is in place on how many entities are implementing King III propositions, including among SMEs. It is thus necessary to examine whether there is a relationship between the application of CG per King III by SMEs and their performance and growth. Furthermore, exploratory data regarding whether King III is being implemented or not, and the challenges experienced by the SME sector, needs to be obtained. This study intends bridging that gap by obtaining evidence where SMEs have commenced implementation of King III and then making recommendations for future research on corporate governance practices in, and suggested elements of the codes for, the SME sector.

Studies have been undertaken on the effects of corporate governance on SMEs, with an emphasis on the board of directors (Brenes, Madrigal, & Requena, 2011; Henschel et al., 2010; Muth & Donaldson, 1998; and Rachagan & Satkunasingam, 2009). This research problem was selected to test and collect evidence on the extent of existing corporate governance practices in SMEs and to test the effect of the implementation of King III by SMEs.

Relevance of the research topic in South Africa

The South African Government envisaged that SMEs would contribute towards achieving the target of creating 24 million jobs by 2030, thus reducing unemployment from 24.9 percent in June 2012 to 14 percent by 2020 and right down six percent by 2030 (NDP,2012). The introduction of King III, with principles that are applicable to all business entity formations, was intended to ensure the strengthening of investor confidence in South African businesses. South Africa as a developing country still requires foreign investment inflows to achieve economic growth, and SMEs become increasingly relevant in achieving this goal.

Investors' confidence in South African businesses will require assurance that business practices, including those of SMEs, are sound and governed by effective oversight that assures investor interests are safeguarded (Bradley, 2010; IoDSA, 2009b). It is therefore important to determine the CG implementation challenges faced by SMEs and propose a solution that will ensure that their governance practices are effective, while safeguarding

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stakeholder interests through sound corporate governance principles. This topic, therefore, contributes to the strengthening of the South African corporate governance landscape by exploring the state of CG and King III implementation by SMEs, an issue that is thus far under-researched.

1.3 Research question

Since the evolution of King II to King III to become applicable to all entities irrespective of size and type of incorporation, there remains a gap in understanding whether SMEs are implementing this code of CG. Information is available on the implementation of this code by JSE listed entities as these have grown with it from King II. But it was only during the introduction of King III in 2009 that SMEs were included within its scope (Bouwer, 2013).

The following is the major research question for this study: Are the SME businesses implementing King III principles as part of their governance systems? The research question is defined as the overall, or the series of key questions, that the study process is to address (Saunders & Lewis, 2012).Sub-questions for this study are as follows:

1. Are agency challenges experienced by South African SMEs; how are the SMEs ensuring ethical culture and leadership is practised to identify and eliminate conflict of interests and unethical practices?
2. What are the views of SME owners with regard to the need for the CG code for SMEs and what will be the proposed governance elements for that code?

1.4 Research purpose

The purpose of this study was to determine, through exploratory evidence, the extent of implementation by SME businesses in South Africa of the King III Report and Corporate Code of Governance. The secondary objective of this study was to determine whether SMEs experienced ethical challenges and how they are instilling ethical behaviour to eliminate conflicts of interests amongst the parties to the business. The secondary objective looked at the presence of measures to ensure ethical leadership and culture in SMEs. Ethical leadership and culture is the founding core of CG principles, developed from the assumptions of theories such as the stakeholder, stewardship and agency theories. The study further intended to establish the context and content of the King Code that would be the most appropriate for implementation by SMEs.

The need for this study was supported by the following reasons:

- Limited availability of research on the application of corporate governance principles and practices by SMEs in South Africa;

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- Lack of data identifying and reporting on the benefits of investments made in SMEs that have implemented corporate governance principles;
- Lack of data on practical elements of the King Code that have been applied with ease by the SME business sector; and
- Inconclusive results from studies carried out in various countries on whether corporate governance improves company performance.

Research objectives and scope

The research objectives will be to evaluate and explore the implementation of corporate governance systems, principles and practices embodied in King III by SMEs in South Africa. The benefits of CG and the contribution it is perceived to make to SME performance and growth will be explored. Another aspect to be examined is the effect of stakeholder, stewardship and institutional theory in strengthening leadership and eliminating conflicts of interests in SME businesses through ethical culture and ethical leadership as recommended in King III. The study also aims to investigate the appropriate context and content of a tailored corporate governance code specific to small and medium enterprises. In the context of SME failures resulting from a lack of proper skills and a lack of access to funding owing to ineffective governance processes, the objective of this study is to evaluate and explore implementation of King III.

The scope and focus of this study will be any SME businesses, regardless of their sector, since corporate governance principles are not sector specific (excluding the state-owned SMEs). To be considered, SMEs will need to be registered with the Companies and Intellectual Property Commission (CIPC), employ between 10 and 200 people, and have a reasonable turnover of from at least R6 million to a maximum of R60 million (Mahembe, 2011). SMEs of this size are likely to have growth objectives that will require good governance to be implemented or will have already implemented good governance. The assumption is made that SMEs with an annual turnover of less than R5 million are unlikely to consider or even implement King III due to its complexities.

The SME would need to have been in business for more than three years, which is the period to date from 2010 when King III became effective in March 2010 (IoDSA, 2009a). Three years is considered a sufficient period for an entrepreneur to have experienced the issues of ethics, reporting and compliance that were cited as causing SME failures within year two to five of business start-up (Fatoki & Garwe, 2010). The business will need to be South African-owned in order to ensure that the study's results are reliable when it comes to deciding whether implementation is considered by South Africans for business reasons. Businesses that fall outside this criterion were not considered for interviews in this study.

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Interviews of at least four experts involved in the field of corporate governance will be considered for research questions regarding the need for a corporate governance code specific to SMEs.

1.5 Conclusion

Most studies on the implementation of corporate governance systems focused on large companies, resulting in a need for a study exploring corporate governance systems in SMEs as identified in the conclusions reached by Gulzar and Wang (2010) and Jansen van Vuuren and Schulschen (2013). These studies indicated the need for research to fully understand corporate governance practices of SME business sectors. This study intends to bridge the gap identified in the literature review that revealed that limited research has been conducted on SME corporate governance in South Africa.

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2 Theory and Literature review

The literature review in this chapter commences with a discussion of corporate governance in general, and then focuses on SME-specific issues. After achieving an understanding of the body of knowledge on corporate governance related to SME businesses, the research questions are formulated, based on relevant theory. The appropriate research instrument is then identified to obtain responses to answer the research question and for the research objectives to be met.

2.1 Background issues and challenges faced by SMEs

Since SMEs play a major role in the economic strength of many countries, a mechanism to ensure that their continuity is not compromised by a lack of good governance practices and oversight mechanism is essential (Rachagan & Satkunasingam, 2009). It was as a result of this realisation that the Department of Trade and Industry (DTI) integrated strategy in regard to the promotion of entrepreneurship and small enterprises (DTI, 2005) was developed to effectively address issues facing SMEs and decide upon frameworks to make this sector sustainable.

Beside the SMEs' failure rate, the general corporate failures (like Enron and Parmalat Italy) that had experienced in recent years signalled a need for effective governance systems and frameworks to be established. These systems and frameworks should not only govern the internal operating controls and systems of an organisation but also provide shareholders with the necessary level of security to ensure that value and returns on investments were being created and maintained (Brennan & Solomon, 2008). It was against this background that countries around the world developed codes of practice best suited to those countries' needs (Brennan & Solomon, 2008).

Good corporate governance is viewed by investors, and the corporate world, as the key to strong and thriving economies (Bradley, 2010). The benefits to listed companies are easily noted as they report publicly on their conformity with the codes of corporate governance. The challenge lies with unlisted SMEs, as there seems to be a very limited understanding of how corporate governance impacts on their performance, growth and sustainability from a researched data point of view. Heenetigala, Armstrong and Clarke (2011) found that corporate governance brings order and compatibility in the economy for all the role players (the SMEs and bigger corporate companies). Heenetigala et al. (2011) also indicated that the purpose of regulation in the form of corporate governance is to reduce

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both investment and non-growth risk, maintain order and confidence in the corporate capital market and safeguard the investments of shareholders, thereby achieving economic growth. Thus CG contributes to an improved business climate resulting in economic growth.

2.2 Key words used in this study

2.2.1 Definitions of key words used in the study

This study primarily fell under the themes of small business ethics and governance administration, as it intended obtaining data on how corporate governance systems and principles were applied by SMEs. It secondary aim was to assess simultaneously—from the perceptions and experience of entrepreneurs interviewed—just what impact these governance systems and principles have on growth and continuity of the SMEs.

The key words for this study were corporate governance, small business enterprise or SMEs, King III report and code, and continuity. These terms are briefly defined below.

Corporate governance in this study refers to internal structures and processes for decision-making, accountability, control and behaviour at the top (Heenetigala et al., 2011). It is about the control and direction exercised by the directors of companies and any decision making in all matters that affects the vision, performance and long-term sustainability of an organisation (Heenetigala et al., 2011). IoDSA: King III (2009) further crystallises this definition, stating that good corporate governance in essence is about effective and responsible leadership regardless of size or structure, because governance applies to any form of business.

A ***small and medium-sized enterprise (SME)*** refers to an entity that has at least 10 and up to 200 employees, with an annual turnover of at least R6 million and less than or amounting to R60 million(Department of Trade and Industry (DTI), 2006).

King III Report and Code refers to the Report and Code on Corporate Governance in South Africa developed by the King III Committee of the IoDSA, which is the official framework containing all principles and elements of corporate governance for South African businesses (IoDSA, 2009b).

Continuity refers to the longevity of the firm, sustainability and ability to pass the business venture to the next hands over a longer period to ensure survival (Siebels & zu

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Knyphausen-Aufseß, 2012). Continuity encompasses growth; g*rowth* being the change in size over any given extended period and increases in terms of employment contribution (Dobbs & Hamilton, 2007).

This study intends reviewing the implementation of all elements of the CG code (King III) by SMEs and not. This will be valuable in determining the extent of corporate governance practices in SMEs and how these impact on company performance and growth.

2.3 Evolution of Corporate Governance in South Africa

In 2008 the Companies Act was revised, leading to the revision of the Johannesburg Stock Exchange (JSE) listing requirements. It became necessary to update the King II report and code of corporate governance (CG).The King II report had adopted an inclusive approach of a holistic stakeholder view as opposed to the exclusive shareholder view adopted in many corporate governance practices within developed countries (IoDSA, 2009). With the revision of the Companies Act, the King III Report and the Code of Corporate Governance were introduced and published in 2009. The main aim of King III was to ensure that integrated business reporting occurred on an annual basis with the focus on three elements: people, planet and then profit (the triple bottom line) (IoDSA, 2009).

The key difference between the two King reports is that King II applied only to JSE-listed companies and state-owned entities whereas King III applies to all entities with the philosophy of an “apply or explain” approach to reporting. Additional requirements introduced in King III were integrated sustainability reporting, directorship appointments, shareholder approval of remuneration policies, board approval of executive directors’ remunerations, combined assurance for internal audit function, information technology governance and business rescue (IoDSA, 2009a).The duties, responsibilities and obligations of directors and prescribed offices, and the business rescue process were legally integrated in the 2008 Companies Act, which became effective from 1 May 2011.

The Companies Act also came with entirely new requirements, one such being the annual public interest score calculation. The Companies Act Regulations (2011) require every company to calculate its public interest score annually. Companies scoring 350 points or more are required to undergo an audit, and companies scoring between 100 and 350 points must have an independent review conducted by a registered auditor or chartered account, while companies scoring less than 100 points must have an independent review

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by an accounting officer (CIPC, 2011).Per Vandiar (2012), the public interest score is calculated as follows:

- 1 point for each employee throughout the year;
- 1 point per million rand of third party liability;
- 1 point for each million rand of turnover during the financial year. If turnover is half million, score half point; and
- 1 point for every individual who at year-end had direct or indirect beneficial interest in the company.

The criteria mentioned above are fully applicable to close corporations (CC), as the Close Corporation Act was amended. This might mean, depending on the score calculated, that a CC will require an audit (Vandiar, 2012). Under the Companies Act of 2008, companies with a score of less than 100 need to have their financial statements compiled by an independent accountant, otherwise the audit requirement will be triggered (Vandiar, 2012).

The independent review, as opposed to an audit, has been reported to bring savings to SMEs of about 25% in countries such as Australia (Vandiar, 2012). The review of points made by Vandiar (2012) indicated that the Companies Act 2008 is likely to benefit the SMEs in costs savings from complex reporting requirements and reduce compliance burden for these businesses. However, SMEs should use the less compliance burden on efforts to strengthen their governance practices to remain at the forefront of risk management, internal controls effectiveness and financial management.

South Africa is in the lead in application of corporate governance and financial accounting standards (Vaughn & Ryan, 2006). The recent onslaught of corporate scandals has compelled the world to acknowledge the profound impact of corporate governance practices on the global economy (Vaughn & Ryan, 2006). South Africa has been no exception to this development. Given South Africa's significance as an emerging market, its potential leadership role on the African continent and its notable corporate governance reform since the end of apartheid in 1994; corporate governance is of particular importance. This is owing to the infusion of international investor capital and foreign aid which is essential to economic stability and growth in the country (Vaughn & Ryan, 2006).Since South Africa is the largest and most developed economy in Africa, generating about 40 percent of the income in sub-Saharan Africa, coupled with its regional leadership success when it comes to the issue of corporate governance, it is important that the process be continually assessed, progress measured and necessary changes enacted (Vaughn & Ryan, 2006).

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Corporate governance is therefore the cornerstone of a strong capital market. As a result, as much as South Africa is ahead of its African peers in corporate governance issues, it needs to ensure that all business sectors embrace and adopt the beneficial principles of corporate governance if the county is to improve and retain its competitive business position on the continent.

2.4 King III—a South African corporate governance framework

King III brought about an evolution of corporate governance and significant opportunities for organisations that embraced the principles therein. The King Committee under the IoDSA is the custodian of the King Report on Governance for South Africa and the King Code of Governance Principles (King III). The board is the focal point of corporate governance within the King Committee Reports as it is ultimately charged with the responsibility of ensuring that good corporate governance is achieved (IoDSA, 2009b). In this study, King III is used interchangeable to refer to both the Report and the Code of Governance Principles for Corporate South Africa.

The fundamental principles of the King code on CG are transparency, accountability and fairness driven from the foundation of ethical leadership. King III still emphasises a focus on the triple bottom line, as with to King II, but has added an element of integrated reporting with the focus on sustainability (IoDSA, 2009a). It encourages companies to focus on environmental sustainability, societal issues of social responsibility and profitability and maintain a balance of attention to all stakeholders as opposed to the previously exclusive attention to the interests of shareholders only(IoDSA, 2009a).

The King III Report advocates a self-regulation approach to corporate governance (IoDSA, 2009b). This benefits entities in that it allows organisations to maintain control over the standards to which they are held accountable through successful self-policing. This also avoids the bureaucratic burden and the cost associated with external agency monitoring of entities (IoDSA, 2009). King III purports an “apply or explain” basis underpinned by corporate governance principles of fairness, accountability, responsibility and transparency (IoDSA, 2009b). King III requires the explanation of how principles and recommendations are applied or not, and if not, the reasons why. This is deemed compliance with King III. In this regard, it should be noted that there is a link between good corporate governance and compliance with law. The latter brings assurance that companies applying CG principles are likely to be compliant with laws and regulations.

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Moving on from the previous King I and King II reports, King III has introduced annual integrated reporting. Such a report should include a statement by the audit committee to the board and shareholders, on the effectiveness of internal financial controls, consideration of the strategic role of IT and its importance, and the internal audit as a strategic function providing a written assessment of the company's system of internal control.

Furthermore, it includes internal financial controls and the governance of risk through formal risk management processes: these were absent from the previous King II. Overall, King III consist of nine elements: Ethical leadership and corporate citizenship, Board of directors, Audit committees, Governance of risk, Information technology governance, Compliance with laws (rules, codes and standards), Internal audit, Governing stakeholder relationships and Integrated reporting and disclosure (IoDSA, 2009b).

The nine elements of the King III Report and Code's principles are summarised in Table 2.1. The summary features as per Table 2.1 indicate various tasks that need to be undertaken by the board of directors, the board itself being one of the nine required elements of King III. This raises questions regarding practical implementation of King III by SMEs (on the formulation of the King Committee that its recommendations applied to all entities irrespective of form and size). This is questionable because many SMEs may not have a board of directors in place or may be unable to afford one.

Although some SMEs may not have a board of directors as defined in the King Report, some family-owned SMEs might have what are called "advisory boards" made up of family councils and the CEO (Poza, 2010). The weakness of the family council may be that in some instances council members may not be independent. This would result in the family council falling short of the requirement in King III that the majority of members be independent non-executive directors. In this regard, it is recommended that the family-owned business advisory board should only have the CEO or the owner sitting on the advisory board and not employees (Poza, 2010). However, the study focus is not on family businesses.

The key features of the King III Report on Governance 2009 are summarised in Table 2.1.

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Table 2-1: Key elements and summary of features of the King III Report on corporate governance

King III Report element	Summary key features of the element
• Ethical leadership and corporate citizenship	Those responsible for governance (the board in King III) should provide effective leadership based on an ethical foundation, ensure integrity permeates all aspects of the company operations, effectively manage ethics, develop a code of conduct for ethical business and ensure the company is a responsible corporate citizen.
• Boards and directors	The board and directors act as the focal point and custodians of corporate governance. Their responsibilities include: • Balance strategy, risk, performance and sustainability, • Report on effectiveness of internal control systems, • Ensure integrity of the integrated report, • Act in company's best interests, • Consider business rescue sooner when company shows signs of financial distress, • The board to appoint the CEO, • Disclose individual directors' and senior executives' remuneration, and have • Shareholders approve the remuneration policy.
• Audit committees	Appointed by the Board; made up of skilled and experienced non-executives. Responsibilities are: • Ensure integrated reporting, that combined assurance model was applied, • Be satisfied regarding finance functions expertise, resources and experience, • Oversee internal audit function and risk management process, and • Appoint or approve external auditors and process.
• The governance of risk	The board's responsibility to determine level of risk tolerance, design, implement, monitor risk management plan and ensure complete, relevant and accessible risk disclosure to stakeholders.
• The governance of information technology	To have an IT governance framework, the board to monitor and evaluate significant IT investments and expenditure and oversee management of IT governance risks.
• Compliance with laws, rules, codes and standards	The board to ensure compliance with applicable laws and consider adherence to non-binding rules, code and standards.
• Internal audit	Establishment of effective risk-based internal audit (IA) function that follows a risk-based audit plan, IA to provide a written assessment of effectiveness of company's internal control and risk management systems.
• Governing stakeholder relationships	Striving for appropriate balance for stakeholder groupings in the best interest of the company, ensuring equitable treatment of shareholders and ensuring transparent and effective communication with stakeholders.
• Integrated reporting and disclosure	Ensure reporting of both finances and sustainability. Integrate disclosures for sustainability with financial reporting. Should ensure independent assurance is obtained for sustainability disclosures.

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A survey was recently undertaken by the IoDSA in collaboration with the University of Pretoria with the purpose of identifying how the perceptions and practice of corporate governance in South African companies had changed with the introduction of King III following a 2006 survey completed for King II(Jansen van Vuuren & Schulschenk, 2013).That study used a web-based questionnaire which was sent to different companies ranging from those listed on the JSE to the NPOs (Jansen van Vuuren & Schulschenk, 2013). The findings of this study covered different areas and sought to determine, among others, the level of implementation of King III across companies and the benefits derived from its implementation, as well as the reasons for that.

The survey received a response rate of 183 returns from the 5 221 sent out; including 12 responses from SMEs and NPOs (Jansen van Vuuren & Schulschenk, 2013). The results are summarized below and analysed just after the summary with regard to King III in general.

- 65 percent indicated that King III had added value to their company;
- 46 percent indicated they chose the demonstration of commitment to corporate governance to external stakeholders as their primary reason for applying King III;
- On outside assurance reports: 84 percent indicated that their boards obtained assurance on the quality of governance through internal self-assessment, 64 percent through an independent third party and the rest stated their boards obtained assurance through combined assurance models;
- On advice from external corporate governance advisors as an enabler to application: 63 percent agreed or strongly agreed that advice from external corporate governance advisors enabled the application of King III;
- On the financial costs to applying King III: 32 percent agreed or strongly agreed that financial cost was a major obstacle in applying King III, which was apparent in JSE-listed companies;
- On IT governance: 57 percent either agreed or strongly agreed that the governance of Information Technology (IT) had improved the alignment of IT with the performance objectives of the business, improved the quality of strategic decision making, strategic risk management and the management of information assets of the organisation; and
- Respondents from NPOs and SMEs felt that there should be a separate set of guidelines for these sectors, as they often did not have the financial and other resources to successfully apply the guidelines contained within the King III report.

From the survey results it follows that entities saw the need for King III in strengthening corporate governance status as it applies to the stakeholders and investors, and that IT governance has resulted in significant improvements in these companies' operations.

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However, an issue of concern was the rate at which entities were able to implement King III through outside assistance, and the perception of costs involved in the implementation process. From a listed company perspective, it is understandable that the costs will be felt, since the King III requirements are included in the JSE listing requirements that need to be complied with, irrespective of the costs involved. Furthermore the new integrated report is an additional cost as a larger annual report than in the past is now a requirement. The skills and expertise issue is still a concern and highlights questions that will need to be answered through this study on the ability and capacity of entities to implement King III. These questions include: Is King III difficult to understand or are companies concerned about implementing it incorrectly and not getting the intended benefits? Some entities, especially large companies may be able to afford to implement King III, but not all SMEs will be able to afford to hire consultants to advise them on implementing the Code. The comments by SMEs and NPOs in favour of a simpler alternative code of governance may be echoing the practice in the UK where SMEs listed in the AIM of the stock exchange are permitted to not apply the Combined Code but instead disclose information that is required as per the AIM checklist (Parsa, Chong, & Isimoya, 2007).

Implementation of King III by SMEs still requires in-depth research in the context of unlisted SMEs to distil the progress they have made. It is important to understand the challenges that SMEs experienced and the benefits perceived from this corporate governance framework in the South African context. This study will test the overall implementation of King III and not simply focus on a few elements of King III, since each principle is of equal importance and forms a holistic approach to governance (IoDSA, 2009b). This study assumes that during this era of economic development, risk management, information technology and internal control effectiveness are vital to the survival and strengthening of any entity's operations. For this reason it is important that the SMEs, which are the engine of economic growth, are at the forefront of implementing corporate governance practices for their own continuity and growth.

2.5 Governance practices in SMEs

Corporate governance mainly involves the establishment of structures and processes, with appropriate checks and balances that enable directors to discharge their legal responsibilities and oversee compliance with legislation (IoDSA, 2009b). In this study, "directors" refers to those who have authority and direct the administrative goals and objectives of an entity, regardless of whether the entity is incorporated in terms of Companies Act or Close Corporations Act, as many SMEs were in the category of close corporations per previous classification by the CIPC. The term includes the members of a CC for the purpose of this study, and the term will be used interchangeably.

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IoDSA (2009b) advocates that should King III apply to all entities regardless of the manner and form of incorporation, whether in the public, private sector or non-profit sectors. It then suggests that all entities should apply the principles in the Code, consider the best-practice recommendations, and make disclosures about how the principles were, or were not, applied. This disclosure will allow stakeholders to assess the board on its quality of governance (IoDSA, 2009b). King III charges the board of directors with ultimate responsibility for the implementation of the code of good corporate governance.

The principles of King III were drafted with flexibility so as to be easily applied by any entity, including SMEs and NPOs. These principles are likely to change the business reporting landscape, which can only enhance the governance systems of entities. However, the concern—as with any piece of regulation that needs to be applied—is the costs to be incurred and the ease of implementation. This is in the context of a high level of red tape, which is a problem for SMEs to handle. Taking into account that all these principles were developed by peopled whom came from large and listed companies, the question that needs attention is whether all principles of King III are SME-friendly or not. As such, the objective of this research will be to test and report on the extent CG principles as per King III are implemented, whether they are SME-friendly and the impact they have on SMEs' growth.

The studies on SMEs found that the causes of the high failure rate of SMEs in South Africa ranged from factors such as a shortage of management skills, lack of strategic thinking and a lack of understanding of business fundamentals (Abor & Adjasi, 2007; Fatoki,2012); Neneh & Van Zyl, 2012). The failure rate of SMEs in South Africa was 75 percent in 2011 (Neneh & Van Zyl, 2012). The same statistic was echoed in the ABSA showcase that cited reasons for SME failures as not being the technical inability to deliver their products and services but rather a general lack of business skills (ABSA Showcase, 2013). The showcase indicated that the reasons ranged from lack of management competence (16 percent), poor bookkeeping and record management (12 percent), poor financial management (34 percent) and marketing problems (11 percent) (ABSA Showcase, 2013). Supporting this ABSA Showcase emphasis on business skills, a study by Wirtz (2011) found that skills, capability and experience are key factors for high-growth entrepreneurial firms. The study by Wirtz (2011) on the effects of corporate governance on entrepreneurial firms found that external collective knowledge and the skills base enable high growth in entrepreneurial firms. To supplement lack of internal skills for growth, Wirtz (2011) found that CEOs can use objective outside directors—recommended as an element of corporate governance—as a sounding board to test ideas in order to achieve sustainable growth. This study's conclusion was based on the literature review on

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high-growth entrepreneurial small firms. High-growth entrepreneurial firms referred to firms created by one or more persons independent of an existing organisation, currently growing at a high rate exceeding 50 percent growth rate (Wirtz, 2011). This study therefore included SMEs that were anticipating graduation into a larger business entity.

The GEM report of 2011 (Herrington et al., 2011) reported that the lack of profitability and problems in securing financing accounted for more than half of business discontinuances at the start-up phase in South Africa. Contrary to the GEM's findings, a study in Scotland by Henschel et al., (2010) found that although certain SMEs had formal structures and produced financial records, banks still focused on the net worth of individual directors when making financing decisions. This limited SMEs' access to finance where directors did not have property or other assets to provide as security (Henschel et al., 2010). The findings above raised the question of whether strong management teams and adequate governance systems could be a solution to the SMEs' challenges of poor profitability and lack of access to required funding for growth.

The lack of interest in governance of SMEs is surprising given the importance of these firms to most economies. The literature review undertaken for the purpose of this study showed the gap on studies performed on corporate governance, in that these only focused on control issues, for example the board at the expense of a more holistic CG concept. They also focused on listed firms and the use of qualitative methods was unusual within this field (Henschel et al., 2010). Henschel et al., (2010)found that when SMEs implemented more formal governance systems, they moved closer to a holistic model of governance, developed from stakeholder theory. A holistic CG model is the one that considers main issues in the role of CG, namely: boards of directors, managers, shareholders, stakeholders, performance monitoring and the formation of corporate strategy (Henschel et al.,2010).This gap indicates the lack of focus on complete CG practices in past research.

2.5.1 Literature on governance in SMEs in South Africa

Clark (2006), as cited in Le Roux (2010), noted that it is assumed that rules, norms and best practices in larger companies will somehow trickle down to SMEs, but neither resources, nor practical guidance are offered for multi-tasking managers of SMEs. In his study, he further stated that it is only by default that the system of corporate governance takes into account the interests of SMEs (Le Roux, 2010).

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A literature search was performed with the intention of determining the extent or number of studies done on SME CG in South Africa to date. The literature review results indicated that very little research has gone into investigating whether SMEs have commenced applying or implementing King III. The results found that only one study had been undertaken on the applicability of King III to SMEs (Le Roux, 2010). Three major interests in adopting good corporate governance by SMEs were identified in a study by Bishara & AbdelSater-AbuSamra (2003), as cited in Le Roux (2010). They argued that the adoption of good corporate practices results in the following benefits for SMEs:

- Leads to better systems of internal control, thus leading to greater accountability and ultimately better profit margins;
- Relieved the owner-operator from operational duties; and
- Good corporate governance practices will pave the way for possible future growth, diversification or even the sale of the enterprise.

The study by Le Roux (2010) was undertaken in the context of South African SMEs to assess the benefits from the introduction of King III as cited by Bishara & AbdelSater-AbuSamra (2003). In that study, the conclusions were that the majority of the nine elements of the King III were fully applicable to SMEs (Le Roux, 2010). The study tested all the elements per Table 2.1 and arrived at the conclusions shown in Table 2.2. The aim of the study by Le Roux (2010) was to, through literature review, conduct an investigation into the King III report on corporate governance and to determine the applicability of the code to SMEs. The study also aimed to determine whether value was derived for SMEs from the King III report on corporate governance (Le Roux, 2010). The findings highlighted in Table 2.2 were based purely on a literature review alone, which was insufficient for academic research. The conclusions were therefore unsupported by researched data.

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Table 2-2: Research conclusions from the study by Le Roux (2010)

Elements of King III	**Conclusion as per study by Le Roux (2010, pp. 61-69)**
Board's responsibilities	The underlying principles surrounding the board's (leaders') responsibilities are applicable to all SMEs, regardless of size. The board (or leaders) are in essence responsible for controlling the company and are thereby responsible for setting strategic direction for the particular SME.
Ethical foundation	The underlying codes and principles surrounding an ethical foundation are applicable to all SMEs, regardless of size. King III places ethics at the heart of corporate governance and organisational values. It describes an ethical foundation as the "licence to operate" for any business. The leaders of a company are responsible for setting the standard for an ethical foundation within an organisation.
Audit committees	The facilitation of the audit committee only applies to a limited number of large SMEs with the relevant formal structures. Most SMEs however do not have this function and the cost implication simply does not justify the associated benefits.
Risk governance	Applicable to all SMEs regardless of size.
IT risk governance	The appointment of a risk committee will not be applicable inmost SMEs. However, the underlying principles of the risk committee are relevant to all SMEs.
Compliance	The adherence to non-binding rules, codes and standards including the compliance with laws as outlined in King III, is applicable to all SMEs.
Internal audit	The principles relevant to an internal audit committee, as outlined by King III are not applicable to most SMEs. The presence of the internal audit committee will only be relevant to large SMEs.
Stakeholder relations	The principles governing stakeholder relations, as outlined by King III, are applicable to all SMEs. Stakeholder relations affect a company's reputation and should be managed to ensure that the SME's reputation is fostered and protected at all times.
Integrated reporting	It follows that the principles surrounding integrated reporting only apply to SMEs with outside shareholders.

The above-mentioned gaps indicated the need for an explorative study on corporate governance in the SME businesses. This study aimed to obtain the status of King III implementation by SME businesses by obtaining evidence through in-depth interviews.

2.5.2 Literature on SME governance research in other countries

Comparison of corporate governance regimes in countries where research on CG practices by the SMEs has been undertaken is presented in Appendix 2 with governance elements listed per country selected. Codes of CG emphasise similar principles in most countries with focus on directors and board members' independence, risk management, integrity of financial reporting and fair remuneration of directors and executives as is evident in the table. Similar principles are emphasised in different countries' codes, except that they may be classified under different categories from country to country. Research undertaken on the SME corporate governance practices is presented chronologically

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immediately after the summary of codes of CG in selected countries; with themes and conclusions drawn from these countries' SME CG practices.

The UK CG code is an "explain or apply" approach, with less onerous requirements specific for small business listed on London Stock Exchange (LSE) – Alternative Investment Market (AIM) index. The UK Code contains 12 essential guidelines for good CG practice by small firms in the AIM (Page, 2012). It requires entities to have governance methods based on company culture, size and complexity. CG code in Malaysia (MCCG) is voluntary, except for listed companies that have to apply or explain the reasons (Anwar, 2012). The MCCG has eight principles of CG to be considered by companies in Malaysia. The Code of CG in Pakistan is compulsory and enforceable to all companies listed on the Securities Exchange Commission of Pakistan. It does not provide for an 'adopt or explain' approach and has nine elements (Unknown, 2012). The Australian CG code applies to listed companies. The ASX CG Council's Recommendations are not mandatory as it is based on the 'adopt a recommendation principle' or if not "disclose or explain why not" approach to accommodate smaller companies that may have challenges in following all the recommendations (ASX Corporate Governance Council., 2007).

2.5.3 Research conducted on corporate governance applied by SMEs

Research conducted in several countries assessing the effect of corporate governance on SMEs is discussed in the next sections.

2.5.3.1 2007-Ghana study on corporate governance applied by SMEs

There is global concern about the applicability of CG to SMEs with the arguments that it will add to business costs and stifle innovation in entrepreneurial firms (Abor & Adjasi, 2007). Abor and Adjasi (2007), in a study performed in Ghana, found that corporate governance infused better management practices, and was no threat to value creation but provided greater opportunities for growth. They further showed that corporate governance does not of itself guarantee success; however poor governance is symptomatic of business failure. The study recommended that SMEs should not lose sight of innovation and creativity value add when they consider implementing CG. Abor and Adjasi (2007) did acknowledge that CG would increase operational costs as it meant additional roles in audit, remuneration and nomination committees, and as new, and more, directors would need to be appointed. These costs are however negated by the benefits derived from CG (Abor & Adjasi, 2007), such as:

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- CG practices grow SMEs as those applying CG went beyond the survival stage;
- Access to finance could be overcome by CG as external directors introduce a culture of innovation;
- Improves investor confidence due to bookkeeping, accounting and disclosures; and
- Paves a way to exit strategy and make SMEs gain experience at an early stage with CG compliance, if planning to go public through an initial public offering (IPO) and listing in the future.

2.5.3.2 2009 –Malaysian study on corporate governance applied by SMEs

In Malaysia, a case analysis research was performed on Malaysian SMEs to identify the problems they faced in enforcing good corporate governance practices, mainly due to related party transactions inconsistent with shareholder wealth (Rachagan & Satkunasingam, 2009). The study was limited to incorporated SMEs. However, it did not specify whether these SMEs were listed or not nor the number of SMEs included in the case analysis. In Malaysia, SMEs constitute 99.2 percent of the economy and provide 65 percent of the total employment of that country. The study results showed that these SMEs have highly concentrated ownership structures, face soaring agency costs and do not have good corporate governance practices (Rachagan & Satkunasingam, 2009). The themes from this study were that agency costs manifest themselves in non-value adding investment decisions. The study noted that the existing laws that protected minority shareholders might reduce these, except where the controlling owner has significant influence in the appointment of directors in those companies. The study found that owing to the collectivist culture in Malaysia, legal venues may not be used to deal with issues of conflict of interest in businesses.

The study proposed the self-enforcing model as a substitute to improve CG in SMEs by providing for more participation by minority shareholders in corporate decisions (Rachagan & Satkunasingam, 2009). The self-enforcing model of Barak and Kraakman (2002),as cited in Rachagan & Satkunasingam (2009) claimed that a combination of market and cultural constraints should be developed as a tool for motivating managers and large shareholders to work in the best interests of the company. The study pointed out that this model requires voluntary compliance with procedural requirements and is suitable in emerging economies where there are weak legal, market and cultural systems. The second theme as per the findings of the study was that the self-enforcing model prevents significant corporate governance failures and provides protection for minority shareholders in the context of emerging economies such as Malaysia (Rachagan &

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Satkunasingam, 2009). The model sought to build legal norms that those managers and large shareholders can see as being reasonable and can comply with voluntarily.

2.5.3.3 2010– Liechtenstein and Scotland study on corporate governance applied by SMEs

An exploratory study was performed in Liechtenstein and Scotland using semi-structured interviews on a convenience sample of 20 SMEs to obtain an understanding of the concept of CG by SMEs, governance methods and procedures implemented and how governance structures affected the SME firms' ability to change (Henschel et al., 2010). This study highlighted the following key facts with regard to CG in the SME firms:

- CG mechanisms influence the wider formation of corporate strategy beyond maximisation of shareholders' wealth;
- CG includes common themes of accountability and transparency that enable performance evaluation, the presence of formal structures to aid decision making and limiting conflict of interests;
- Various variables can be used to measure corporate governance systems' effectiveness;
- Good governance is an important mechanism for a small firms' continuity; and
- Where formal structures are rare, relational governance become more appropriate. Relational governance refers to the creation and usage of social capital embedded in social relationships and is effective where there is trust, cooperation and stability.

The results and conclusions obtained from this study were, amongst others, that there is danger in applying concepts valid for large firms to smaller firms' governance, such as the board, and which negate the value of concepts like governance (Henschel et al., 2010). Relevant education was found to influence firms' governance. Most importantly, the study found that SMEs often adopt the simplest governance structures they need to operate their business and do not benefit from relatively complex governance systems (Henschel et al., 2010). It concluded that when SMEs begin to implement formal governance structures, they move to a holistic governance developed from stakeholder theory other than narrower shareholder influenced systems (Henschel et al., 2010). These results might be an indicator of the need to modify systems of CG that had been developed in the context of large firms so that they would suit the size and business operations of smaller firms. The themes and conclusions, such as level of education on governance and variables to measure governance systems' effectiveness will not be scoped into this study; other themes were incorporated into research questions per Chapter 3 of this study.

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2.5.3.4 2011– Australian study on corporate governance applied by SMEs

Heenetigala et al. (2011) criticised the solutions proposed to overcome agency theory problems, such as stringent regulation of corporate governance, as they are not necessarily applicable to small businesses. The purpose of their study was to investigate the views of small business owner/managers and CEOs of industry associations in relation to corporate regulation and corporate governance for small businesses in Australia. A purposive sample of 21 directors of business associations was selected with both quantitative and qualitative methods used to analyse the results. The ASX had issued guidelines called Replaceable Rules per Corporation Act simplifying the regulation of private—especially small—businesses. These best-practice guidelines recommended boards with independent directors, the separation of ownership and control, appropriate skills and diversity of directors, succession plans, a code of conduct, record keeping and information disclosure (Heenetigala et al*.,* 2011).

The following were the results and conclusions from this study (Heenetigala et al., 2011):

- The CG legislation that applied to all businesses was written with big business in mind, in language that was directed at accountants and lawyers and not easily understood by small businesses.
- The agency theory was not necessarily appropriate for small corporations in Australia. It found that reported internal factors that could promote performance are high levels of skills and knowledge by owner/manager/directors, their expertise in the use of information and communications technology (ICT), and ability to obtain information and advice.
- The financial record keeping was considered complex to understand and follow; as a result it was outsourced to accountants. Therefore there was a need for a simplified reporting framework version that could be easily implemented by small companies.
- Two areas identified in the study's results that could promote good governance and monitor results are the code of conduct and independent auditing. However, only half of the small businesses reported having a code of conduct and only two of the 21 respondents reported that their entities were audited. The issues of ethical requirements therefore still required enhancement.
- With regard to education and skills, two directors had professional qualifications but most relied upon business or commercial experience. This might have been because of small businesses not understanding the CG code and reporting frameworks in Australia.
- Fewer than 25 percent of small business members had a succession plan, meaning the majority of SMEs did not have one in place.

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2.5.3.5 2011 – New Zealand study on corporate governance applied by SMEs

In the same year, another study on CG practices in SMEs was performed in New Zealand (NZ) on unlisted small businesses with the main aim of determining the extent of agency costs in these companies (Wellalage & Locke, 2011).This study was a quantitative research using secondary data for a sample of 100 unlisted small companies regarding ownership structure and financial indicators for the period 1998 to 2008 inclusive. The study was longitudinal in nature. The study showed that governance was considered important in contributing to owners' rights and benefits, enhanced performance and created wealth through governance-strategic policies. Corporate governance emerged as contributing to the decision-making process, procedures, and attitudes that assist a business in achieving its objectives and was a tool the small business needed to consider if it sought to improve the professionalism and sustainability of its activities (Wellalage & Locke, 2011). The study found the following (Wellalage & Locke, 2011):

- Agency costs were present in small businesses;
- The regulatory environment in NZ did not encourage evolution toward better governance in smaller businesses; and
- There was a need to develop a corporate governance code for smaller firms that was flexible enough to take into account the needs of firms at different stages in their life cycles as well as the nature of the businesses.

The two studies agreed on the need for CG developed in the context of SMEs' needs; however, the results differed regarding agency costs as in Australia they were said not to be present in small SMEs whereas they were present in NZ SMEs. This was interesting as the studies were performed in countries in the same region and that were neighbours, with almost identical corporate laws.

The studies above (Abor & Adjasi, 2007; Belghitar & Khan, 2013; Hamelin, 2011; Henschel et al., 2010; and Rachagan & Satkunasingam, 2009) reached consensus on the need to implement governance systems in SMEs. The challenge was only that there are still gaps and inconclusive outcomes on how these are actually implemented in practice and the impact on business growth and failures. Results of literature review per element of CG principles as in King III are discussed below for each element.

2.5.4 Boards of directors in SMEs

The nature of SMEs is that they are characterised either by ownership and control being exercised by one or a few individuals, or by a close relationship between owners and managers (Huse, 2007). Depending on the context of the SME, outside directors provide tremendous benefits they can bring into the business. If the SME adopts a resource-

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based perspective for its business operations, the outside directors strengthen the resources and capabilities of the firm through their expertise and experience (Huse, 2007). If the SME adopts resource-dependence theory, the outside directors can help in offering legitimacy in the business community, influence stakeholder groups and achieve competitive advantage for the firm through networking activities (Huse, 2007). What outside directors bring to the advantage of SMEs is a valuable resource that can be exploited at a low cost. It is in this context that the South African Institute of Chartered Accountants (SAICA) suggested that SMEs consider retaining CAs (SA) to act as advisors and provide a useful external and independent perspective, similar to the role a non-executive director would play at a significant cost to the SME (Bowes, 2013). SAICA argued that the CAs (SA) have specialised skills that the average business owner may not have and are valuable when it comes to cash flow analysis and assessing risk (Bowes, 2013). The same context of the suggestion was supported by Small Enterprise Finance Agency CEO in that a small company might not be able to understand the risk it faced in business, necessitating an outside expert and non-executive directors where there was a board in place (Bowes, 2013).

Parsa et al. (2007) examined the extent of compliance with the governance regulatory requirements by SMEs listed on the AIM in the UK. This study's findings concluded that there exists a positive association between the presence of non-executive directors on boards of directors, the audit committees and governance information disclosure. However, it disputed that CEO duality enhances disclosures required for corporate governance. CEO duality refers to the situation where the CEO is also chairman of the Board of Directors, which leads to conflicts of interests and lack of independence (Parsa et al., 2007). This conflict of interests and lack of independence is due to the fact that since the CEO determines what information is to be supplied to the board, the board tends to see the company through the CEO's eyes. The study concluded that the greater the number of non-executive directors, the more fully SMEs report on their governance mechanisms, which reduces the agency costs.

2.5.5 Compliance with laws, codes and standards

CG is the expression of ethical values and standards. As result, compliance should be viewed as an ethical imperative for the governance of companies (IoDSA, 2009b). In order to accomplish this, the leaders of a SME should have a thorough understanding of the relevant laws and regulations confronting a business. Adherence to non-binding rules, codes and standards including the compliance with laws as outlined in King III, is applicable to all SMEs (Le Roux, 2010).

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2.5.6 Risk management practices and IT governance in the SMEs

Risk management is identifying, evaluating and mitigating all factors and events that could result in the company not achieving its intended objectives and strategies (IoDSA, 2009a). Risk is an uncertain future event that can negatively or positively affect the achievement of company objectives. The board is responsible for preventing risk, and governance of risk through formal processes that manifest into a documented risk management policy and plan (IoDSA, 2009b). King III recommends that risk management policy should be widely distributed in the company and that risk is inseparable from strategic and business processes.

Le Roux (2010) found that if risks can be anticipated, they can be managed. It follows that SMEs with formal risk management processes in place are likely to identify, anticipate and mitigate risks facing their businesses. Appropriate risk assessment and management is key to the success and growth of an enterprise. Gilbert and Eyring (2010) found that a common mistake made by entrepreneurs when they launch new ventures is focusing on one key risk to the exclusion of others. They recommended that entrepreneurs be satisfied with partial risk resolution in one area, even as they start to consider and work on risk in another (Gilbert & Eyring, 2010).

Effective risk management and assessment and tapping into IT-abundant opportunities for growth are important for SMEs to achieve sustainable growth. IT governance is a framework that supports effective and efficient management of IT resources to achieve a company's strategic objectives (IoDSA, 2009b). Technology has played a major part in forward movement of the African continent (Nyakudya, 2013). The growth factors in Africa are now in the telecommunications and retail areas, which need IT strategy if SMEs are to tap into this growth (Nyakudya, 2013). It is in this context that King III suggested IT governance should be at the core of corporate governance since most business is done via IT platforms.

2.5.7 Internal audit, external audit and the Audit Committees

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations (The IIA, 2013). An internal audit function will vary depending on company-specific factors including the scale, diversity and complexity of the company's activities and the number of employees, as well as cost/benefit considerations (Le Roux, 2010). In many cases, especially in owner-managed SMEs, the internal controls of the company are relatively simple and the number of staff members is few. Thus a formal internal audit is not applicable to many of these SMEs as the costs outweigh the benefits.

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An Audit Committee (AC) is a BoD subcommittee responsible for ensuring integrated and financial reporting integrity and financial controls, also for identifying and managing financial risks (IoDSA,2009b). An AC is voluntary for private companies, NPOs and personal liability companies but mandatory for public and state-owned companies (IoDSA,2009b). It follows that SMEs can elect not to have an AC depending on their size and structure. However Jones and Tilley (2003: 64) as cited in Le Roux (2010) found that there was a point in the growth of an SME when it needed to set up sub-committees to assist in delegating some of the board's responsibilities, and this may be the point where an AC is required.

2.5.8 Stakeholder management

A stakeholder is any group affected and affecting the company's operations (IoDSA, 2009b). The concept of a company as being a responsible corporate citizen applies to all SMEs and includes the "bigger picture" that refers to the triple bottom line including economic, social and environmental performance as per King III. The reality is that all SMEs, large or small, have to a certain degree an effect on the society within which they operate; as a result, the importance and impact of formal and informal stakeholder relations is considered to be a key element for the success of any business and is therefore applicable to all SMEs (Le Roux, 2010). Also, from a risk management point of view, stakeholders may have a material effect on the operations of a company and it is expected that the company should appreciate stakeholders' concerns and expectations.

2.5.9 Integrated reporting

Integrated reporting means a holistic and integrated representation of the company's performance, which can take the form of a single or dual reports (IoDSA, 2009b). King III charges the board with the responsibility of ensuring the integrity of the company's integrated report; this report should integrated with annual financial reporting. A study by Le Roux (2010) noted that the extent of integrated reporting depends on size and whether the SME has external shareholders or not.

The challenge with SMEs is that they often lack transparency and frequently do not disclose financial and tax information and the knowledge of proper accounting procedures, accountability and responsibility is very limited (African Development Bank, 2005: 27, as cited in Le Roux, 2010). This challenge may result in an inability to assess the level of integrated reporting in SMEs, since many also have their financial reports prepared by independent consultants.

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Companies' systems of internal control are important aspects of the corporate governance framework. A study by Brennan & Solomon (2008) show that corporate governance weaknesses contribute to business failure. In that study, they indicated that traditional mechanisms of accountability included governance regulations, boards of directors, financial reporting and disclosure, audit committees, external audit and institutional investors. Within the framework of strengthening accountability in the firms, stakeholder accountability and social responsibility, were highlighted as key ingredients for business success (Brennan & Solomon, 2008). It follows that SMEs have to do proper and credible reporting in order to satisfy all stakeholders and enhance their business success from adopting such practices.

2.5.10 Ethical leadership and corporate citizenship

Several theories are used in corporate governance studies in regard to how companies deal with conflicts between owners and managers, where the two roles are separated. These include agency theory, stewardship and stakeholder theory, principal agent theory and the institutional theory. The problems addressed from the review of these theories were applicable to SMEs where similar issues are evident (Abor & Adjasi, 2007). Ethical leadership and culture is the core foundation of King III CG principles.

Enforcement of ethical leadership and culture in SMEs

Ethics or morality refer to that which is good and right in human interaction, with one's conduct considered to be ethical if it gives due consideration not only to that which is good for oneself but also good for others (IoDSA, 2009b). Ethical leadership is the cornerstone of corporate governance. Ethical leadership is about doing what is right for the long-term benefit of all stakeholders (Oates & Dalmau, 2013). Ethical leadership starts at the top, with the board of directors and senior executive group including the CEO (Oates & Dalmau, 2013). Ethical leadership is required of all businesses regardless of their size and nature, as it eliminates conflicts of interests that lead to business failures. Companies, including SMEs, need to have espoused values expressed amongst all their leaders along with behaviour and governance structures, principles and policies (Oates & Dalmau, 2013). Adoption of ethical leadership by SMEs will strengthen the corporate governance landscape (Le Roux, 2010).

Ethical leadership builds sustainable businesses, the BoD needs to ensure that ethical standards are articulated in the code of conduct, assess, monitor and report company's ethics performance (IoDSA, 2009b, p.26)

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Non- Executive Directors (NEDs) strengthen ethical leadership

An ethical culture in a business brings advantages such as the ability to attract and retain top staff and board members, increased loyalty and trust from stakeholders (Schoeman, 2013).Hence, leadership is recognised as the most influential factor in shaping behaviour towards being ethical as good leadership implies that leaders act to entrench sound values, and drive and encourage ethical conduct (Schoeman, 2013). The board is charged with the responsibility of ensuring that a business is run in an ethical manner and CG practices are implemented (IoDSA, 2009a).

In the UK, the agency costs of equity were found to be higher where there was a relatively small number of shareholders, especially in SMEs. Another study was carried out in India in 2007 to examine the relationship between corporate governance and the growth of small business service firms (Gill, Mand & Mathur, 2012). The findings of this study concluded that CEO tenure, CEO duality, board size, board meetings and increase in total assets, influenced the growth of small business service firms in India. The study also found that while CEO duality had a positive impact on the growth of small business firms, larger board size had a negative impact on the growth of small business service firms and suggested they consider changing board size based on the firm's size (Gill et al., 2012). The differing results above were possibly due to the fact that in the UK, the AIM-listed SMEs are not required to undertake all disclosures per the Combined Code, but could give reasons for non-compliance. However in India, the firms surveyed were non-listed companies and most SMEs in India are family-owned. In the family-owned small firms it is likely that the CEO would be the chairman of the Board. Due to the economic structure of that country where small business survival is the source of employment opportunities for many citizens, the CEO will do anything to ensure survival of the company and therefore do all required to retain investor confidence.

Stakeholder theory

Stakeholder theory argues that there are other parties involved than just shareholders, including governmental bodies, political groups, trade associations, trade unions, communities, financiers, suppliers, employees and customers (Muth& Donaldson,1998). Per this theory, the interests of all parties need to be safeguarded and it included the resource-based as well as market-based view approaches to business management results in connectedness (Muth & Donaldson, 1998). This connectedness and inclusive approach formed the basis of principles in King III that propose an independent board which would ensure that conflicts are addressed in an holistic manner and should consider all stakeholders and not only the shareholders (IoDSA, 2009b).

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Agency theory

The concept of CG itself forms the basis of agency theory, as it proposes that boards are put in place to protect shareholders' interests against agency problems (Parsa et al., 2007). Agency problems arise when there is separation of ownership and control of the entity, resulting in managers maximising their self-interest at the expense of the entity's profitability thereby compromising shareholders' interests (Muth & Donaldson, 1998). Since small businesses can be owner-managed or be agent-managed, various challenges are faced which could impede growth and continuity (Rachagan & Satkunasingam, 2009).

Collewaert (2012), in his study of businesses funded by angel investors, found that elimination of conflict of interests and goal alignment can be achieved through implementation of proper governance systems. These systems would ensure alignment throughout the entire relationship, to reduce the risk of early exit by angel investors before the SME achieved its target growth level (Collewaert, 2012).When agency costs are present; information asymmetry results in managers behaving opportunistically for their own interests at the expense of shareholders. Information asymmetry could be reduced by effective monitoring by those charged with governance (the Board, or family councils for family-owned SMEs), thereby reducing agency costs leading to better company performance (Collewaert, 2012). The implementation of corporate governance principles seems to have a positive effect on reducing agency costs and eliminating information asymmetry.

From the review of corporate governance theories outlined above, it was evident that the board of directors has an important role to play as an internal governance mechanism in enabling management and improving the performance of companies ((Haat, Rahman, & Mahenthiran, 2008).

2.5.11 Governance enhances prospects of securing funding

Wirtz (2011) found that corporate governance is a cognitive lever for strong growth strategy. Furthermore, he proposed a systematic exploration of the high-growth, entrepreneurial, small firms' governance that past studies in this area had omitted (Wirtz, 2011). The study by Wirtz (2011) emphasised the need for an open governance structure in SMEs graduating from start-up stage (when financial capacity may be exceeded)as this would assist in securing outside investors' funding, for example from venture capitalists.

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2.6 A corporate governance code specifically for the SMEs

In 2004, a study was undertaken which indicated that the costs of compliance were about 6.5 percent of GDP for that year (Darroll, 2004). In the same study, it was found that in 2004 on average, the annual costs of regulatory compliance were R105, 000 per firm; big firms have the largest costs absolutely but in relation to their size, small firms bear the heaviest burden. Compliance costs represented 8,3 percent of turnover for enterprises with annual sales of less than R1 million, and 0,2 percent of turnover for corporations with sales of R1 billion or more (Darroll, 2004). These may have either increased or reduced by 2013. The Government made efforts to improve the environment for doing business in South Africa and at the same time introduced new laws that may either positively or negatively affect businesses. However, many entrepreneurs are still concerned about the red tape, thus any form of new framework that resembles regulation might be met with resistance. It is in this context that some respondents to the recent survey by the IoDSA indicated a need for a corporate governance framework suited to smaller organisations (Jansen van Vuuren & Schulschenk, 2013).

A corporate governance code has been considered in different jurisdictions, such as the United Kingdom (Parsa et al., 2007), Pakistan (Gulzar & Wang, 2010) and Australia among others. It would be interesting to understand the context and the content for the proposed King Code specific to the SME sector. In New Zealand, the corporate law framework is essentially a “one-size-fits-all” matter, irrespective of company size, and that has resulted in many SMEs being devoid of effective governance, as per the study by Devlin (2008) as cited in Le Roux (2010). The latter findings might strengthen the case for a simplified, specific version of a CG code for SMEs as opposed to a one-size-fits-all approach to codes of CG.

For financial reporting purposes, internationally it was recognised that SMEs have different needs and challenges. As a result a set of International Financial Reporting Standards (IFRS) for SMEs was designed to meet the needs and capabilities of SMEs, which are estimated to account for over 95 percent of all companies around the world (IFRS Foundation, 2013).This IFRS for SMEs is less complex in a number of ways and easy to implement by SMEs (IFRS Foundation, 2013). If this was undertaken to simplify financial reporting for SMEs, can such simplification and modification be replicated over the entire SME governance system?

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The aim of this study was also to consider this requirement and make recommendations for this aspect of corporate governance based on the responses from interviewees. This was done in an attempt to investigate the appropriate content for a separate set of codes of corporate governance, specific to NPOs and SMEs.

2.7 Corporate governance and company performance

The aim of starting a business and the aim of any entrepreneur who identifies opportunity is to make a profit and have a thriving business that is sustainable into the future (Nieman & Nieuwenhuizen, 2009). Company performance is mostly measured by annual profits (Nieman & Nieuwenhuizen, 2009).When a company makes profits and shows growth in terms of return on equity and earnings per share, it is said that the company is performing well, and when it makes losses it is classified as an under- or poor-performing business. In this section, performance refers to the ability of a business to make profits and be sustainable into the future.

The relationship between corporate governance and companies' performance is still one of the most debated topics as studies performed in the past yielded different results for each study (Bauer et al., 2008; Bhagat & Bolton, 2008; and Rambajan, 2011). The results are summarised later in this paragraph. In the midst of this debate, investors have become more conservative due to the recent corporate scandals (Bradley, 2010). Investment in corporate governance can act as a mechanism to attract and provide comfort to potential investors that their investments are likely to bear returns through controls and processes brought about by the corporate governance principles (Bradley, 2010).In their study examining the relationship between corporate governance and share price performance, Bauer et al., (2008) found that well-governed companies significantly outperformed poorly governed companies by 15 percent per annum. These results came after correcting the figures for market risk, company size and book-to-market effect. In the study Bauer et al., (2008) used the six measures of CG to determine if it impacted on company stock performance of a sample of 356 companies listed on Japan Stock Exchange using the Governance Metrics International (GMI) indices. The CG categories on which the GMI was applied were: (1) board accountability, (2) financial disclosure and internal controls, (3) shareholder rights, (4) remuneration, (5) market for control, and (6) corporate behaviour.

Equivalent results were obtained in the study on the relationship between CG with major emphasis on the board of directors and company performance in South Africa (Rambajan, 2011). The study conclusions were that independent non-executive directors (NEDs) maximise stakeholder value, while the skills and knowledge of each director

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contributes to company performance (Rambajan, 2011). However on the other hand Bhagat and Bolton (2008) found that there was no correlation between governance measures and future stock market performance. These differences are likely to be as a result of different tests used to assess corporate governance impact on performance, and testing different elements or variables. The study by Bhagat and Bolton (2008) was quantitative secondary data research, using seven CG measures to determine a correlation between CG implementation and future stock performance. These measures included stock ownership of board members, CEO-Chair separation and subsequent operating performance among others.

Another study was performed by Muniady et al., (2010) as cited in Rambajan (2011) to evaluate the association between governance variables and firms' performance after the introduction of King III, using a sample of 105 large firms listed on the JSE. Some of the findings from that study showed that having a majority of non-executive directors on the board strengthens investment opportunities and concluded that there was a relationship between the two. It was evident from these results that investment in corporate governance facilitates the ability for stakeholders to have confidence that companies will be accountable for their actions (Stanwick & Stanwick, 2010). It emphasised that the dominant force in corporate governance was the board of directors (Stanwick & Stanwick, 2010).

The main criticism of the studies on CG is that most of them focused on the board of directors. This has occurred at the expense of other elements such as effectiveness of internal controls and internal audit, risk management processes and most recently the issues of IT governance, which has been given more weight in the King III Report. Considering the above matters, it was noted by Haat, Rahman and Mahenthiran (2008) that in the absence of corporate governance mechanisms, the overall economic performance of companies will suffer and outside investors would not be willing to lend to those companies or buy their share stocks. The study had tested the relationship between corporate governance mechanism, transparency and performance on a sample of 73 companies listed on the Malaysia SEC to benchmark companies with good performance to good governance practices (Haat et al., 2008). The metrics used were the board characteristics, foreign ownership, quality of audit, debt-to-assets ratio, timeliness to publish annual results and disclosures as required by MCCG (Haat et al., 2008).

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The range of corporate governance measures that can be implemented by a company in South Africa was outlined in Table 2.1 and discussed in that part of this chapter. There are many metrics used to measure CG effectiveness as per the literature review above. For the purpose of this study, since it is exploratory, the general implementation of CG principles and measures put in place to ensure proper governance will be tested.

2.8 Conclusion

This study will focus on the holistic corporate governance practices applied by SMEs. Holistic corporate governance refers to an overall system of risk management, IT governance, governance structures including boards and audit committees, internal control systems reviews and implementation (IoDSA, 2009b).

The literature reviewed indicated that there was a strong case for governance principles and codes to be implemented by SMEs as they contributed to improved company performance, growth and continuity. The challenges foreseen, including the costs of compliance and concern that CG might stifle innovation, are outweighed by the benefits shown in the literature examined in this study.

Ethical leadership and entrenchment of ethical culture form the foundation of CG principles of transparency, fairness and accountability. Ethical leadership can only be entrenched if companies ensure that conflicts of interests are managed and eliminated through codes of conduct and by having NEDs on their boards where possible. In this regard, SMEs may consider using outside advisors as the equivalent of NEDs to obtain objective advice on business strategies and risk management issues should there be no NEDs on their boards. SMEs are to ensure that they have board of directors that drive innovation for growth. Key to issues of CG in the SMEs is IT governance and risk management. Modern businesses are faced with day-to-day ICT challenges and at the same time have to harness the power of technology to offer their products and services in innovative and efficient manners. Every business faces operational, strategic and even macro-environmental risks. Risk identification, assessment and management therefore become relevant to all businesses including SMEs. King III now includes IT governance and risk management as the core responsibility of the board of directors.

South Africa is considered to have the best CG code amongst the countries in emerging markets. The benefits of applying good governance principles have been evident in the large firms that received increased FDIs between 2006 and 2012 (IoDSA, 2009b). King III became effective in March 2010 with a widened scope, in that it is now applicable to all entities. However the country had the highest failure rate of small businesses when

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compared to other emerging and also developed economies. The big question that arises is why, if South Africa is leading in CG, does it have this high SME failure rate and should not its CG code assist and improve performance and continuity?

The literature search and review performed for the purpose of this study indicated that research on implementation of CG by SMEs is still at an early stage in South Africa. As a result of an absence of data on whether SMEs have actually implemented the King III and CG practices, an exploratory study is necessary to determine the status quo in this regard. Once data is available whether SMEs implement CG principles and practices, research could be performed on whether implementation has an impact on company performance, growth and continuity. It is against the background outlined above that this study becomes more relevant and important in taking forward the implementation of CG by SMEs. This study is likely to add value to both business and regulators in confirming whether King III is practicable to implement or not, while highlighting challenges SMEs may face in this regard.

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3 Research Questions

3.1 Background

The research problem was that corporate governance improves company performance, and contributes to growth and continuity (Wellalage & Locke, 2011). South Africa is regarded as leading in CG practices, however it is experiencing a high failure rate among SMEs (Fatoki & Garwe, 2010), which brings into question whether SME failures are due to non-adoption of CG principles or the blame rests on the failure of governance systems to effectively influence their performance and continuity. In the meantime there is absence of data on whether CG principles are implemented by SMEs or not and whether, where implemented, they do contribute to company performance and growth.

The purpose of this study is to determine, through exploratory evidence, the extent of implementation, and the elements of, the King III Report and Corporate Code of Governance applied by SME businesses in South Africa. The secondary objective is to determine whether SMEs have developed measures and practices to cultivate ethical leadership and culture through review of whether the stakeholder, stewardship and agency theory approaches have assisted them in eliminating conflicts of interests. Lastly, it aims to establish the context and content for the need of a King code for the SMEs.

3.2 Research questions

A research question is the hypothesis of choice that best states the objective of the research study (Blumberg, Cooper& Schindler, 2008). The research question should be considered a fact-orientated, information-gathering question (Blumberg et al., 2008). The unit of analysis for this study is the implementation of King III report and code of corporate governance by SMEs. A unit of analysis is the piece of data being analysed (Zikmund, Babin, Carr & Griffin, 2013) .The research will evaluate the implementation of corporate governance principles as per King III by SMEs. In addition, the study will examine how ethical culture and leadership are practised and how conflicts are managed, and will determine whether there is still a need for the simplified version of the King code for SMEs.

The following research questions are therefore defined:

Research Question 1: To what extent are the elements of the King III Report and Code of Corporate Governance implemented by SME businesses in South Africa?

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Research Question 2: What impact has the King III Report and Code of Corporate Governance had on improving SME businesses' performance and growth? What benefits and challenges are associated with the implementation of King III by SMEs?

Research Question 3: What processes and procedures are applied by SMEs in enforcing the ethical leadership and culture to eliminate conflicts of interests and achieve transparency, fairness and accountability?

Research Question 4: What are the views of the SME business sector on the need for a King code for SMEs? What should be the content of this piece of corporate governance code for SMEs?

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4 Research methodology and Design

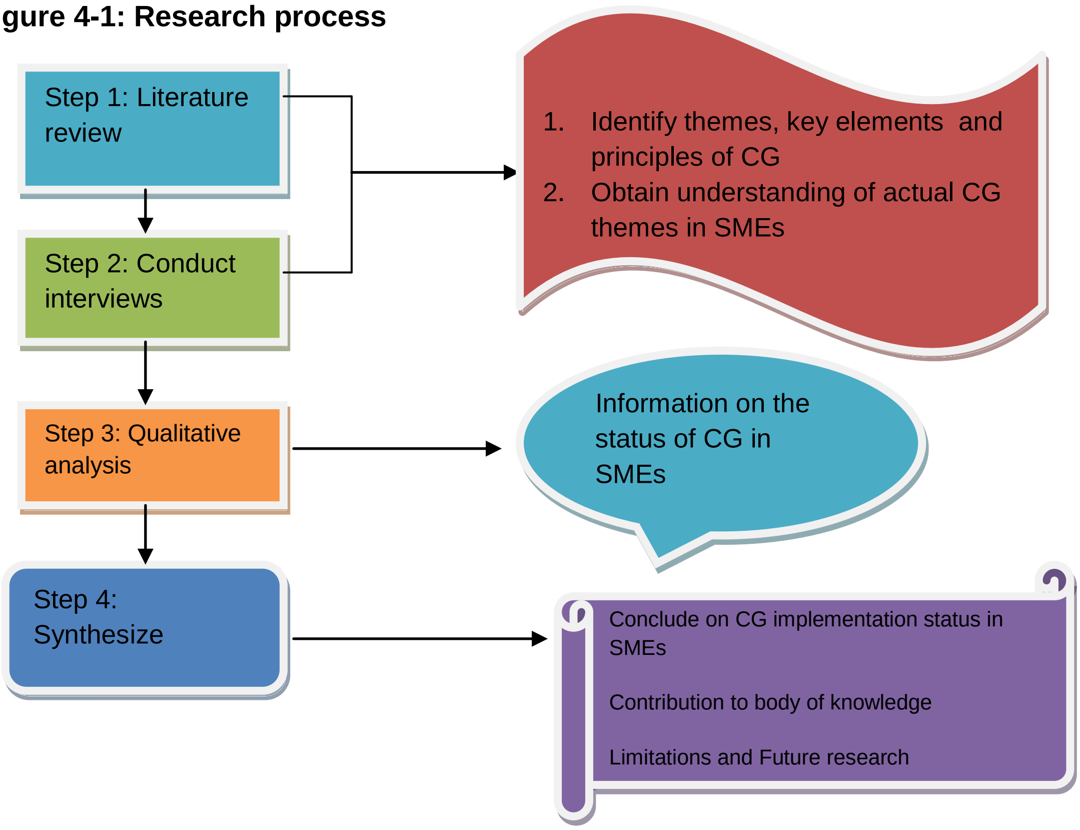
4.1 Introduction

Governance is the key driver of company performance, promoting small firms' continuity and growth; South Africa CG is among the best in the world, however the country's SME failure rate is high (Bradley, 2010; Fatoki & Garwe, 2010; and Wellalage & Locke, 2011). This leads to the question of whether SMEs have considered or implemented CG principles to help them grow and achieve continuity.

The aim of the study is to obtain an understanding of whether SMEs are implementing King III and other corporate governance practices and to understand if there is a need for the CG Code for SMEs, and the context and content of such should there be a need for one.

Figure 4.1 summarises the process followed during the study.

Figure 4-1: Research process



In this chapter, the research methodology and the research design will be discussed.

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4.2 Research philosophy, process and methodology

The philosophy of this study was determined by research questions and the objectives, which was to look at the state of CG in SMEs from the practical perspective. Research philosophy refers to the critical analysis of fundamental assumptions, the development of knowledge and the nature of that knowledge in relation to research (Saunders & Lewis, 2012).

An exploratory qualitative study method was used to seek new insights and assess typical SMEs' CG practices in a new light by using in-depth interviews (Saunders & Lewis, 2012). An in-depth interview is an interview where the researcher is looking for rich and detailed information, for examples and experiences using open-ended questions (Rubin & Rubin, 2012). The research used the responsive interviewing style, which is a method that is flexible and allows questions to evolve in response to what the interviewee has said, and follow-up questions designed to tap into the experience and knowledge of each interviewee. Interviews elicited relevant, valuable and analytically rich data that was used in Chapter 6 in informing insights on SMEs' CG practices and conclusions as to whether the research was answered (Barbour, 2008).

After having searched the literature and in the absence of an appropriate measurement tool for CG in South Africa; the principles of the Delphi method were used in this study to obtain the views of CG experts with regard to whether there was a need for a simplified code of CG for SMEs. The Delphi method is a flexible research technique suited to incomplete knowledge about a phenomenon; it is used in studies to develop, identify, forecast and validate a wide variety of research areas (Skulmoski, Hartman, & Krahn, 2007). The Delphi methods allow for researcher to go back to interviewees and ask follow up questions on responses provided in light of new ones provided by other interviewees. There is currently no standing data on who is the expert on SMEs' CG, as a result, the Delphi method was only used in selecting experts to be interviewed to answer Research Question 4 as stated in Chapter 3.

The Delphi method was used in obtaining expert opinions on the subject matter, as it allowed for flexibility in soliciting data and the sample size typically used in the research studies comprised at least four members: there are standing rules on the sample size (Skulmoski et al., 2007). The principles of both exploratory qualitative and the Delphi methods were considered appropriate in this study for the following reasons:

- The study was an investigation into implementation of principles of CG and King III report and code of CG, which have complex elements to be explored through analysis of the interviewees' responses;

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- Gain opinions from each participant that could be used to formulate insights, conclusions and recommendations on the extent of King III implementation in SMEs;
- The research questions in the study were such that there was uncertainty as to whether specific responses could be considered valid or invalid, consistent with what the Delphi method of study accommodates; and
- The Delphi study is flexible in its design and amenable to follow-up interviews where required. This permits collection of richer data leading to a deeper understanding of the fundamental research questions (Okoli & Pawlowski, 2004).

The research began with the gathering of knowledge from the literature review in the areas of corporate governance and its benefits to companies. This was then narrowed to focus on SME-specific issues. After understanding the body of knowledge on corporate governance related to SME businesses, relevant theory was identified and categorised into themes. Research reports on elements of CG as per King III were reviewed, and conclusions thereto arranged into themes that were tested as part of the interviews conducted.

The next phase, after developing themes from the literature, was to complete the research interviews. Explorative interviews were conducted, aimed at obtaining an understanding of the application and implementation of the corporate governance principles embedded in the King III Report and Code. This was performed to ensure that the data was available regarding conclusions on whether King III was applied by all entities irrespective of size and form.

4.3 Research approach

A deductive research approach was used to obtain answers in response to research questions in Chapter 3. This approach involved testing of theoretical propositions using a study or research strategy specifically designed for the purpose of the intended test (Saunders & Lewis, 2012). The study tested the theory as per the literature review discussed in Chapter 2and data was qualitatively tested to provide insights and form the basis of conclusions as to whether research questions had been answered.

4.4 Research strategy

An exploratory qualitative research method was followed in this study. The reasons for choosing qualitative research were that it was appropriate for this study as it defines what needs to be studied when a relevant theory base has inadequate conclusions and as it serves to describe, interpret, verify and evaluate certain assumptions held in the findings of the studies or literature and contribute to the knowledge base (Leedy & Ormrod, 2013).

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To date, very limited studies have been done on CG within SMEs in South Africa. Some earlier studies, on the practice of governance in small firms, was undertaken using quantitative methods for listed firms with the focus on BoD (Henschel et al., 2010). The challenge with SMEs was that most do not publish their reports, and there was no previous data on the extent of their having implemented CG and King III. An understanding of the extent of implementation was required before any other tests—such as, whether CG improves SMEs' performance, and its effect on growth rates—could be performed. As a result, the qualitative method was most appropriate for this type of study in South Africa.

4.5 Research scope

This study limited its scope to SMEs that were registered with the CIPC and which had been in business from the 2010 calendar year. For the purpose of this study, the definition used of an SME was aligned to that found in the Small Business Act (DTI, 2006). Small enterprises are defined as organisations employing between five and 50 workers, generating at least R6 million in annual turnover, whereas medium enterprises are those that employ a maximum of 200 workers and have annual turnover of under R60 million (DTI, 2006).

As a result, the SMEs in this study referred to small business entities formed solely to generate profits for the owners and stakeholders who have more than 10 but fewer than 200 employees and a minimum of R6 million and maximum of R60 million annual turnover. These criteria were considered appropriate in that it was highly probable that an SME with more than 10 employees and annual turnover above R5 million might have grown to a level where it faced challenges that King III sought to address.

4.6 Universe and unit of analysis

The universe for this study was limited to all businesses meeting the criteria of a small and medium enterprise as defined in the Small Business Act (DTI, 2006)and which are registered with the Companies and Intellectual Property Commission (CIPC). Furthermore they were required to have been in business at least from January 2010, thereby accommodating the timeframe from when the King III Report became effective for all entities, which was 1 March 2010.

The key unit of analysis was the implementation or non-implementation of the King III Report and Code of corporate governance. The unit of analysis is defined as a predetermined piece of data such as a line of transcript, sentence, paragraph or response

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(Saunders & Lewis, 2012). Unit of analysis also indicates what or who should provide data and at what level of aggregation (Zikmund et al., 2013).

4.7 Population

The population for this study was the owners and managers of the CIPC-registered SMEs in different sectors. SMEs that are state-owned companies as defined in the Companies Act of South Africa, 2008 and the Public Finance Management Act, 1999 (PFMA) were excluded from the population from which the sample was drawn. The population refers to the complete set of group members (Saunders & Lewis, 2012).

There is currently no central or an SME association of significance that maintains the full database of all SMEs in South Africa, although the CIPC has the records but (limited only to those who are registered). However the CIPC database is not accessible to the public. As a result, there was no appropriate sampling frame for this study. A sampling frame is a complete list from which the sample is drawn (Zikmund et al., 2013).

4.8 Sample size and the sampling method

Random sampling was considered in order to allow all SMEs an equal chance of being selected for this study; however it was impractical due to the lack of a readily available sampling frame. Due to the limitations indicated below, the study used convenient sampling as this sampling method ensured that the selected sample represented certain characteristics in the population. Convenient sampling is a method in which the researcher's judgement is used to select a sample to be tested based on a range of reasons and premises (Saunders & Lewis, 2012).

The non-probability judgement sampling technique was used to select a sample of 12 SMEs in the Johannesburg metropolitan area for convenience purposes due to time limits and cost implications. The sample size did not necessarily need to be representative, since the goal of qualitative sampling is rather to reflect diversity and provide potential for comparison as much as possible (Barbour, 2008). Convenience sampling was more practical considering the challenges of limited publicly available data on SMEs. Out of 12 SMEs selected for interview, one was disqualified as had annual turnover of R24 million but with only two employees; which made it fall outside the scope with regard to a minimum number of employees.

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In addition, four experts were selected for specific interviews on the need for the set of corporate governance codes for the SME businesses, following the Delphi method. It was found that three of these CG experts had no experience in dealing with SMEs but only with JSE-listed firms. The Delphi method was not fully used (although it was initially part of the research strategy to determine the number of experts); due to non-availability of more than one expert for the subject matter. As a result, only one CG expert was ultimately interviewed. The profile of this expert is shown on Table 5.2.

4.9 Data Collection

All the interviews were conducted face-to-face, with the exception of one conducted on Skype because the director concerned was on business trip at the time. The interviews were conducted between 27 September 2013 and 15 October 2013.

The first three interviews took one hour 10 minutes on average whereas subsequent ones took less than one hour, ranging between 33 and 56 minutes. This was due to the questioning style having been adapted from the experiences of the first three. Results were analysed and synthesised and overall conclusions made in Chapter 7, including recommendations for future research.

4.9.1 Research instrument

Research data was collected using in-depth interviews. The format for collecting data was the semi-structured interview, a method of data collection in which the interviewer asks about a set of themes using predetermined questions which could be modified as appropriate to the responses being obtained (Saunders & Lewis, 2012).The interview explored elements and aspects of the King III report and code of corporate governance, such as risk management, IT governance, board of directors or equivalent structure, internal and financial controls, financial reporting, internal audits, ethics and compliance with laws and regulations.

Data was collected during the interviews through auditory and manual transcripts (notes) that were transcribed later and manually coded into themes. Before data was collected, an interview schedule was prepared. (See Appendix 1 for detailed interview guide.) The interviews commenced with introductory questions that were considered to be the least threatening, and progressed on to probing question to elicit more information, where it was necessary as described in Table 4.1.

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Table 4-1: Interview guide design

Topic	Explanation
1. Introduction	The purpose of this discussion is to introduce myself, give the background on the research topic and its need in the South African business context and confirm the basic understanding of the interviewee and his/her company about the CG principles and King III in particular. The outcome of this discussion was to ensure that the interviewees understand what corporate governance entails and have them understand that the interview objective is not to point out bad or good management, either having or having not implemented King IIII, but to obtain general understanding on the motivation to implement or not to implement the governance code.
2. Discussion of the company profile and administration	The discussion focuses on the administrative practices currently in the interviewee's business, level of shareholding and staff relations in the company. The outcome was to determine whether the company was likely to fully implement King III and determine currently the themes that indicate the alternative governance practice in the absence of King III in that company.
3. Discussion of King III and other corporate governance principles in the context of the SME being interviewed	The purpose of this discussion was to move to a macroeconomic level and discuss the application of King III within SMEs in the context of an interviewee company. The intended outcome was to establish whether King III in its current form was easily implemented, determine the reasons and also solicit the views and evidence of challenges and benefits perceived or experienced by the interviewee's company with regard to general corporate governance and specifically King III.
4. Conclude: SME owner views on the need for a King code for SMEs	The discussion of this topic was specifically to solicit the views of SME owners regarding the corporate governance code for the SMEs. The intended outcome was to establish whether this code should be less comprehensive or should it mirror the current King III and also obtain the proposed manner of implementation and monitoring of its progress once adopted by the SME business sector.

The above interview guide allowed for the interviewer to cover all aspects and be able to obtain responses to the research questions posed in Chapter 3 while at the same time soliciting rich and in-depth information about the CG status quo in the SME business sector. Since these were semi-structured interviews, interview questions as per Appendix 2 were used and modified where required to the current circumstances of the interviewees' companies.

4.10 Data analysis

Results of the detailed interviews were analysed by themes that emerged during the interviews conducted. Data analysis was performed manually by sifting through data collected and finding key themes that responded to the research objectives, which were the words that represented themes (Zikmund et al., 2013).

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The content analysis for key words was performed on data collected by formulating themes, reviewing those themes, building an overarching narrative, arranging themes according to research questions, and then reporting them with the evidence as per Chapter 5. The responses allowed for the formation of an overall summative model on SME corporate governance practices as per Chapter 2. Digital recordings of interviews were transcribed by the professional service provider.

The researcher performed the coding of data collected. Thereafter the data cleaning was performed by inspecting corroborative evidence to sources mentioned during the interviews and through comparison to literature themes identified in Chapter 2. The digital recordings of interviews were listened to at least three times to ensure accuracy of transcripts and themes noted. Transcripts were read several times, applying the word counting routine and a theme developed there from. This was followed by data analysis to produce results as per the questions in order to reach the appropriate conclusions.

4.11 Trustworthiness

During the interviews, data was gathered regarding principles applied by SMEs and where King III was implemented, a follow-up was undertaken on the specific elements that were fully adopted and the reasons thereto. Literature was used to interpret the results in Chapter 5 from the research interviews conducted. The results were considered reliable as evidence confirming the presence of implementation of CG principles was obtained in the form of sample minutes, reports and registration certificates inspected on site whilst carrying out the interviews.

Interviewees were made to be at ease to freely share their thoughts without fear that they may provide the wrong answer; which ensured that the same interviews could be re-performed and come to the same results and conclusions. Also data results were checked for the flow to theory and vice versa; which proved that the tests were not biased. Data was collected with objectivity and ensuring that there was no researcher’s biases in the process of analysing the results.

Data was triangulated by comparing responses obtained to identify any that seems to significantly differ from the rests; which there was none noted.

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4.12 Research limitations

The research study had the following limitations:

- Certain reports that prove evidence of the King III were not in place as some SMEs lacked good record keeping practices. The research thereby relies on responses provided. The geographic spread of South Africa limited the interviews to SMEs in the Johannesburg metropolitan area because of travel costs and limited time available to complete the project.
- Timelines for the research submission also did not allow for follow-up interviews to be conducted across the sectors.
- The small sample size of companies selected did not cover all sectors in which SMEs operate, therefore the results cannot be generalised to SMEs in any sector of the economy.

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5 Research results

5.1 Introduction

The semi-structured interviews were conducted with owners/managers of SMEs in the Johannesburg metropolitan area. Data obtained from these interviews answered questions on general implementation of CG principles per King III, benefits and challenges experienced by SMEs with regard to King III and views obtained as to whether there was still a need for a simplified code of CG for the SMES. The Delphi research technique was used in interviewing the expert on SME CG in South Africa to obtain opinions and views on whether King III was suitable and had any benefits for SMEs. The respective profiles of SME owners and the expert interviewed are outlined in Table 5.1 and Table 5.1 of this chapter.

A sample of 12 SMEs was selected using the convenience sampling method. Out of the 12 selected, one was not interviewed as falling outside the scope and definition of an SME as outlined in Chapter 4to this study. The results of the interviews conducted are laid out as per the questions used to answer the main research questions, in a structure per the interview guide in Appendix 2.

5.2 Interview results

As the objective of this study was to determine the extent to which CG principles and King III in particular were implemented by SMEs and which elements were being implemented, plus the challenges and benefits experienced in such implementation, below are highlights of results from interviews conducted. The state of King III implementation and its elements is presented and discussed under Tables 5.1 to 5.8 with the emergent themes presented in Table 5.9 in this chapter together with the summary of responses as to whether there is a need for a simplified code of CG for SMEs and the summary of emergent themes from the interviews.

The profile of companies interviewed is presented in Table 5.1; which consisted of five CCs and six privately incorporated companies (Pty) s. The size as per turnover was between R6 million and R49 million with the highest number of employees being35.The maximum number of shareholders noted for the privately incorporated companies was four whilst the maximum number of members in CCs was three.

Only one expert on SME corporate governance was interviewed as only one specific service provider (expert) on SMEs' CG could be identified. All other selected experts had not worked with SMEs. The profile of the expert is laid out on Table 5.2.

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Table 5-1: Profile of SMEs whose owners/managers were

Company ID	Type of incorporation	Location	Years in business	Annual turnover (Rands)	No. Employees	Post/level of interviewee
A	Pty	JHB- Illovo	5 years	48,000,000	33	Shareholder
B	Pty	East Rand- Boksburg	3 years	15,800,000	21	Shareholder/Manager
C	CC	JHB-Midrand	3 years	8,769,600	11	Member/Manager
D	CC	JHB-Midrand	4 years	12,670,000	14	Member/Manager
E	CC	East Rand- Edenvale	4 years	8,000,000	21	Member/Manager
F	CC	JHB- Langlaagte	14 years	11,000,000	27	Member/Manager
G	Pty	JHB- Lonehill	12 years	49,000,000	35	Shareholder
H	Pty	JHB-Rivonia	3 years	22,000,000	16	Shareholder & Manager
I	Pty	PTA- Centurion	16 years	13,000,000	14	Shareholder/Manager
J	Pty	JHB- Honeydew	3 years	11,200,000	15	Shareholder
K	CC	JHB- Sandton	12 years	23,000,000	35	Member/Manager

Table 5-2: Profile of SME CG expert interviewed

Expert	Qualification	Profile and experience	Boards served on
Expert 1	Chartered Accountant	Expert is an entrepreneur, speaker, author, mentor and director. A dynamic entrepreneur who guides small to medium businesses to achieve success. International expert on the education and implementation of enterprise governance in small and medium businesses, enabling understanding of the role of enterprise governance as both a performance and conformance tool	CEO of a branch of international company, Member of the King Committee, Independent Chairman of two boards and an NED in two companies

5.2.1 Implementation of CG principles in King III by SMEs

Overall results from the interviews conducted on implementation of King III are presented in Table 5.3, which shows that King III was implemented by only 27 percent of the SMEs surveyed. These three companies had all other elements in place except for the audit committee and integrated reporting. Since King III operates on an “apply or explain basis”, these SMEs had reasons why the two elements were not being applied, being mainly due to size and the number of shareholders in these entities. All SMEs surveyed with regard to

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how they embraced the principles of accountability, fairness and transparency in their businesses; indicated that everything was recorded in the books and ensured compliance with regulatory authorities, especially SARS. There was a majority agreement that King III principles were applicable in spirit to SMEs, except for certain elements that were not necessary for businesses of their size.

Table 5-3: Overall implementation status of CG principles in King III

State of implementation of King III CG principles	Number of Interviewees	%
SME owners/managers familiar with King III	7	64%
SME owners/managers not familiar with King III	4	36%
SMEs that had implemented 7 of the CG principles in King III	3	27%

Regarding understanding and knowledge of King III, seven SMEs interviewees were knowledgeable and understood its contents and intentions and thus viewed King III principles as vital in entrenching an ethical culture, accountability and transparency to produce a well-run business. Six of those interviewed viewed King III as merely another piece of legislation affecting SMEs. This group viewed regulations and governance issues as “red-tape” and expressed strong views in favour of an environment that supported the growth of start-up SMEs with a reduced compliance burden. There was a trend in that amongst the six respondents viewing King III as equivalent to another legislation merely adding more red tape, four had never been exposed to, or read, the King III document.

In as much as there was a general consensus on the need for a governance framework that would assist in strengthening SMEs’ performance and growth prospects and curb failures, the willingness and ambition of SME owners to have a well-run and governed company was seen as key to improving the current situation at SMEs. For example, a comment on this matter was noted as below in support of this view:

> “...*Yes, no recommendation from the King commission is going to make you behave in a different way, you behave that way because it is important for your business.”* [CEO of Company F]

5.2.2 Board of directors in SMEs

Table 5.4 shows the results regarding the presence of a board of directors (BoD) and their constitution in these SMEs. Five (45 percent) respondents felt that the BoD or similar structure was necessary in a small business as it brought accountability, led the business via a formal structure and was vital for strategic direction of that business.

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Table 5-4: Status of the Board of Directors and its composition in SMEs

Elements (variables) of King III	**Number of SMEs compliant with the element**	**%**	**Benefits / value from this process (per SMEs)**	**Challenges in implementing this element**
Board of Directors				
Have the BOD in place, or equivalent structure	5	45%	Brings accountability, formalisation, strategic direction	Size and structure of SME, time resource
NEDs involved in the governance structure	2	18%	Guidance, objective eyes and formalisation	Time and value add from such element not convincing to SME owners

The trend noted from all interviews was that, depending on the number of shareholders or members in the entity, there was an equivalent structure accountable for governance and direction with the members of that structure meeting on a regular basis to take decisions and account for the progress and challenges in the business. The board of directors was present where there was a minimum of three shareholders, in as much that very few had non-executive directors (NEDs) in their board.

Regarding the constitution of the BoD, the majority felt that for an SME, shareholders constituted as the BoD would be sufficient considering the time and costs required for the BoD as a governance structure. The general feeling was that the SME would need to be stable enough to warrant a NED in its board. The majority felt that relevant experience in the SME's business was necessary if the NED is to add any value to the business growth and performance improvement. This is viewed as the benefit for having this King III element.

"*I think in a SME if you were to have a NED...should have some kind of SME background. You wouldn't want to have the CEO of MTN and the CEO of Vodacom on your board, as these people aren't from the SME sector. ...so you will need people* ***that have been around for three or more years that understand SMEs*** *(emphasis added)...You don't want someone that's three months into their business to be on your board but one who will say: I have been in business for five years and this is the area where I can add value with my input.*" [MD of Company C]

Four interviewees felt that the BoD and presence of NEDs brought accountability, fairness and a consultative spirit in the SME decision-making. However, it was generally acknowledged that since most SME owners might be the sole shareholder and manager

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at the same time, they might not need to be accountable to outsiders. Collaboration and having an objective view of the business was seen as important. Examples where these were mentioned are presented below.

*"...it gives **accountability**, it gives **fairness**, it enhances the fiduciary duty of directors and managers... the sole purpose of the board of directors is to **pull ideas together**, there is no conglomerate that was built by one person, I am yet to see that..."* [CEO of Company A]

"*The challenge is that the small businesses… owner-managed. In that, because of the size of the company…if it is owner-managed, there is not a need for accountability because the manager is the shareholder. The managers are accountable to themselves*." [MD of Company B]

Despite the above concerns being expressed, consideration was given by the majority of interviewees to the need for NEDs.

"*One of the biggest things I think would be the value add is accountability...we are a family-owned business running things ourselves, we don't really hold each other accountable for the mistakes and the decisions we make whereas with a board you will be held accountable someone...your risk taking...would be more of a calculated risk*." [MD of Company E]

"*The non-executive director is definitely there to give us strategic direction, help the company because of their knowledge of other companies.*" [CEO of Company I]

*"...if you do not have the **discipline** (*emphasis added*) of having actual board meetings, all that the board of directors is, are a bunch of names at the bottom of the letterhead...*" [CEO of Company F]

Most interviewees felt that, with regard to remuneration, serving on the SME BoD should be voluntary and no board fees be remunerated as noted in one of the quotes with this viewpoint. Only two felt that remuneration should be part of the deal on the grounds that no value would be realised to SMEs if the work was voluntary.

"*It should definitely be voluntary because the minute you start introducing a package into something then you introduce corruption into it by default.*" [MD of Company C]

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"*...Well, you can't put cost to human capital, especially if human capital contributes in a positive way in the company's growth and success. Be that as it may... to me it's not a costly exercise, it's a mandatory exercise actually.*" [CEO of Company A]

"*If they don't charge for their time, I don't think they will apply their time well on the business*." [CEO of Company F]

5.2.3 Ethical leadership and corporate citizenship

With regard to ethics, ethical leadership and managing conflicts of interest in the business, there was a general consensus that an ethical culture was key to the sustainability and growth of SMEs. The state of ethical leadership and corporate citizenship in SMEs is laid out in Table 5.5 and the results of further analysis are presented below the table.

Table 5-5: Ethical leadership and corporate citizenship in SMEs

Elements (variables) of King III	**# of SMEs compliant with the element**	**%**	**Benefits/ value from this process (per SMEs)**	**Challenges in implementing this element**
Ethical leadership and corporate citizenship				
Formalised and written policies, frameworks, practices and code of conduct in place	4	36%	Brings discipline, integrity and order. Contributes to business continuity	Size, time and resources to develop the policies to be in writing
Experienced ethical dilemmas in the business	9	82%	None	Attitude of personnel, lack of ethics and honesty

Most SMEs did not have their ethics policies, practices and frameworks in writing, including the code, with just 36 percent having one in place. The majority SMEs in the study had experienced ethical challenges with staff integrity issues due to negative attitudes, lack of ethics and integrity. There was a general view that ethical challenges were an integral part of doing business and SME owners needed to have a strong ethical moral code to guide them in the grey and ambiguous areas encountered by their businesses.

"*...if you are in business and you do not believe your ethics can be challenged, well then you are not in business*." [CEO Company F]

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All interviewees felt that the morals and ethics of business owners or leaders were the benchmark for all in the company to follow. This view is in line with the requirements of King III regarding ethical leadership in the company. There was general consensus that directors and managers had a stewardship responsibility to the company for it to grow and be sustainable.

It was noted that the agency costs problem was present in all SMEs. The incidents indicating agency problems occurred mainly from lower-level staff, other than between shareholders, members and managers. There was only one SME in which an agency problem had occurred at senior management team level where the manager had a conflict of interest, resulting in costly decisions for the SME.

> "*I found him to be stealing quite a bit, yes more or less, over three or four hundred thousand rand...that really put us back. Yes, but I think when people start a business with the wrong ideas and the wrong goals then it is a big problem, you know. My dad always tells me, he says when you are pushing the trolley up the hill both of you should get behind. And when it is going down, one should take control but it should be a mutual agreement...I don't think he was helping push the trolley. He was already taking the wheels off.*" [MD of Company E]

As much as there was a general view that decisions and actions are made in a responsible, accountable manner and with due regard to the country's economic interests, the ethical standards to drive these values were generally not articulated in the form of a code of conduct document. With the ethical dilemmas widely experienced, the results show that the absence of a code of conduct to curb negative ethics risks and guide the company's ethics may have contributed to these ethical challenges not being detected timely. There was general acknowledgement that formalising the code of conduct, ethics policies and practices in writing would strengthen the ethical culture and practices in the business.

The emergent theme was that ethics and ethical culture are critical to business continuity and credibility. Ethical challenges were experienced and dealt with verbally or otherwise and reliance was placed on the moral code of the group rather than written policies. There was a need to have ethical policies and procedures, including the code of conduct, formalised in writing in SMEs.

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5.2.4 Compliance with regulatory statutes and codes

Results regarding the state of compliance with laws, codes and standards as per the interviews conducted are presented in Table 5.6.

Table 5-6: State of compliance with laws, codes and standards in SMEs

Elements (variables) of King III	# of SMEs compliant with the element	%	Benefits / value from this process (per SMEs)	Challenges in implementing this element
Compliance with laws, rules, codes and standards	11	100%	Financial sustainability, credibility	Burdensome red-tape and bureaucracy

There was agreement that compliance with laws and regulatory standards is important for survival of business as regulatory authorities can penalise lack of compliance, resulting in business shutdown. There was, however, consensus amongst SME owners that applicable laws to comply with were complex and not easily understandable; as a result they relied on accountants and lawyers to advise on compliance status. Laws requiring compliance were a burdensome matter of "red-tape" seen as hindering company growth, as per the example presented below.

*"I think one of the major challenges that we face as SMEs is...**compliance is very expensive** (emphasis added) so you need that backing partner...help you be compliant.*" [MD of Company C]

5.2.5 Internal audit, external audit and the Audit Committee

The state of Audit Committees, the use of external auditing or internal audit service in SMEs is laid out in Table 5.7 and the commentary thereon presented below.

The results as per Table 5.7 showed that no SME had used the services of an internal auditor and only three used the services of an external auditor, the majority of which were due to association with a large corporate (shareholder) that was audited, or by a directors' decision to have an audit review for credibility purposes. The general view as per the results was that external audit brings credibility and independence to the financial reporting and checking of internal controls in a business. Two of three that used external audit indicated that only an independent review, not full statutory audit, had been used which was a new benefit to SMEs brought about by the Companies Act of 2008.

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Table 5-7: State of Audit Committees and Use of Internal Audit in SMEs

Elements (variables) of King III	**# of SMEs compliant with the element**	**%**	**Benefits/value from this process (per SMEs)**	**Challenges in implementing this element**
Audit Committees				
External audit services in use	3	27%	Compliant with stakeholder requirements, credibility to the AFS	No value add in relation to size and structure of many SMEs
Have the audit committee in place	-	0%	None	No value item to SME, due to size, time and structure
Internal audit				
Have used/ currently using the Internal Audit service	-	0%	No value or benefit due to size	Size and structure of SME did not warrant
Considering using internal audit service in the future	4	36%	When grows bigger, turnover above R1 billion: independent and objective view of business	Some with accounting background fulfilled IA role

There was consensus among all SME owners interviewed that having an Audit Committee (AC) and using the internal audit service was of no value to a start-up business. The view was changed when an SME grew to have many branches and a high turnover of above R1 billion.

"*Full external audit is done due to day- to-day operations. No AC in place. Reason is King III is* ***practically not feasible with AC. There is no value*** (emphasis added), *not for small business especially if you already have the board in place.*" [CEO of Company I]

"*External audit...I don't see any other benefits. It is just to give credibility for financial statements*." [MD of Company B]

"*It is for complete anonymity. The problem with someone in-house doing your books is that it opens the door for bias... Need somebody completely independent. As you will find yourself in a position where you have to explain to a stranger any discrepancies that may have arisen. When you introduce a lot of factors, which are not personally related to your business, I believe you are actually helping your business to grow because you are giving it that respect.*" [MD Company C]

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With regard to internal audit, there was a generally shared view and feeling that this was not appropriate for an SME. The role played by internal audit per King III was being performed by financial managers with accounting experience in some SMEs and by strong internal controls. There were, however, differing views regarding the possibility of using this service in future. Eight respondents felt it would be necessary to use internal auditing in the future when the company grew bigger than it was at the time of this study. The consensus feeling was that an AC was not necessary; even in the future, especially if there was already a BoD in place.

> "...*an internal audit for a business of this size, never*." [MD of Company H]

> "*Never. In the future, no. I mean at some level I suppose I fulfil the internal audit function for our businesses, I used to be an accountant...so when we set up processes and any business, we make sure that we set up processes that are transparent and open to us to have a look-see. We build strong internal controls and then we rely on those*." [CEO of Company G]
> "*Being that I'm an accountant myself...so we do from time to time look at our own internal controls but your proper internal audit as prescribed by King, not at all... Well even in the SMEs that I am involved in, I have seen that kind of service*." [CEO of Company I]

With regard to the possibility of using internal audit (IA) in the future, most see the value of IA service as strengthening internal controls when they grow their businesses.

> "*God willing, if the company grows much bigger then I would like to have someone come outside, you know who, does not know all the nitty-gritty and who is not emotionally attached to the business. Put it that way*." [MD of Company E]

> *"I am trying to take it a step further where the business runs itself and I don't have to be in the office the whole day working on a client's project. I am looking to engage an internal auditor in future to check what's going on in my business and to sign that off, and say this is legit and this is what happened in 2013. If money goes missing, the internal auditor must be able to say, Ok there is something going wrong here. An internal auditor is not just there to say corruption, corruption, fraud, fraud, but they are also there to grow your business and say this is where you need to start looking because there is something going wrong here*." [MD of Company C].

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"I mean you need to know what you are up against...for you to move forward. I would think...you need to be knowledgeable of where you really come from, what you have...so audits I think are quite critical and they need to be done regularly." [MD Company K].

The emergent theme regarding the use of audit committee, and internal auditing versus external auditing, is not in line with the recommendations of King III due to reasons of practicality related to size, structure and the value to be attained from such processes, with the latter being seen as non-existent. Independent reviews as opposed to full statutory audits had been used by two SMEs. The services of an internal audit would be necessary in future when the company was growing in size, structure (number of locations) and annual turnover. Currently, three SMEs internally fulfilled the role of reviewing internal controls due to their experience and qualifications from past careers.

5.2.6 Risk management and IT governance in SMEs

The results on the state of risk and IT governance are laid out in Table 5.8. All SME owners interviewed agreed that risk governance was key to business growth and continuity, important for competitive edge and profiling and targeting the right opportunities for the business.

Table 5-8: State of Risk and IT governance in SMEs

Elements (variables) of King III	**# of SMEs compliant with the element**	**%**	**Benefits / value from this process (per SMEs)**	**Challenges in implementing this element**
Risk governance				
Risk assessment and management (governance) formalised in writing	1	9%	Focus and direction, formalisation and continuity	Staff capacity and time, not given consideration to
View risk governance as key to sustainability/continuity	9	82%	Key for opportunity analysis, continuity and risk profiling	Resources to perform one
IT governance				
IT governance structure in place	4	36%	Accountability, continuity, key to competitiveness, formalization	Size and time resources to put in place
Policies, procedures and framework in place	5	45%	ICT integrity, continuity, competitiveness in information age	Size of entity and time to develop such policies

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The results from these interviewed showed that risk and IT governance was at the top of SME owners' agendas and a few had formalised the risk and IT governance issues in written policies and had governance structures in place. There was consensus on the need for most SMEs to undertake risk analysis, management and for IT governance policies and framework to be formalised despite the size or structure of an SME.

With regard to risk governance, the following came out in many interviews, as in the comments below.

"...*we want to monitor risk on a daily basis because... anything can happen... because something must not catch you off guard... will be encompassed into your monthly reports...we will have a consistent risk profile is when we get a risk analysis guy... who will do risk management as a position and then we will have proper risk analysis and proper risk profiling that we can file and always monitor."* [CEO Company A]

"*You think of risks and things all the time, and that's why King requires a formal process, so it's the extent of formality... actually when having four board meetings and business planning processes, we say what are the risks to this business, what do we do to mitigate them? What are the plans of this business? And it goes back to the discipline of having a board meeting in saying every year..."* [CEO of Company G]

Regarding IT governance, the consensus was that it added value to the business; only time resources were viewed as being a challenge to full implementation.

"...one of the sub-committees that we have is an IT oversight committee, because a lot of our businesses have IT as their core skill...a ***specific oversight role is assigned to a director*** (emphasis added)*...so that director could recommend an independent review on certain things. "Well they do add value but it's the* ***scarcity of time and the resources that curtail*** (emphasis added) *most SMEs from doing them."* [CEO of Company F]

5.2.7 Stakeholder management

The results regarding the state of stakeholder management are laid out in Table 5.9. All interviewees agreed that stakeholder management in a balanced manner is key to business sustainability and nurturing business relationships. There was consensus regarding the challenge of moving away from the view of shareholders as key stakeholders to a balanced view of all stakeholders as a coherent whole as per King III.

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The challenges of the lack of right attitudes and ethics of people in the industry were cited by all owners and managers as threats to balanced stakeholder management. The results on the state of stakeholder management are laid out in Table 5.9.

Table 5-9: Stakeholder management in SMEs

Elements (variables) of King III	**# of SMEs compliant with the element**	**%**	**Benefits/value from this process (per SMEs)**	**Challenges in implementing this element**
Stakeholder relationship management				
Key stakeholders identification clear	8	73%	Business relationship and continuity	View shareholders as key stakeholders; cannot satisfy everyone's attitude/view of owner/managers
Understanding rationale for balanced attention	9	82%	Sustainability	Ethics of people in the industry were cited as a challenge across

The following comment is typical of the views of the respondents:

> *"Stakeholder management is critical because you need to be very good in the balancing act, so something that is vitally important to the side of the business, if you ruin those relationships the business suffers.*" [CEO of Company A]

The emergent theme with regard to stakeholder management is that it is key to business relationships and business continuity.

5.2.8 Annual and integrated reporting within the SMEs

Regarding annual reporting of financial performance and position by SMEs, all SMEs saw preparation of financial statements as a key feature in embracing accountability, continuity and compliance with regulatory laws. Keeping credible records was viewed as bringing fairness and transparency to the SMEs' stakeholders and building a positive business image.

The overall theme in regard to annual reporting was that only the full set of financial statements, including the disclosure notes with a limited commentary on performance, was presented. No extensive annual reports with directors, CEOs and statements of

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compliance with CG were being prepared as most felt it did not necessarily add value to the SME business and it was costly to produce such an annual report. The preparation of financial statements was mostly outsourced to external accountants owing to the complexities of accounting standards and reporting frameworks.

In addition, there was agreement between all interviewees that integrated reporting was not relevant to SMEs, as most had no external shareholders. Therefore there was no need for them to prepare an integrated report with the contents required to be included in that report as listed by King III, as SMEs reported to internal shareholders.

"*No, I cannot see us ever doing that to be honest. If we get big enough that we are attracting the public interest, sure, but it's not something I would see us do.*" [CEO of Company G]

The results on the state of integrated reporting are shown in Table 5.10 together with the summary of emergent themes from this King III element.

Table 5-10: State of Annual and Integrated Reporting by SMEs

Elements (variables) of King III	**# of SMEs compliant with the element**	**%**	**Benefits/value from this process (per SMEs)**	**Challenges in implementing this element**
Integrated reporting and disclosures				
Preparing a full set of AFS	11	100%	Accountability, continuity, compliance with regulatory authorities like SARS	82% outsourced due to lack of skill and accounting framework understanding
Preparing an annual report	1	9%	Accountability (good governance)	Cost vs. benefit consideration, viewed as red tape item
Preparing an integrated report/ disclosures	-	0%	No value	Size and structure, no value to business

The results from face-to-face interviews confirmed that record keeping and preparing financial statements was important in case when the SMEs need to apply for funding. However, 90 percentage of the SMEs indicated that financiers were not honest and giving due support to the SMEs; as no matter how perfect records were, the banks will grant funding to these businesses. Most SMEs indicated that they have had to apply for

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business related finance in their personal capacity, due to banks having stringent non-transparent requirements which go beyond the required record keeping.

The emergent theme is that financial reporting is necessary for accountability, record keeping and compliance whereas the compilation of annual and integrated reports added no value to businesses of the SME size and structure.

5.2.9 Corporate governance code for SMEs

The overall results and theme was that there was a need to have a simplified version of the CG code that would be easy to understand and apply in the context of businesses of SME size, structure and growth level. There was a consensus that the principles of King III were relevant with a few elements being impractical for the SMEs, and that adoption of CG principles would improve the SMEs' performance and ensure accountability and continuity.

There was consensus that understanding and awareness of CG was not at the required level considering its importance in entrenching an ethical business environment and reducing business failures. There was also agreement that emphasis on the importance of CG and King should form part of the business registration process, that is, an entrepreneur registering a company should be required to produce evidence or be required to attend some training or workshop on King III. A governance-reporting tool in the form of a checklist was considered to be an effective and easy instrument that would make it easy to implement the CG principles in King III. There was further consensus that SMEs were challenged in regard to time and resources which hindered them from adopting complex codes and standards. Examples of comments regarding a simplified code of CG are presented below.

> "*Most stakeholders you have in any business, the more King III becomes valuable and it should be enforced. For SMEs, I think...it is too onerous, if there is a level of governance that you know investors or financial institutions would look at in terms of going into the business then I think there should be an SME governance standard and it should consider things like what if you are a sole director? It's your business, how then do you handle four board meetings a year? I think it actually comes down; the whole King III is about ethical responsibility and how you operate in that, and... Again education. ...if there was an SME standard which was doable, people I believe would do it. But when there is a huge document with all these requirements, I don't think they*

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even look at doing any of them because they think: Well, I am going to be non-compliant anyway..." [CEO of Company H]

"*The King expects reporting of the highest quality, when I run a business I must think of people, employees, I must think of making certain unsavoury decisions.*" [CEO of Company A]

"...helping by training, you know, seminars, webinars. That kind of thing, I think definitely will add value to the interpretation and to assisting small business to achieving what they should. Because, let's take it, most of the SMEs or the local businesses, entrepreneurs, that is, the owner does not necessarily understand the processes that we discussing here. He...is only entrepreneur that he can start up a business. He doesn't understand all the processes." [CEO of Company I]

Regarding the coordination necessary for developing such a code, there was concern that getting comments and agreement on the appropriate content would be difficult as SMEs were widespread in all sectors and difficult to assemble in one place.

"*I think it would be good to have a code, I think the practical reality of that would be very difficult because when you talk to big business, you have BUSA, and you got the black business council, people you get engaged with, there is no SME business forum of any real significance.*" [CEO Company F]

However, a CG expert involved in the setting of King III felt t there was no need for another or separate code of CG apart from the King III; since it is already allowing an either "apply or explain" approach. The emergent theme from the expert interview was that SMEs lacked understanding of the King III and confused governance with compliance. Another noted theme was that governance is a performance enhancement tool; and that SMEs need to have a clear methodology, process to run governance and right people in place to implement effective enterprise governance for business success. The expert view, though, was in line with general consensus amongst the SME owners that there was value in implementing and reporting as per King III. This said value was felt will result in SMEs understanding the return on investments, strengthened business operational procedures resulting in sustainable growth.

"*What they don't understand is that King III it has a line in it that says, the directors must apply their minds when applying King III. So it's an apply or explain model, so therefore anyone in the small to medium business space that says King III does not*

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apply to us, frankly does not understand King III. And they do not understand that ... good governance is a key driver for performance and we see governance ...as a performance enhancement tool." [Expert]

"I think most people think governance equals compliance instead of governance equalling performance... Because there's no active education about good governance in the market place." [Expert]

"...*is about performance enhancement, governance is about ensuring effective strategy, it's about performance managing the executives*." [Expert]

"*First of all, I don't think by in large SME's implement governance at all, so the commentary regarding King III is erroneous in that they are not even trying to implement nor understand King III... Because if they are not completing their annual report they are not thinking about how to communicate with their shareholder about return on investment*." [Expert]

"...my view as the chief executive of that business is, the issue is not King III nor is the issue having a King III for SME's. It's just going to over complicate the matter even further and create more space for debate... But until there is mass understanding of basic governance principles, independent directors, regular board meetings, formalized processes, evaluation of directors, board calendar, these things, No...By which I mean its implementation and its education, by having another framework that still will not get it implemented. Because it does not matter, whether King III is called King 4 or King 5 for SMEs." [Expert]

With regard to NEDs in SMEs; the expert felt that the challenge faced by SMEs owners was an emotional attachment to their businesses to an extent that they fail to implement independent NEDs in their governance processes, which leads to business failures as they are not accountable to anyone else.

"*The biggest challenge for SME in governance is the emotional challenge of shifting from being your own boss, being accountable to themselves, to stepping out of that and being responsible and reporting to independent directors*." [Expert]

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Regarding the content and elements needed to form part of a simplified code of CG for SMEs, Table 5.11 provides an overview of suggestions from the interviewees.

Table 5-11: Suggested elements of the CG code for SMEs

#	Suggested elements of the CG code for SMEs	# Suggested	%
1	Compliance with laws and regulations	11	100%
2	IT governance	11	100%
3	Record-keeping and financial reporting	11	100%
4	Risk management and governance	10	91%
5	Business strategy	9	82%
6	Board of directors or members with access to external advisor	8	73%
7	Ethical code of conduct in and amongst SMEs	7	64%

5.3 Summary of emergent themes from the interview results

Table 5.12 provides an overall summary of emergent themes from both the interviews with SME owners and managers and the expert with regard to the King III CG principles and elements applied by SMEs. The emergent themes from all owners' and managers' interviews showed that, although not all SMEs were fully implementing King IIII, there were practices adopted or being applied as equivalent governance measures. These practices might form the basis to move closer to full implementation of King III and CG principles should they be scaled up by the SMEs.

Table 5-12: Summary of emergent themes

CG element	Key themes
Board of directors and NEDs in the SMEs	• Having a board of directors/members was viewed as adding formal structure, which brings accountability and strategic direction in terms of advice to the business. • The number of shareholders/members determined the level of formality and the extent of having standard written procedures and policies in place. • NEDs only relevant when the SME grows beyond start-up and having turnover close to R1 billion, due to cost vs. value add and time involved. • Differing views were noted regarding NEDs' remuneration; most believed NEDs should serve on the SME board on a pro-bono basis whereas a few believed pro-bono NEDs would be reluctant to add any significant value to the business under such an arrangement. Costs of remuneration vs. the size and growth phase were the major concern in this regard. • Instead of NEDs- most SMEs used or viewed an external advisor valuable in providing objective view of where the business is and constructively critic the strategy.

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CG Element	Key themes
Ethical leadership and culture in the SMEs	• Ethics was at a low level amongst the SMEs' business-to-business dealings. • Ethical leadership and practices were key to business sustainability/ continuity. • All shareholders and managers were aware of the importance of having policies and procedures dealing with ethics and conflict of interests, except that due to time and staff capacity challenges there were none in writing. • Group morals and ethics were relied upon to guide staff.
Compliance with regulatory statutes and applicable codes	• Compliance, especially with regulatory authorities, assists in financial sustainability. • The regulatory environment is not pro-SMEs; too much red tape and inefficiencies that hinder SME growth from the compliance perspective.
Risk management and governance	• Risk governance brings focus, accountability and identification of appropriate opportunities. • It is key to business success. • Staff capacity and size of the SME prevented having risk identification, assessment and management in writing.
IT governance	• IT strategy is key for business competitive edge in the information age. • It brings IT integrity, accountability and sustainability. • Only limited backups are made offsite for entities that are dependent on IT for operations.
Internal audit	• The size, structure and strength of internal controls do not necessitate the need for an IA. • Review of internal controls, financial management and risk management was done internally by those who had been accountants in the past.
Audit Committee and external auditing	• There was no need for an AC in SMEs, especially if a BoD in was in place. • No value was derived from external audit except for compliance purposes.
Stakeholder management	• Stakeholder management was key to business relationships and business continuity
Integrated reporting	• Presence of outside shareholders and size of SME is a key factor on level of reporting undertaken.
Need for simplified code of CG for the SMEs	• A simplified and easy-to-understand version of CG code is necessary. • Education and awareness about the King Codes is necessary for all SMEs and should be done at registration of the business. • All other elements of King III are necessary in principle, except that NEDs, AC, Internal Audit and Integrated Reporting do not add value or assist in the growth of SMEs.

5.4 Conclusion

In this chapter the findings of the in-depth qualitative interviews were presented and discussed. The results of the in-depth face-to-face interviews conducted will be discussed in detail in Chapter 6 to answer research questions per Chapter 3.

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6 Discussion of results

6.1 Introduction

This chapter is laid out as per the research questions in Chapter 3 of this study. The preceding chapter presented the outcome of the results from qualitative, face-to-face in-depth interviews with 11 SME owners and one CG expert specialising in CG of SMEs. This chapter will analyse and interpret results as per Chapter 5, in light of the research objectives and the literature review in Chapters 1 and 2, presenting insights and conclusions as to whether the research questions were answered or not.

6.2 Discussion of results by research question

6.2.1 Research question 1: Implementation of King III by SMEs

To what extent were the nine elements of the King III Report and Code of Corporate Governance implemented by SME businesses in South Africa?

Outcomes relating to this question are shown in Table 5.3 to Table 5.10. Table 5.2 showed that three SMEs had implemented the CG principles in King III, whilst eight had equivalent practices and measures in place to address their governance requirements, although these were mainly not in written format. Surprisingly, seven of the respondents were conversant with King III and its recommendations despite the fact that only three entities actually implemented the code. This was contrary to findings by Wellalage & Locke (2011) that most SME owners do not have an understanding of the codes. The results of the extent to which the nine elements of King III are implemented are analysed below.

Board of directors

With regard to whether SMEs had board of directors in place and what role and value they viewed was attributable to SMEs having such structures in place, the research outcomes are shown in Table 5.4 in Chapter 5. The data showed that five SMEs had board of directors or board of partners in place; whilst out of five only two had an NED on the board. Data from most respondents showed that remuneration for NEDs was key for NEDs to add value to a business; however there was consensus that this should be based on experience, time spent and value added to SMEs. This is in line with literature findings in Bowes (2013); Collewaert (2012) and Huse (2007).

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Literature indicated that, from a resource based perspective, outside directors add legitimacy of that SME in the business community, assist the entity achieve competitive advantage through networking activities and all these can be exploited at a low cost (Huse, 2007). Also, from the agency perspective, they bring more independence and their involvement in strategy setting contributes to internal value creation through innovation (Huse, 2007).

The theme was that having a BoD gives SMEs a formal structure, brings about sustainability and accountability to life in the decision-making process. These results were similar to the findings by Wirtz (2011).

Considering the results in Table 5.4 showing that only two of the SMEs had an NED (outside director) citing time and value for money; the apparent emotional attachment of loosening control to be able to account to independent directors was a challenge for the SMEs. This emotional attachment was inhibiting proper implementation of effective CG practices in the SMEs as CG is about supervising and holding management accountable; it also concerns separating the respective roles of shareholders as owners and the managers (Abor & Adjasi, 2007). The issue of emotional attachment to business brings a new light on the challenges of SMEs having NEDs on their boards and it was not noted in the studies conducted in South Africa by Le Roux (2010). This challenge is a concern as noted by the expert on SME CG quoted below.

> "*The biggest challenge for SME in governance is the emotional challenge of shifting from being your own boss, being accountable to yourselves, to stepping out of that and being responsible and reporting to independent directors*." [Expert]

Ethical leadership and corporate citizenship

The results of the state of ethical leadership, corporate citizenship and whether ethical dilemmas are experienced in the SMEs in light of the propositions of the agency theory are shown in Table 5.5. The question on this King element sought to establish the practices adopted by the SMEs to ensure ethical leadership and culture is entrenched and how they dealt with ethical challenges from their daily business operations.

The results in Table 5.5 show that as much as there was awareness of ethics importance in business; only four SMEs had formalised in writing the policies, practices and the code of conduct as recommended by King III (IoDSA,2009b). Nine SMEs had experienced ethical challenges mainly from conflict of interests with junior employees and one amongst the nine at management level. The lack of ethics, honesty and attitude of personnel was a

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general concern amongst the SMEs. The SMEs relied on the group or person morals to guide employees from the example demonstrated by the SMEs managers or leaders code; where the policies and procedures on ethics were not in writing. This was in line with literature (Oates &Dalmau, 2013).

Formalising ethical practices and measures in writing was generally viewed as important in bringing discipline, integrity and order whilst it contributed to business continuity; despite that size, time and resources of the SMEs prevented them from having ethics measures including the code of conduct to be in writing. These results showed that SMEs were not conforming to the recommendations of the literature reviewed which stated that code of conduct should be formalised in writing (IoDSA, 2009a; Oates & Dalmau, 2013).

The ethical challenges experienced by nine SMEs, indicated that conflict of interests existed between owners and employees in general; whereas there were few cases where managers were involved in dealings that did not promote shareholder value thereby impeding the SME growth. These results confirmed the existence of the agency problem that was identified by the studies performed in the SMEs somewhere else (Collewaert, 2012; Parsa et al., 2007; Rachagan & Satkunasingam, 2009; and Wellalage & Locke, 2011). Results showing presence of agency problems noted in SMEs differed from those in Heenetigala et al. (2011) which found that agency theory was irrelevant to the SMEs as no agency problems existed due to duality of shareholder and management roles in one person.

Audit committee and external auditing

The study question for the results in this section was whether the SMEs were externally audited and whether they had an AC in place. The study results for the state of SMEs with AC subcommittees and use of external audit services are shown in Table 5.7. The results from Table 5.7 showed that none of the SMEs had an AC in place. This was as a result of costs associated with such committee out weighing the benefits associated with such structure in place. This was in line with the conclusion of the desktop research by Le Roux (2010). There were only three SMEs that had made use of external audit; while two of the three used independent review as per the new Companies Act. Use of independent review instead of statutory audit was a benefit to SMEs, resulting in cost saving in line with Vandiar (2012) findings.

Literature stated that the AC is a voluntary structure for unlisted entities (IoDSA, 2009b) and that there is a point in the SME growth when it would need to set up subcommittees to assist in delegating some of the board's responsibilities, such as the AC (Jones &

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Tilley, 2003 as cited in Le Roux, 2010). The theme and conclusion regarding the AC in SMEs was that it adds no value and it is a useless structure to have in place, especially when there is a board of directors in place.

Internal audit

The question asked sought to establish if SMEs were using the services of an internal audit, whether they considered doing so in the future and what value was viewed to be derived from using such service. Data in Table 5.7 showed that no SME had or was using the services of an internal audit. Only four were considering using such services in the future. However, results showed that most SMEs will use an IA as they grow beyond R1 billion annual turnover and have many branches; because it brings objective views of business and strengthens the internal control environment. These results were similar to a conclusion made by Le Roux (2010) in that the smaller SMEs obtain no value from having an internal audit and it is only applicable to larger SMEs. These results differ from the recommendations of King III that organisational dynamics and regulatory environment require companies to establish effective an internal audit function (IoDSA, 2009b).

Two key themes emerged from the interviews as reasons why IA services had not been used as shown in Table 5.7. The two key themes were that size and structure of SMEs did not necessitate the need for an IA service. Secondly, formal qualifications and experience of managers with accounting background assisted SMEs in that these managers fulfilled the role of designing and testing effectiveness of internal controls; hence no need for such service as no value will accrue to an SME.

Risk governance

Research results for state of risk governance in SMEs are shown in Table 5.8. The question on risk governance sought to establish whether SMEs had risk governance structures within their boards, whether there were risk management policies and frameworks in place and determine what challenges were faced by SMEs to have effective risk governance. The results showed only one SME had risk governance processes formalised in writing. Nevertheless, the consensus was that risk governance is key to business management but they still did not formalise it in writing. The consensus was that risk governance causes the entity to focus, is a tool for risk profiling and opportunity screening and assists with business continuity.

The theme from the results discussed above; support the literature which states that if risks can be anticipated they can be better managed, and that appropriate risk management is key to the success and growth of an enterprise (Gilbert & Eyring, 2010;

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and Le Roux, 2010). Considering the above results, it is recommended that SMEs formalise their risk governance processes and structures as they are all aware of the importance of having this practice in place; as shown in the example below.

> "...*we want to monitor risk on a daily basis because, ..., anything can happen... because something must not catch you off guard... will be encompassed into your monthly reports...we will have a consistent risk profile is when we get a risk analysis guy... who will do risk management as a position and then we will have proper risk analysis and proper risk profiling that we can file and always monitor."* [CEO Company A]

IT governance

To establish the state of IT governance in SMEs, a question was asked regarding the processes (including presence of IT policies, disaster recoveries and business continuity plans) they have in place and the presence of IT governance committees. The results to the question asked are shown in Table 5.8; which shows that 36 percent of the SMEs had IT governance structure in place while 45 percent had written IT policies, procedures and IT framework.

The themes from these results were that formalising IT governance ensures accountability and continuity, ICT integrity and is critical for competitiveness in this information era. These results were similar to the findings of a study by Le Roux (2010) and the literature discussed in Chapter 2 on IT governance. The literature stated that IT has to be at the core of CG since most business is done via IT platforms and that tapping into IT could provide abundant opportunities for growth necessary for SMEs to achieve sustainable growth (IoDSA, 2009b; and Nyakudya, 2013).

Stakeholder management

The results for the state of stakeholder management in the SMEs are shown in Table 5.9. The results show that the majority (eight) of the SMEs had identified their stakeholders and nine had a good understanding of giving balanced attention to all stakeholders. The benefits viewed from giving stakeholders balanced attention was that, identifying and satisfying them was key for business relationships and business continuity. These results were in line with the recommendations of the studies on SMEs which stated that the role of all stakeholders should be well articulated in the SME business strategy (Abor & Adjasi, 2008; Le Roux, 2010; and Muth& Donaldson, 1998).

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Literature stated that outside directors who have a good market knowledge, developed personal and business networks can mediate trust and establish links between stakeholders and the business (Huse, 2007). It is recommended that SMEs incorporate stakeholder management into their normal business processes including in their business strategic plans (Abor & Adjasi, 2008).

Compliance with laws, codes and standards

The results on the state of compliance with laws, codes and standards in SMEs are shown in Table 5.6. The question on state of compliance with laws, codes and standards sought to determine whether SMEs owners and directors had the full understanding of all regulatory laws applicable to them and whether they complied with those laws.

The results in Table 5.6 show that SMEs have an understanding of key laws applicable to them and feel that they were fully compliant with those laws. These results confirm the conclusions in the study by Le Roux (2010) and the literature that stated that compliance should be an ethical imperative for governance of companies (IoDSA, 2009b). Compliance was viewed as giving credibility and financial sustainability to business. However, there was a general concern that there was too much bureaucracy and red tape inhibiting growth of the SMEs as compliance was expensive and the regulatory laws were not simple and easy to understand and apply. The same conclusions reached by the study in NZ that the regulatory environment did not encourage evolvement toward better SME governance (Wellalage & Locke, 2011).

Integrated reporting

Study results on the state of preparation of integrated reports in the SMEs are shown in Table 5.10. The question had sought to determine whether SMEs compiled integrated reports as recommended by King III. The results in Table 5.10 showed that all SMEs were preparing full sets of annual financial statements either in compliance with regulatory requirements like record keeping and financial reporting, tax compliance and ability to access finance in the future. None of the SMEs were preparing integrated reports (IR) as required by King III due to the fact that they were small in size and had no external shareholders. These results confirmed the conclusion made by Le Roux (2010) that IR was applicable to SMEs as far as they have external shareholders. King III requires that IR be integrated into annual financial reporting (IoDSA, 2009b). The SMEs were preparing only the annual financial statements and only one was found to be compiling an annual report as a result of having external shareholders.

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There was a general consensus that financial reporting resulted in accountability, compliance with regulatory requirements and sustainability. This was in line with the literature reviewed which stated that good CG practices assist SMEs improve their prospects of securing funding due to compliance with proper bookkeeping and accounting practices (Abor & Adjasi, 2007). However, nine SMEs in the study used consultants to prepare their financial statements due to complexity of the accounting standards and regulatory laws on annual reporting. This practice was similar to the finding of the study done among Australian SMEs' CG reporting (Heenetigala et al., 2011).

Conclusion on Research Question 1

In summary, King III as shown in Table 5.3 was not yet fully implemented by the SMEs. SMEs had implemented other elements except for AC, internal audit and IR that were not in place, due to the value not seen in having these elements and absence of external shareholders. It should be noted that guidance and awareness about and complexity of King itself hindered its full implementation; this was in line with study by Clarke (2006) as cited in Le Roux (2010). All SMEs agreed that the principles of King III are applicable, except that there are elements that did not make sense for SMEs to comply with.

Considering these results; it is recommended that SMEs familiarise themselves with the principles and spirit of King III in order to be able to apply or explain and still be compliant (IoDSA, 2009b). The research question 1 was therefore answered.

6.2.2 Research question 2- Impact, benefits and challenges of implementing King III

What impact has the King III Report and Code of Corporate Governance had on improving SME businesses' performance and growth? What benefits and challenges are associated with implementation of King III by SMEs?

This research question sought to understand from the views of the SME owners, if implementing CG principles in King III resulted in a positive impact on their business performance resulting in growth. It also sought to understand what other benefits were derived and challenges experienced by SMEs in implementing these CG principles in King III.

The results of benefits and challenges with implementing King III are shown in Table 5.3 – Table 5.10 and Table 5.12. These results stated that most SMEs feel implementing CG contributes to growth and ensures formality, respect, accountability and helps in

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competitive positioning of an SME. The results also showed that SMEs feel they need independent directors or outside persons for advice on effectiveness of their business strategies and for guidance. These results supports the literature which states that effective governance promotes SME's continuity, growth and is a key driver of company performance (Bradley, 2010; and Wellalage& Locke, 2011).

Literature indicated that effective CG makes entities attract external investors, helps entities prevent failures and achieve rapid growth (Abor & Adjasi, 2007; McGee, 2010; Wirtz, 2011). On all the benefits cited as per results in Chapter 5, only the expert had experienced SMEs whose bottom line improved due to effective governance whereas most SMEs felt there was likely to be improvement if CG was to be effectively applied.

> "*In the four years that we are in South Africa we guarantee that if a company invested in our governance processes, they would see an increase in bottom line profitability and an increase in value..."* [Expert]

There were challenges experienced with implementing CG principles in King III ranging from the SMEs' structural arrangements, size, presence or absence of external shareholders, lack of adequate staff and financial resources to put effective CG measures in place. Only three respondents cited that King III will dampen the spirit of innovation in the SMEs; this was not in line with studies that have proven CG does bring new innovation to SMEs (Abor & Adjasi, 2007). The skills of applying King III were not adequate to an extent that most of the SMEs viewed that having an external advisor will assist them comply; these results are in line with a study on practice and perception of King III which found that 63 percent of entities agreed that external advice enabled application of King III (Jansen van Vuuren & Schulschenk, 2013). Considering these results; it might be concluded that King III is still complex and not easily understood by the SMEs.

In summary, the following were cited by respondents as benefits in implementing King III.

- It introduces the culture of formality, respect and accountability in the business.
- It is necessary for improving strategy determination and execution.
- It is a tool for performance enhancement, growth and continuity or sustainability.
- It brings credibility to financial statements, results in quality documents that enhance chances to secure funding.

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The following were cited as challenges inhibiting full or effective implementation of CG principles in King III.

- Due to size and structure of SMEs, there are no sufficient staff, time and financial resources to afford formalising policies that will strengthen governance.
- There was not sufficient awareness, training and efforts to make SMEs understand King III as a tool to enhance performance, achieve accountability and transparency while tapping into outside independent advice from NEDs. In the absence of these initiatives, it was not easy to implement King III as it is complex.
- It appears there are no clear guidelines with regard to the level of growth and the stage of SME development; when implementation should be considered and which elements to consider as alternatives at each stage.

Conclusion on Research Question 2

Considering the results discussed above, it can be concluded that there are benefits to SMEs implementing King III in that it ensures accountability, fairness, order and formality and is seen as a key driver of growth and performance by the SME CG expert (Abor & Adjasi, 2007; and Le Roux, 2010). Where nine elements of King III were not implemented; SMEs had other equivalent practices adopted to deal with matters that King III sought to address, at a small scale although these practices were not formalised in writing. These results shows that SMEs adopt the simplest governance structures suited to their operational needs; which is in line with the literature which stated that SMEs do not benefit from complex governance systems (Henschel et al., 2010).

6.2.3 Research question 3- Ethical leadership and culture in SMEs

What processes and procedures are applied by SMEs in enforcing the ethical leadership and culture to eliminate conflicts of interests and achieve transparency, fairness and accountability?

The research question above sought to determine the extent of the presence of ethical leadership practices in SMEs; how they handle the ethical challenges and whether agency problems were experienced by SMEs. Study outcomes for this research question are shown in Table 5.5.

Table 5.5 showed that four entities had policies and a code of conduct in place, whilst nine of them had experienced ethical challenges or dilemmas. Ethical compliance was not formalised and there were no effective practices for these dilemmas. The results show that respect and integrity was lacking amongst the SMEs themselves; where managers

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were separate from owners, agency problems were experienced. Also the agency problem had been experienced in most (nine) SMEs due to staff attitude not aligned to shareholders interests. These results were in agreement with conclusions in literature which stated that agency problems do exist in the SMEs (Abor & Adjasi, 2007; Muth & Donaldson, 1998; and Wellalage & Locke, 2011) . Also data as quoted below confirmed the ethics issue.

> *"...Because currently the trend that I am picking up in the three years that I have been around is that they have a* ***selfish mentality*** (emphasis added)*... Now when people see tenders they are like let me get the most I can from this and live good and everyone else can disappear. When you do business like that, you are not showing any respect at all for yourself and for your fellow business people."* [MD of Company C]

> *"In terms of staff there is lots of unethical behaviour like theft... Your other risk factor is that you have local manufacturers that manufacture at 30 percent less than what you are doing, and* ***these very companies are unethical*** (emphasis added) *in that they run their business for three years max and then liquidate their business."* [Company F]

Currently most SMEs use employment contracts to have employees sign commitment to ethics and good conduct in writing. Only four SMEs had written policies including the code of conduct required by the King III (IoDSA,2009b). There was reliance on personal trust and morals (which included religion) to drive all in the organisation to be ethical; which could be a challenge if these practices are not enforced in writing. SMEs used preparation of statutory reports for compliance and ensuring they were transparent and accountable to their stakeholders; which included completing tax returns, financial statements and labour reports where required.

> "...*we are Muslims and everything has to be declared open and fair, so we bring that type of practise into our business in terms of being loyal to every party involved... Also, accountability in terms of everything, our books are open, our bank accounts are open and our files are open and if any party has any issue with us, they are free to come and look.*" [MD of Company F]

> "*With accountability, everything is recorded and handed over to whoever needs the account... We need to pay our VAT we pay the correct amount because we never...we always feel actually speaking if you steal the VAT man's money, you stealing*." [CEO Company E]

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Conclusion on Research Question 3

As ethics are a foundation of CG, SMEs felt CG may help them deal with ethical issues and conflicts of interests in an effective unbiased manner as was confirmed in a study in Malaysian SMEs; thereby bringing more accountability and limiting conflict of interests (Abor & Adjasi, 2007; Heenetigala et al., 2011; Henschel et al., 2010; Rachagan &Satkunasingam, 2009; and Wellalage& Locke, 2011). Considering the results discussed above, SMEs are not yet fully compliant with requirements of King III with regard to ethical leadership and corporate citizenship due to financial and staff capacity constraints to entrench ethics in their businesses. These results on personal morality reliance and businesses being unethical in dealing with each other were not covered in any literature reviewed. Positive, ethical leadership and corporate citizenship was considered by all SMEs as vital for business continuity and it is in line with literature; which states responsible ethical leadership builds sustainable businesses (IoDSA, 2009a; Oates & Dalmau, 2013).

Therefore based on the data results and literature review; it can be concluded that SMEs have unwritten practices and policies that deal with ethical issues, falling short of requirements of good corporate governance as per King III. Agency problems as per agency theory propositions; are present in the SMEs. There was not much detailed reference to fairness, and transparency was used synonymous with accountability by the respondents. These results answered research question 3 with regard to ethics and practices to ensure accountability, fairness and transparency was entrenched in SMEs.

6.2.4 Research question 4 – Simplified CG code for SMEs

What are views of the SME business sector on the need for a King code for SMEs? What should be the content of this piece of corporate governance code for SMEs?

The research question above sought to understand if SMEs' experience with King III, and to determine from the respondents' views if there was a need for a simplified code of CG for SMEs other than the general King III and what would be the content of that code, should it be deemed necessary to have one.

The results for the research question above are shown in section 5.2.9, with summary themes in Table 5.12. There was a general consensus amongst the SMEs that there is a need for a simplified version of CG code that suits the specific needs and circumstances of the SMEs. The main theme noted from the study results was that King III was complex, onerous, misunderstood and was developed with large firms in mind as opposed to SMEs. These results were similar to the ones found elsewhere which stated that CG codes were

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developed with the mind of large and listed companies (Heenetigala et al., 2011; Jansen van Vuuren & Schulschenk, 2013; Wellalage & Locke, 2011).

With regard to awareness, understanding and ease of access to training and workshops on CG principles; all respondents were concerned that CG is barely promoted amongst the SMEs as a tool to improve their operations, profitability, growth and continuity. This concern about ease to understand and implement King III was in line with recent study on perceptions and practices of King amongst RSA companies which indicated that only 47 percent implemented King through their own internal skills whereas 63 percent engaged the outside CG advisors in order to comply (Jansen van Vuuren & Schulschenk, 2013). These findings raise a question why this is the case that not many people can implement King III without outside assistance. It should be noted from study results, that understanding of King III CG principles in SMEs was not sufficient to help them tap into the benefits provided by this tool. It could be concluded therefore; that King III is not simple and easy to understand, hence the general feeling that a simplified code of CG is required for SMEs to be better in governance.

However, the view of the expert was that there is no need for another code for SMEs, because understanding of King III principles was lacking. So, if there is a gap in understanding the current code of CG, it cannot be concluded that King III is a problem until there is proper and full understanding of what King III is about. The issue of lack of understanding King III was in agreement with all SMEs owners' views and comments, except that they saw the need for an SME code of CG.

With regard to NEDs in SMEs; the expert felt that the challenge faced by SME owners is emotional attachment to their businesses to an extent that they fail to appoint independent NEDs as part of their governance processes, which leads to business failures as they are not accountable to anyone else. This (emotional attachment) brought a new factor inhibiting implementation of CG in the SMEs to the discussion; as there was no literature reviewed that dealt with this point. The research needs to be undertaken to establish to what extent do SME owners fear loss of control and as a result, not establish BoDs with independent NEDs.

> "*The biggest challenge for SME in governance is the emotional challenge of shifting from being your own boss, being accountable to themselves, to stepping out of that and being responsible and reporting to independent directors*." [Expert]

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It could be concluded, therefore from the results and literature that there is a case for a simplified version of CG code designed to suit the SME needs and challenges. This code could be a separate framework or simplification of current King to exclude items that are not relevant to SMEs in totality; other than the SMEs having to explain why they did not apply those elements found to be impracticable to this sector.

As a result of the need for a simplified code of CG for SMEs, the general view was that it should at least contain the following elements to be implemented by SMEs as part of their governance systems, as shown in Table 5.11. The consensus was that all SMEs will have to apply, at minimum, the following elements as recommended by SME owners:

- Compliance with laws and regulations,
- Have formalised IT governance systems and structures in place,
- Ensure have proper record keeping and sufficient financial reporting is in place,
- Perform risk assessment, management and governance,
- Have business strategy in writing,
- Establish a board of directors or members with at least one external advisor to ensure independence, and
- Should have code of conduct that addresses the ethical requirements for business dealing by the SMEs, employees and shareholders.

6.3 SMEs and corporate governance

The results from the interviews conducted showed that there was a general understanding of CG principles in King III amongst many SME owners, especially ones that had a corporate career before starting their entrepreneurial ventures. Owners without such prior experience, showed no or little understanding of this code.

There was a general feeling that CG principles to bring accountability, improves the SME's ability to grow and be sustainable (continuity). SMEs are willing to implement the CG principles; however their size and structure, lack of staff capacity and financial resources prevent them from enforcing many of the principles exactly as per the King III. This was the background against which there was consensus that a simplified easy to implement code of CG for the SMEs might be necessary.

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6.4 Research limitations

It is important to note the following research limitations of this study:

- The interviews were conducted with SMEs in the Johannesburg metropolitan area, and thus no inferences can be generalised across the country;
- The small sample size of SMEs interviewed, as study was exploratory qualitative in nature;
- The impact of King III on company results could not be assessed as it would have required longitudinal data; therefore only annual turnover and growth trend as provided by interviewees was used to assess if implementing King III had any effect on company performance.

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7 Conclusion

7.1 Introduction

This Chapter consolidates the outcomes of this study against the main study objectives, that is, to determine the level and extent of implementation of corporate governance (CG) principles and King III in the SME businesses. It also includes recommendations to key stakeholders and proposes research ideas for future research.

7.2 Overall summary

Good governance is increasingly being viewed as a valued feature of a well-run company; a tool for the enhancement of SME performance, growth and continuity (Bradley, 2010; Wellalage & Locke, 2011; and Rambajan, 2011). Small businesses need to have effective governance systems in place to assist with securing access to finance; as investors have become hesitant to invest in companies that do not subscribe to good governance principles (McGee, 2010). As a result, high growth SMEs would require to invest in their governance processes by developing clear governance methodology, process and procedures and have the right calibre of human capital in place; to be able to reap benefits offered by CG as a performance enhancement tool.

Review of literature as per chapter 2 indicated that CG codes written with larger companies in mind was too complex for SMEs as "one size fits all" results in less effective governance in these businesses. There were conflicting results regarding presence of agency problems in the SMEs (Heenetigala et al., 2011; and Henschel et al., 2010). The study results were largely consistent with the literature reviewed on the studies that reached consensus on the need to implement governance systems in SMEs (Abor & Adjasi, 2007; Belghitar & Khan, 2013; Hamelin, 2011; Henschel et al., 2010; Rachagan & Satkunasingam, 2009).

The aim of this study was to determine the extent CG principles in King III were implemented by SMEs, to understand the process followed by SMEs in ensuring ethical leadership and culture was in place and to determine if there was a need for a simplified code of SME governance. This was achieved by noting themes from the literature review that relates to elements of CG in the context of SMEs, with the nine elements of King III analysed. Data was collected and content analysis was used to extract key themes from data obtained during in-depth interviews with 11 SME owners and one expert on CG for SMEs. The overall results of this study indicate that King III is not fully implemented by the SMEs; however, its principles are fully applicable with the exception of three elements (audit committee, internal auditing and integrated reporting) that are not suitable for

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SMEs. Benefits of implementing CG code like King ensured accountability, professionalisation or formalisation of business and was viewed as contributing to performance and growth of the SMEs. Study results also show that emotional attachment to own business by entrepreneurs did not bear positive results in strengthening SME governance. This brought a new inhibitor of CG implementation in the SMEs; as there was no literature reviewed that dealt with this point. The research needs to be undertaken to establish to what extent do SME owners fear loss of control (emotional attachment) and as a result, do not establish board of directors with independent NEDs.

The study results were mostly aligned with literature claims of studies on SME CG regarding the need for CG in SMEs and the importance of CG elements like boards, financial reporting, internal audit, risk management and stakeholder management. However, it should be noted that these studies lacked researched data as they were desktop research including ones by Le Roux (2010) and Abor & Adjasi (2007). The same limitations were on the results from study findings on listed SMEs by Rachangan & Satkunasingam (2009), Heenetigala et al. (2011).

This study makes new contributions to the body of knowledge by presenting the status of King III implementation in the SMEs based on exploratory qualitative tests conducted. The study determined what ethical processes and practices are adopted by SME businesses to instil ethical culture and leadership and confirmed the existence of agency problems in South African SMEs. Furthermore, the significant contribution it makes is that of reporting on the context and content (elements) that should inform a simplified version of a CG code for the SMEs.

The following conclusions can be drawn from this study results:

- King III is not simple and easy to understand, hence the general feeling that a simplified code of CG is required for SMEs to improve their governance. Lack of education on governance contributes to negative understanding of the CG code.
- SMEs ethical measures and practices are not formalised; resulting in ethical issues with financial loss to these companies. The agency problem, (due misalignment between owners' and managers' or senior employees' business interests); existed in the SMEs in South Africa.
- Implementing CG practices in SMEs improves performance and contributes to growth.
- SMEs' high failure rate in South Africa may be due to failure of SMEs to effectively understand and use governance as a tool that drives performance and growth, that could result in business continuity and less failures.

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- Therefore, South Africa needs a simplified, easy to understand and implement corporate governance code or framework similar to King with only elements specifically applicable to circumstances of SMEs.
- Compliance with laws and regulations, ensuring effective IT governance, risk management and governance, having business strategy, importance of record keeping and financial reporting, having a board with access to outside advice and recommended code of ethics in and among SMEs were noted as key elements that all SMEs should have in place; to strengthen their governance processes, performance and growth.

7.3 Recommendations for SME managers and stakeholders

In terms of practical implications from this study, the following recommendations are made to all stakeholders responsible for promoting growth and development of SMEs, management and business associations:

- The DTI and other small business agencies should educate, create and strengthen awareness and understanding of corporate governance practices as a tool for performance, growth and continuity of small businesses among all SMEs registering with the CIPC;
- The DTI should consider revising the SME classification threshold set regarding turnover, number of employees and assets base at regular intervals, such as every five years, to be aligned with latest economic dynamics. This process should include introducing small businesses' development stages at which certain elements of corporate governance principles become mandatory for implementation;
- Managers and shareholders of SMEs should consider implementing all elements suggested for the simplified SME code of corporate governance and measure their performance from thereon;
- The business associations like the Institute of Directors should simplify the King Code and identify key and core elements suitable for SMEs' circumstances and position; for SMEs to apply without explaining reasons for non-adoption. This will ease the administrative burden on SMEs and make the CG code understandable; and
- CG practitioners should, in recognition of the role SMEs play in the economy (contribution to employment and GDP growth), consider extending professional support to SMEs as part of their clientele base.

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7.4 Recommendations for future research

Future research is further recommended on the emergent themes from the interviews which were not specifically explored within this study. These would include qualitative or quantitative testing around the following in assessing effectiveness of implementing King III:

- The effect of educational qualifications in assisting entrepreneurs understand and implement effective enterprise governance practices in small businesses;
- A study with focus on the impact of effective governance in enhancing SMEs' prospects to secure funding from external parties; and
- Empirical, longitudinal studies on CG impact on SMEs' performance, growth and continuity using quantitative methods or a case study research.

7.5 Concluding remarks

This study with literature review and data collected from in-depth face-to-face interviews; using a convenient sample of 11 SMEs and one SME CG expert determined the extent of King III implementation; outlined challenges and benefits experienced by SMEs from adopting such code of corporate governance and conclusions on ethics and agency problems in the SMEs. SMEs are dynamic players in most developed and developing economies, yet vulnerable during economic crises (Rowlatt, 2012). The study results confirmed that CG in SMEs brought accountability, transparency and improved performance and could be used as drive of growth. Therefore CG in SMEs should not be viewed as a compliance burden, rather as a performance enhancement tool.

It is in the best interests of many economies to continuously look at ways to promote and grow SMEs to be major players as they contribute significantly to employment creation and to the GDP growth. SME failures, should therefore not be a norm; rather an exception. CG needs to be promoted and be effectively used by SMEs, since poor governance is symptomatic to business failure (Abor & Adjasi, 2007) whereas effective good governance contributes to business performance and growth.

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APPENDIX 1: SEMI-STRUCTURED INTERVIEW GUIDE

Informed consent section

I am conducting research on the extent to which the King III Code of Corporate Governance is implemented by SMEs in South Africa.

Our interview is expected to last about an hour. The information obtained from the interview will help in understanding whether South African SMEs are implementing the King III principles and if not, what are the alternative processes currently applied to address matters covered in King III. Data collected through this interview will assist in understanding the context and content of King Code that is tailored to the business needs of SMEs that many SME business owners have suggested to the Institute of Directors in Southern Africa, the custodian of King III Report and Code.

Your participation is voluntary and you can withdraw at any time without penalty. All data will be kept confidential. Interviewee information disclosure choice in the final report:

Interviewee identity disclosure option	**Tick**
Maintain anonymity of the interviewee identity: name and details	
Free to disclose the identity of the interviewee name and details in the final report	

If you have any concerns, please contact me or my supervisor. Our details are provided below.

Researcher: Malusi Shezi
Email: sigananda@gmail.com
Phone: +27 71 886 4349

Research Supervisor: Prof Elana Swanepoel
Email: swanee1@unisa.ac.za
Phone: +27(11) 652 0212

Signature of participant: ________________________________

Date: ________________

Signature of researcher: ________________________________

Date: ________________

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Interview structure (guide)

<table>
<tr><th>Topic and Questions</th><th>Time</th></tr>
<tr><td>

1. Introduction

The purpose of this discussion is to introduce myself, give the background on research topic and its need in the South African business context and confirm the basic understanding of the interviewee and his/her company.

The outcome of this discussion is to ensure that the interviewee understands what corporate governance entails and have them understand that the interview objective is not to point out bad or good management either having or having not implemented King IIII but to obtain general understanding on the motivation to implement or not to implement this piece of governance code.

PART A

Interviewee's company business information

1. Name of the company?
2. The type of business formation or incorporation the business falls under?
3. The period the company has been in business?
4. In what economic sector/ industry is the business operating in?
5. Registration with the CIPC? In which year?
6. Interviewee's role in the business

<table>
<tr><td>Owner</td><td></td></tr>
<tr><td>Manager</td><td></td></tr>
<tr><td>Both</td><td></td></tr>
</table>

7. How many people does your business employ?

<table>
<tr><td></td><td></td></tr>
</table>

8. What is the ownership structure of the business

<table>
<tr><td>Family-owned business</td><td></td></tr>
<tr><td>Not a family-owned business</td><td></td></tr>
<tr><td>Number of shareholders / members of the business</td><td></td></tr>
</table>

9. What has been the growth trend or growth level of the business? (High growth or low growth in annual turnover?)

</td><td>**10 mins**</td></tr>
<tr><td></td><td></td></tr>
</table>

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2. Discussion of the company profile and administration The discussion on this topic is to determine the administrative practices currently in the interviewee business, level of shareholding and staff relations in the company. The outcome is to determine whether the company is likely to fully implement King III and determine currently the themes that indicate the alternative governance practice in the absence of King III in that company. **The following questions (1-4) relate to implementation of King III principles** 1. What practices has your company adopted or implemented to ensure it subscribed to principles of transparency, fairness and accountability? 2. Does your company compile annual reports including financial reporting, e.g. financial statements and formal annual reports? 3. Does the company have a board of directors or an equivalent structure that provides oversight to its strategy and performance? How many members and are these directors considered independent or not? 4. Describe the role you see being played by the board of directors in your business as an SME.	**10 mins**
3. Discussion of King III and other corporate governance principles in the context of the SME being interviewed The purpose of this discussion is to move to a level of and discuss the application of King III within the SMEs in the context of an interviewee company. The intended outcome is to establish whether the King III in its current form was easily implemented, determined the reasons and also solicited the views and evidence of challenges and benefits perceived or experienced by the interviewee's company with regard to general corporate governance and specifically King III. **Questions 5 to 14 relates to this part of the interview** 5. Describe the ethical challenges and ethics practices adopted or applied in your company and indicate the assessment of the impact these are having on your business. 6. Does your company have, or have used, or will in future consider the use of internal audit services? 7. What is the role or functions that are performed by internal audit? 8. Does your company have an audit committee or consider having one in the future?	**20 mins**

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9. What do you envision or have experienced as the value from having or not having an audit committee? 10. Describe the risk-governance process approach adopted, if any, by your company. 11. What is the value add that you see this playing in strengthening your company for growth? 12. Who do you consider as stakeholders in your company? 13. What approach and practices are followed by your company in ensuring balanced attention is achieved on stakeholder management? Is there any value add experienced from this process? 14. On financial and annual reporting, how is your company ensuring integrated reporting is performed? Has this made any impact on the reporting clarity, disclosures and financial strength of the company?	
4. Conclude – SME owner views on the need for a King code for SMEs The discussion of this topic is specifically to solicit the views of SME owners and entrepreneurs being interviewed regarding the corporate governance code for SMEs. The intended outcome is to establish whether this code should be less comprehensive or should it mirror the current King III and also obtain the proposed manner of implementation and monitoring of its progress once adopted by the SME business sector. **Questions 15-17 relate to this part of the interview** 15. In your view, how has King III served the business interests of SMEs? 16. There is a strong view and suggestion amongst entrepreneurs and SME owners that there should be a corporate governance code specific to be needs and circumstances of the SME sector. What are your views regarding this SME code of governance? 17. What elements of corporate governance code should it contain? What are the proposed elements to be included in King Code for the SMEs should one be agreed to be developed?	**15 mins**

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Expert interview questions- on the need for a King code for SMEs

The discussion of this topic is specifically to solicit the views of CG experts regarding the corporate governance code for SMEs.

The intended outcome is to establish whether this code should be less comprehensive or should it mirror the current King III and also obtain the proposed manner of implementation and monitoring of its progress once adopted by the SME business sector.

Questions are listed below

1. In your experience of dealing with SMEs: describe your views on the current corporate governance regime with regard to the SMEs. In what areas of King III has it contributed in shaping the performance of the SMEs and continuity?

2. What are your views and your experience regarding the practical implementation of King III by the SMEs?

3. There is a strong view and suggestion amongst entrepreneurs and SME owners as per IoDSA and UP survey (2013) that there should be corporate governance code specific to the needs and circumstances of the SME sector. What are your views regarding this SME code of governance? How practical will it be to develop and track its implementation as well?

4. What elements of corporate governance code should it contain/ What are the proposed elements to be included in King Code for the SMEs should one be agreed to be developed?

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APPENDIX 2: Comparison of CG practices by SMEs in selected countries

Corporate Governance Element	Country Australia	Pakistan	Malaysia	UK Alternative Investment Market CG Code
CG approach	The Australian CG Code applies to listed companies. The ASX CG Council's Recommendations are not mandatory as it is on the adopt a recommendation principle or if not "disclose or explain why not" approach to accommodate smaller companies that may have challenges in following all the Recommendations (ASX Corporate Governance Council., 2007).	The Code of CG in Pakistan is compulsory and enforceable to all companies listed on the SEC of Pakistan. It does not provide for adopt or explain approach and has nine elements (Unknown, 2012)	CG code in Malaysia (MCCG) is voluntary, except for listed companies that have to apply or explain the reasons (Anwar, 2012). The MCCG has eight principles of CG to be considered by companies in Malaysia	The UK CG code is on an "explain or apply approach, with less onerous requirements specific for small business listed on LSE –AIM index. The UK Code contains 12 essential guidelines for good CG practice by small firms in the AIM (Page, 2012)
Structure and process	-	-	-	Have the most appropriate governance methods based on company culture, size and complexity
Foundation for management and oversight/ Responsibility and accountability	Companies to establish and disclose the roles and responsibilities of the board and management. Should also disclose the process for evaluating the performance of senior executives	-	Clear functions reserved for the board and management, formalise ethical standards through the code of conduct	Outline the responsibilities for management and achievement of key and tasks; the board to have collective responsibility for long-term success of entity
Board balance and size/ Composition	Should have a board of an effective composition, size and commitment to adequately discharge its responsibilities and duties. The board to have majority independent directors	Number of Executive Directors not to be more than 75% of elected directors including CEO	Establish a Nominating Committee made of majority exclusively independent non-executive directors. Have formal and transparent remuneration policies	The board not to be large that it prevents efficient operation. It should contain at least two independent non-executive directors
Promote ethical and responsible decision making	Companies should actively promote ethical and responsible decision-making; have and disclose the summary of the code of conduct, have the diversity policy	-	-	-

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	and measurable objectives for the achievement of diversity objectives and targets which are to be disclosed			
Reinforce independence	-	One independent director is mandatory while preference is for 1/3rd of the total members of the board to be independent directors Criteria for assessment of independence	The board should undertake an assessment of its independent directors annually	-
Board skills and capabilities		The Chairman of the AC shall preferably be a non-executive director		It must have an appropriate balance of functional and sector skills Capabilities, experience and be supported by subcommittees
Performance and development / and Number of directorships	-	A director can be on the board of seven listed companies at the most at any one time. The Board to put in place a mechanism for annual evaluation of the Board performance	The board should set out expectations on time commitment for its members and protocols for accepting new directorships	The board should periodically review its performance and its committees and individual board members
Information and support	-		-	The board and its committees should be provided with the best possible information so that they can constructively challenge recommendations before making decisions; and have access to external advice where necessary
Cost-effective and value-added	-	-	-	There should be a clear understanding of how cost and benefits of CG added value through the publication of key performance indicators
Safeguard integrity in financial reporting	Companies to have a structure to independently verify and safeguard the integrity of their financial reporting like the audit committee (AC) that has an AC charter	-	The Audit Committee should ensure financial statements comply with applicable financial reporting standards	-
Appointment and removal		Appointment and removal,	-	-

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and qualification criteria for Chief Financial Officer (CFO) and Company Secretary (CS)		remuneration and terms and conditions of employment of CFO and CS are determined by CEO and approved by Board		
Vision and strategy	-	-	-	There should be clear vision of what the company tries to achieve over a period and when it would achieve such
Recognise and manage risk/ Risk management and internal control	Companies to have sound system of risk oversight and management and internal control. This to include policies for the oversight and management and such be disclosed in the annual report including whether assurance was received from the CEO and the CFO	-	The board should establish a sound framework to manage risks and have internal audit that reports directly to the AC	The board is responsible for maintaining a sound system of risk management and internal control. Should define risk appetite and balance risk management with entrepreneurship
Shareholders needs and objectives	Should design a communications policy for promoting effective communication with shareholders and disclose a summary of that policy	-	The board should take reasonable steps to encourage shareholder participation	The board to have dialogue with shareholders to understand their needs, objectives and their views on company performance
Investor relations and communication/ protect high quality disclosures	To promote timely and balanced disclosure of all material matters concerning the Company	-	The board should ensure the company has appropriate corporate disclosure policies and procedures. Company should leverage on information technology for effective dissemination of information	There should be a communication and reporting framework between the board and shareholders
Stakeholder and social responsibilities	-	-	-	Good governance includes a response to the demands of corporate social responsibility and a proactive CSR policy
Remunerate fairly and responsibly	The level and composition of remuneration should be sufficient, reasonable and clearly related	A formal and transparent procedure to be followed and disclosure of aggregate remuneration in the	-	-

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	to performance. The board to establish a remuneration committee	annual report		
Internal audit	-	The internal audit function may be outsourced by a listed company to a professional services firm or be performed by the internal audit staff of the holding company	-	-

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