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EDITORIAL

Dear readers!

The recent issue of the journal is devoted to several governance and regulation issues.

Ashenafi Beyene Fanta examines how the manufacturing SMEs reacted to acute shortage of formal credit. Author found that SME owners actively react towards financial restraint by resorting to alternative schemes such as iqqub (variant of rotating saving and credit association), customer advances, and trade credit.

Daniel Chigudu aims to undertake a reflective inquiry on the ethical conduct in the Zimbabwean public sector through content and process analysis in order to provide intervention mechanisms to the problem. Statistical analysis of corruption level is made to benefit the study. Results indicated some legislative gaps and an incapacitated Anti-Corruption Commission which has been unable to execute its mandate fully.

Malla Praveen Bhasa reviews the growth and development of corporate governance literature over the past eight decades. In doing so, author studies 1789 published research papers to track how literature organized itself to build the corporate governance discourse.

Sly Newton Mutiro and Stanley Fore establish the perceptions of the corporate services directorate in the South African Metropolitan municipality on King III good governance compliance by interviewing some employees orally and through a questionnaire. The responses were captured and analysed using IMB SPSS software. Problems were identified in governance training and understanding in general. Another major finding was poor communication internally and externally. To overcome these shortfall recommendations were made. Communication models, communication plan, governance models and training were recommended.

Nandi Lubbe and Dave Lubbe provide an exposition of how business ethics links with philosophy. Referral is also made to how professional ethics of the concerned professions fit into the comprehensive discipline of philosophy. The second aspect addressed by the authors is regarding one of the main challenges in presenting business ethics courses. Reasons are mentioned that may result in business ethics courses being irrelevant and impractical and therefore possible solutions to this problem are also suggested.

Queen Sarah Khetsi and Itumeleng Pleasure Mongale investigate the impact of capital markets on economic growth in South Africa from 1971-2013. The results indicated that there is a positive relationship between economic growth and capital markets in South Africa. Furthermore, the country should focus on factors that contribute to the development of capital markets, such as the development of financial institutions. The study contributes to the existing body of empirical literature with regards to economic growth and capital markets, especially with reference to stock markets as South Africa has one of the largest stock markets (JSE) in the world.

We hope that you will enjoy reading the journal and in the future we will receive new papers, outlining the most important issues in the field of governance and regulation.

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CONTENTS

INFORMAL FINANCE AS ALTERNATIVE ROUTE TO SME ACCESS TO FINANCE: EVIDENCE FROM ETHIOPIA

Ashenafi Beyene Fanta *

Abstract

The problem of SME financing has received attention of policy makers and academics in recent years owing to the role of the sector in reducing unemployment, narrowing income gap and alleviating poverty. Alternative financing schemes were suggested but their success depends to a large extent on the development of legal, informational, and institutional frameworks. Existing body of literature grossly undermines SME ability in reacting towards financial restraint and generally assumes they are passive participants in the credit market. Through a survey of 102 randomly selected firms across 10 industrial sectors in the manufacturing sector, we examined how the Ethiopian manufacturing SMEs reacted to acute shortage of formal credit. We found that SME owners actively react towards financial restraint by resorting to alternative schemes such as iqqub(variant of rotating saving and credit association), customer advances, and trade credit. Although the alternative financing schemes are not the best but they are useful in evading the impact of credit restraint on their operation and growth.

Keywords: Trade Credit, Smes, Iqqub, Informal Finance, Ethiopia, Customer Advances

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1. Introduction

Literature shows that underdevelopment of the financial market coupled with imperfections are the prime causes of SME financing problems (see (Beck, Demirguc-Kunt 2006). Cross country studies reveal that whilst financial underdevelopment prevails in most of the developing and emerging economies, imperfections exist even in advanced economies, implying pervasiveness of SME financing problem. Although financing constraints also exist in advanced economies where financial markets are more developed, the extent of SME financial exclusion is by far less severe in developed economies owing to the fact that they have a better informational, legal, and financial framework.

Various SME friendly schemes were suggested (Beck and Demirguc-Kunt 2006; Berger et al. 2005; Frame and Woosley 2004; Klapper 2006) but their efficacy hinges on the existence of legal and financial institutions-the inexistence or inefficiency of which is the primary cause of SME financing problems in most developing countries. Besides, disparity in the level of economic development, the financial intermediary system, and characteristics of the SME sector, often renders a scheme effective in one country barely useful in others. This calls for both better understanding the each country's financial system including the informal financial market, and also the ways in which SMEs manage to shred off the financial obstacles. Most of the existing literature assumes the SME sector as passive that does not react towards hostile financing environment. Hence, studies that shed light on SME reaction to financial restraint are very scant. Only few studies have ventured into the issue (Lin and Sun, 2006; Vandenberg 2003), and it was reported that SMEs do react in many ways ranging from bootstrapping to active participation in the informal credit market. However, country case studies show that the way they react differs from country to country owing to the difference in each country's social, economic, and business setting.

Understanding the alternative financing schemes used in each country's SME sector paves the avenue for determining the economic soundness of the schemes, for setting up workable models that can enhance their efficiency, and also in standardizing them such that they are applicable elsewhere too. We argue that a closer study and analysis of these schemes helps in averting the severity of the credit market against small firms and can provide at least a short-term solution to their financing problems. We also contend that a critical look at the informal credit market helps in forging a link with the formal credit market. Such a scholarly engagement will foster transformation of the informal markets from their rudimentary level to essential elements in the credit market in developing countries.

Through a survey of 102 randomly selected firms across 10 industries in the manufacturing sector, we examined how the Ethiopian manufacturing SMEs coped with acute shortage of formal credit. We found that the SMEs use various mechanisms to avert the impact of credit restraint on their operation and growth. The schemes they use can be fairly classified into three categories as *customer-based, vendor-based,* and *peer-based*.

The rest of the paper is organized as follows. Section 2 reviews the alternative financing mechanisms small firms employ in quenching their thirst for finance. Section 3 describes data and methodology. Section 4 dwells on the reaction of the Ethiopian manufacturing SMEs towards financial restraint. The last section concludes.

2. SME reaction: literature review

The general finance theory predicts that liberalized markets are vital in ensuring a widespread access to financial services. Consequently, financial deepening has been at the center of every financial reform initiative in many developing countries across the globe. However, financial reform in developing countries did not give rise to a better credit access to certain group of firms such as SMEs. For instance, Steel et al (1997) find that financial liberalization in most SSA countries did not yield in financial deepening and hence no improvement has been witnessed in SME credit access. SMEs, therefore, responded to repressive financial environment by participating in the informal financial market; establishing self-governed networks within a peer group; and using trade credit. The following paragraphs present alternative financing techniques employed by SMEs as a means of averting financial restraint.

2.1 Informal finance

Informal finance involves deposit and lending services offered outside the formal financial markets. Informal credit market is often characterized by being rudimentary, poorly organized, and mostly confined within a small friendship group or neighborhood. Yet it is crucial in offering alternative means of finance for firms with little or no access to the formal credit market. In his empirical study on the informal financial markets in Kenya, Atieno (2001) found that of those that ever accessed credit, 67% acquired credit from the informal market, showing the extent to which the informal market is used by firms. Compared to larger firms, SMEs tend to participate more in the informal market. This has been confirmed by Kan (2000) who finds that in Taiwan 35% of SMEs borrow from the informal market while the figure for larger firms is only 12%. And in China, underground banks[1] provide as much as a third of their loans to SMEs (The Economist, 2007).

Quite many SMEs turn to the informal credit markets after their attempt to acquire credit from the formal market proves futile, due to stringent lending policy or out of their resentment of the bureaucracy. In contrast, the informal credit market is easily accessible and more appealing to the specific attributes of small firms. While acquisition of loans takes weeks in the formal credit market, it is only a matter of few days in the informal market. The informal market thus allows firms to circumvent the often rigorous credit procedure banks follow in granting loans. Besides, while the formal lending institutions demand physical assets as collateral to resolve the problem of adverse selection and moral hazard, informal markets rely only on group guarantee. In most developing countries where legal framework is weak, informal lenders outshine formal financial institutions in enforcing collateral (Steel et al ,1997), giving them an edge over banks in satisfying small business demand for loan.

However, it is worth noting that except for its accessibility, the informal credit market is not the best alternative due to excessive cost of credit and its inability to supply loans of a desired size. Theoretically, informal credit should have been by far cheaper as informal lenders have little or no administrative costs and pay no income tax. Besides, their transaction cost is believed to be lower compared to those of banks. However, as reported by Steel et al (1997), informal rates are much higher than formal market rates although it tends to be lower in countries with diversified sources of informal credit. Moreover, informal lenders supply credit at smaller sizes, failing to satisfy SMEs need to finance large investment projects undertaken as part of their growth strategy. Confirming the foregoing notion, Ayyagari et al (2008) report that informal finance is not the major driver behind the fast growing private sector in China. They rather discovered that fast growth is associated with more attachment with formal credit market and less with the informal market. They confirmed that informal finance is predominantly used by firms in the private sector. SMEs in many developing countries continue to rely on the informal credit despite its excessive cost and low size.

SMEs also use self-governed ethnic based networks as an alternative. Evidence from Kenyan manufacturing sector shows that SME operators establish ethnic-based networks through which lending is carried out (see Biggs & Shah, 2006). Biggs & Shah (2006) claim that while such a network improves performance of the group, it has adverse repercussions on those outside the network. In an earlier study, Biggs et al (2002) find that while such networks are open to ethnic group member irrespective of their size, they are available only to

[1] Also called black banks these are illegal banks that conduct the banking business in the black market. Underground banking is a serious problem in countries where the formal credit market is inefficient (see The Economist, August 9, 2007). The Ethiopian government too has imprisoned illegal lenders in a fight against black banking (see AddisFortune, 2010).

large businesses owned by those outside the ethnic network.

2.2 Trade credit

Trade credit arises when vendors sell goods on credit. It serves as an alternative financing scheme satisfying the need to finance working capital. It is important to SMEs because the suppliers grant it in consideration of a long standing business relationship and also to keep it continue. Three theories exist justifying the essence of trade credit in the product market, namely, financing advantage theories, price discrimination theory, and transaction costs theory(see for details Peterson & Rajan, 1997). The financing advantage theory contends that suppliers enjoy superior advantage over financial institutions in handling the information asymmetry problem. First, they can exploit their business relationship to acquire customer information at a cheaper cost. Suppliers may at times hold captive customers with poor credit standing if they perceive there would be valuable business ahead. Secondly, in cases where the supplier acts as a sole vendor for the product, it can use its power to enforce repayment of the debt. The supplier can threaten to cut future delivery if it happens that the customer fails to honor his/her obligation. Thirdly, where default is eminent, the supplier has the power to repossess the products in order to recover the debt. Trade credit can also help suppliers to discriminate customers as cash purchasers and credit purchasers wherein the effective price of credit customers is higher compared with price paid by cash customers. Moreover, trade credit may appeal to the interests of a customer as it allows accumulation of bills to be paid periodically. This avoids the need to settle bills in a dispersed way every time delivery is due.

Trade credit is a significant part of short-term liabilities in both small and large enterprises. Trade credit is a common place in manufacturing, construction, wholesale and retail firms (Mach & Wolken, 2006). Literature conjectures that availability of trade credit is partly determined by the extent to which suppliers can access credit from financial institutions. Supply of trade credit is higher in countries where supplier can easily access credit whereas its supply is small in markets where credit is hard to come by. Hence, it can be implied that firms in developed countries are likely to have better access to trade credit than those in developing countries where financial markets are weak.

Examination of the existing empirical evidence shows that demand for trade credit is greater among smaller firms, due to the reason that these are more credit constrained firms. Confirming the above claim, Mach & Wolken (2006) in their survey of SMEs in US in 2003, found that 60% of small firms use trade credit. Large firms, on the other hand, prefer commercial paper. Trade credit is costly and firms use it as a last resort after exhausting other financing alternatives.

One legitimate question would be what advantages suppliers enjoy over financial institutions in extending credit. Chandler (2009) explains that supplier are better positioned in handling the problem of information asymmetry. Adverse selection and moral hazard can be best managed by a vendor. The supplier can elicit valuable customer information from a business relationship, general market conditions and demand for the product. This allows the supplier to assess whether the customer has the ability to honor its obligation, in a much better way than financial institutions (Cook, 1999). They can also manage the moral hazard problem more effectively. First of all, the very fact that credit is offered on the sales of tangible goods offers a room to exercise power related with the right of repossession. Besides, where the supplier acts as a sole vendor, it can use its power as leverage for enforcing repayment by threatening to discontinue delivery in case of default. Consequently, a firm that has been denied credit by financial institutions can acquire trade credit.

From debtor's perspective, trade credit has two important purposes: an alternative means of financing and a signaling tool for acquisition of bank credit. Trade credit can serve as both a complement and substitute for bank loan. Where bank loan is hard to come by, firms resort to trade credit despite that it is expensive. Most importantly, trade credit serves as a primary source of financing in times of financial restraints. This has been confirmed in many occasions. For instance Love et al (2007), from their study of 890 firms across six emerging economies, report that the magnitude of trade credit reaches its peak at the apex of financial crisis. In fact, if the financial crisis persists, suppliers tend to pull back their generosity in extending credit. This is often caused by fall in trust and also a dwindling of supplier's financing access. Trade credit is also used as a signal of creditworthiness that can help acquire bank loans. Small businesses that often have little chance to access bank loan due to lack of financial transparency can use trade credit as a testimony for their trustworthiness, and hence can get loans (Cook, 1999). In general, trade credit plays a crucial role in SME financing by mitigating the problem of information asymmetry as it can be used as a substitute for bank loans and as a tool to pave the way towards accessing bank credit.

3. Data and methodology

Data was collected through survey of 102 randomly selected manufacturing SMEs operating in Addis Ababa, the capital that hosts nearly one half of manufacturing SMEs. The sample represents 27.2% of manufacturing SMEs operating in the capital. The sample are drawn from 10 industrial sectors that include Food Products and Beverages (31.4%), Wearing Apparel (5%), Tanning and Dressing of Leather (7.8%), Paper Products and Printing (15.7%), Chemical and Chemical Products (5%), Rubber and Plastic Products (6.9%), Non-metalic Mineral Products(5.9%), Fabricated Metal Products (2.9%), Machinery and Equipment (7.8%), and Furniture (11.8%). Survey response rate is 85%, implying that the survey outcome is clean from non-response bias. The survey was conducted using a door-to-door self-complete questionnaire filled by SME owners. A cross sectional data was generated from survey and analyzed using descriptive statistics.

4. Ethiopian SME reaction: *empirical evidence*

Survey results revealed that Ethiopian SMEs do react to financial restraint. The alternative financing schemes used by SMEs can be fairly grouped into three categories: client-based schemes, vendor-based schemes, and peer-based scheme.

As shown in Table 1, firms use retained earnings, *iqqub* (A term driven from the “Geez” language, meaning something that is safeguarded and is closer in meaning to the word saving, signifying the principal purpose it is set up by members.), credit from friends, customer advances and trade credit in lieu of bank loan. Retained earnings are the primary sources of financing operation and expansions. This is consistent with the pecking order theory set up by Myers (1984) who posited that internal capital is the most accessible source of finance. The next most commonly used sources include *iqqub*, customer advances, and credit purchases. However, as revealed by survey results, these techniques are not uniformly employed across industries. The kind of scheme used depended on SME specific conditions and networks with which they are linked. Moreover, we found that a single financing scheme is used by different industries for satisfying varying financing needs. For instance, some firms use *iqqub* to satisfy their short term financing needs while others use it for financing expansion projects as well. We tried to understand the financing practice of SME by inquiring streams of questions that are summarized into financing business operation and planned expansion.

Table 1. Alternative financing schemes

Rank	Financing scheme	Working Capital*	Financing expansion*
1.	Retained profit	Yes (47%)	Yes (83%)
2.	*"Iqqub"*	Yes (34%)	Yes (16%)
3.	Customer advances	Yes (8%)	No
4.	Credit from friends	Yes (6%)	Yes (1%)
5.	Trade Credit	Yes (5%)	No

Source: *field survey (*represents the percentage of SMEs using that type of financing)*

A glance at the table reveals that SMEs have more choices for financing working capital than expansion. While customer advances, credit purchases, and credit from friends and relatives are mainly used for financing working capital, *iqqub* is used for satisfying working capital needs such as payment of wages, taxes, servicing bank debts as well as long term financing needs such as business expansion.

4.1 Client-based scheme: Customer advance

Our survey has revealed that customer advance is an important client-based scheme used as an alternative source of financing operation. Firms require their clients to deposit portion of the negotiated price of a product whose delivery is expected to take place sometime in the future. This scheme is commonly used by firms that manufacture goods to customer order. We found that it is widely practiced among firms in the publishing and printing industry and furniture manufacturers. Customer advance serves the dual purposes of financing acquisition of raw materials and as a mechanism that ensures payment of the remaining balance of the invoice. This implies that firms also use advances in order to avoid the possibility that a customer cancels the order in favor of a less expensive or better quality producer. Customer advance therefore locks price and is also used as a mechanism of ensuring commitment by the customer.

We came to know that whilst the importance of customer advance as an alternative finance varies across sectors, its benefit as an insurance against possible customer infidelity is highly valued among most of them. We also noted that firms that face serious financing problems tend to rely on customer advance more heavily. For instance, those in the furniture industry are relatively smaller in size compared with firms in the publishing and printing sector and hence see customer advance as a principal source of financing raw material purchases. Although customer advance is mostly a short-term means of financing and often small in amount, its role on relieving firms from the heavy burden of credit restraint is significant.

4.2 Vendor –based scheme: Trade credit

Trade credit is a short term financing technique that comes into existence when a vendor sells goods to its customers on credit. Trade credit is a major component of the balance sheet and remains outstanding over a period of commonly 30 days, sometimes 60 days, and exceptionally 90 days. The length of the credit period, amount of discount for early payment varies across firms depending on the nature of the goods in question and the financial strength of the vendor. Vendors tend to allow a shorter credit period when goods are perishable and credit is scarcer.

Survey revealed that although not as popular as in developed countries, trade credit is used by some firms. Literature reports that besides its use as a source of financing, trade credit can be used as a signal of credit worthiness and hence a gateway to bank loan (Cook, 1999), but this does not happen in Ethiopia. There are two justifications. Firstly, trade credit is not created through a legally binding contract between the vendor and its client. It rather comes into existence only through a verbal agreement. The supplier decides to extend credit based on an indirect assessment of client's business, his personal integrity, and information from family and friends. Trade credit is often not backed by a more formal evidence of indebtedness. Consequently, documents in the customer's hand may not be validly used as evidence of an outstanding credit obligation. Secondly, banks may not use trade credit as a basis of their credit decision. This is because vendors extend credit to their clients not based on a prudent credit analysis, and thus a client that gets trade credit may not be the one with a good credit standing. Therefore, from a bank's perspective, the signaling power of the trade credit is negligible. Besides, collateral is crucial in banks' lending decisions, and any additional document that testifies credit worthiness of a client is considered only supplementary.

4.3 Peer-based schemes: "Iqqub"

Iqqub refers to an informal financing technique that belongs to what is generally known as Rotating Credit and Saving Associations (ROSCA). It is a scheme where closely associated group of individuals periodically contribute to a pool that is allocated to each member in a random rotation or according to a prescribed fashion. The group decides the amount of periodic contribution that in turn determines the size of the pool distributed to a member. The scheme can be initiated by one person or more people who have an urgent need for cash. The initiators usually take the responsibility of soliciting new members and getting drafted a mutually acceptable bylaw that prescribes, *inter alia*, the amount of the contribution, frequency of meeting (weekly, bi-weekly, monthly etc), size of a fund to be kept as a cushion against defaults. Size of *iqqub* is a factor of the number of members in the group and the amount of periodic contribution. For example, an *iqqub* with 20 members, each making a periodic contribution of ETB 1,000, has the size of ETB 20,000, that can be given out as a loan to its members. Each member periodically brings ETB 1,000 and a member chosen gets a credit of ETB 20,000. How much he owes the rest of the members and the number of periodic payments he has to make depends on the time at which he gets credit. In the foregoing example, a member that gets the pooled sum right at the beginning of the cycle owes ETB 19,000 while the one that gets it at the end owes nothing.

Despite its non-interest bearing features on deposit and loans, *iqqub* serves as a tool for saving and credit. It plays a vital role of encouraging households to postpone consumption and hence assists in developing the culture of saving in areas where banking services are unavailable. Until a member gets the credit he acts as a depositor, and he takes the position of a debtor immediately after getting the credit. Similarly periodic payments are all deposits until a member gets credit, they will then become repayments of an outstanding credit afterwards.

Iqqubs are widely practiced in most developing countries in Africa and Asia. In Ethiopia, they are claimed to have preceded the emergence of modern banking system in the country (Aredo, 1993). Their wider prevalence is evident from existing evidence on the number of households participating and amount of resources they managed to mobilize. For instance, 95 *iqqubs* surveyed by Mauri (1987) mobilized ETB 139 mill (approx €50 mill), and this represents 15.3% of household saving deposited at the Commercial Bank of Ethiopia in 1986, the sole commercial bank at the time.

We discuss in the following paragraphs three important aspects of *iqqub*, namely, membership requirements, amount of contribution, and technique used in allocating the fund.

(a) Membership

*Iqqub*s are often established among homogenous group of people representing individuals from the same firm, trade, ethnic background, or neighborhood (Aredo, 1993). The most important shared characteristics of members in the scheme is that they fall into roughly similar income category. Establishment of *iqqub* takes different forms. It is mostly initiated by one person or a group of individuals with an eminent expenditure that requires a sum bigger than they can afford with their current earning. Alternatively, in some areas *iqqub* may run in a more organized manner having a chairman and secretary who almost act like employees of the scheme charged with the responsibility of soliciting membership and handling various administrative matters. One notable aspect of *iqqub* is that any new member must be well known by the rest of the members or at least by a few of them. A mutual trust among members arises from a personal relationship nurtured through working or trading together or living in the same neighborhood. Depending on the interest of the group, each member in the scheme may have one or more shares. It is also possible that two individuals co-own a single share. The former occurs when a member is relatively wealthier while the latter takes place when members are unable to afford a full share but need to join the scheme.

(b) Periodic contribution

Contribution is mostly in cash except in some places where people form *iqqub*s in which contributions are in kind such as butter, honey, sakes of wheat etc (see Aredo, 1993). Size of periodic contribution is set by the members by taking into account the amount they can afford to contribute on the one hand and the size of the scheme that is partly determined by the number of members on the other. The length of periods hinges on the frequency at which members generate income. For instance, traders often meet weekly or fortnightly while employees meet monthly. Every member is expected to make the periodic contribution on a regular basis and a failure often results in forfeiture. Some *iqqub*s collect additional contributions to keep a contingency fund that is used in cases where a member fails to make periodic contribution. Any remaining balance on such a special fund is distributed to members if it remains intact till end of the cycle.

(c) Allocation

Allocation of pooled money takes place at agreed upon interval that spans from a week to a month. Only one member is entitled to collect the pooled sum at each meeting. Three different techniques are used in identifying the one entitled to collect it: *random*, *discretionary*, or through *auction*. In a random allocation, a recipient is identified by a lottery in which the probability of each remaining member keeps on rising in each subsequent meeting. In a traditional *iqqub* where no consideration is given to time value of money, such an allocation is a real lottery for the first recipient and a bad luck for the one collecting it last. For the member who collects it first, it is tantamount to getting an interest free loan, whereas for the one who collects it last, it is a non-interest bearing deposit. In other words, all subsequent collectors indirectly subsidize interest that would have otherwise been paid by the first collector; the burden of subsidy steadily rises and reaches its peak on the last collector. However, people nowadays recognize the time value of money and hence have a mechanism in which every member gets similar amount of benefit. They do so by charging a discount from early collectors and distributing it to late collectors such that each receives the same amount of money.

While the first allocation technique is probabilistic, discretionary allocation and auction are not. In discretionary allocation, members mutually agree on a schedule that specifies the order in which allocation occurs. This takes place when degree of need for cash by members is not the same. In other words, while some of the members urgently need cash while others are indifferent as to the timing. This is common when *iqqub* is established within a closely tied family or friendship group whose relationship transcends beyond the scheme. Discretionary allocation is also employed when a member is under emergency situations arising from occurrence of unforeseen events. This signifies that *iqqub* is much more than a mere saving and credit technique as it plays a vital role in maintaining social ties among members. In auctions, on the other hand, the pooled sum is presented for a bid among members, and the one with the highest bid price is entitled to the money and the excess of the bid price over the value of the pooled sum is kept as a special fund to meet certain unforeseen needs and to cover administrative costs of the scheme. Auction has been introduced as a better alternative to random allocation where benefits may not be fairly distributed among members. In cases where all members need the money equally urgently, the auction offers the same chance to acquire it by paying a higher price.

Types of Iqqub

As has been indicated previously, *iqqub* is established within a group of individuals that earn a comparable amount of income. One way to understand *iqqub* is analyzing them into groups based on their income categories because the way the scheme functions in each group is different and formality increases as size of the scheme increases. Following Aredo (1993) and Mauri (1987), the salient features of the scheme can be presented by dividing it into three categories as household, small trader and large trader *iqqub*.

a) Household "Iqqub"

This is often established either within colleagues in an organization, individuals living in the same neighborhood, or among friends. Even employees of financial institutions join *iqqub* despite the fact that they work in a financial service industry. For instance, Bouman (1995) stated that 75% of Agricultural Bank of Egypt were members of *iqqub*. The most common characteristics of such a household *iqqub* is that the purpose is to accumulate money to meet household expenses such as furnishing, paying school fees for children, spending for holidays etc. Such schemes are also characterized by having closely related small number of members, often not well organized, and with limited number of cycles. It is more likely that allocation is random because the time value of money is not an issue of much concern as the cycle often ends within a short period of time. Individuals in such groups are mostly less affluent and hence lack access to the formal financial sector. The scheme therefore offers an alternative tool of saving for those who survive by meager earnings.

b) Small traders "Iqqub"

As opposed to household *iqqub*, small trader's iqqub is set up with the principal purpose of financing business related expenditures. This may include acquisition of raw materials, equipment, and machinery. Membership may be open to non-traders who afford the periodic contribution. One of the distinguishing characteristics of such types of schemes is that the members are mostly individuals engaged in small scale trading activities in the informal sector of the economy. This is a little more organized compared with household *iqqub* but less so compared with large trader *iqqub*.

c) Large[2] traders "iqqub"

Businessmen engaged in different types of trade often establish *iqqub* aimed at financing investment activities that require a larger sum. The group includes people engaged mostly in general wholesale and retail trade, bakery, restaurants, and hospitality services, who lack a physical collateral to access bank loan or afraid to present their property as a collateral in fear of possible foreclosure[3]. The most notable features of the large traders *iqqub* is that they are more institutionalized and hence operate in a more organized manner (Aredo, 1993). They often have a salaried chairman and secretary who almost act like employees of a legally registered organization. As full time workers, the chairman and secretary are vested with the responsibility to carry out activities including ensuring trustworthiness of a new member, bringing a defaulter before the court, imposing and collecting penalties from those who trespass bylaws of the *iqqub* etc.

In this type of *iqqub*, membership is a serious issue as the sum involved is big in amount and membership extends to large number of people. A new comer is admitted only after a serious scrutiny of his financial history and personal characters. Besides, some individuals from the incumbent members need to testify for him and must be ready to act like a guarantee in case of failure to abide by the rules. In some cases membership is open only to those who own a business concern or have a property in their possession. Where a person desiring to join is unable to bring guarantors, he may join only if he agrees to collect the sum at the end of the cycle.

While the length of periods is usually one month in household *iqqub*, in a large trader's *iqqub* a period may be as short as a week. Large trader *iqqub* raises a large sum of money, often more than ten times their periodic contribution. One SME owner, who uses *iqqub*, reported that he contributes ETB 20,000 weekly to an *iqqub* with 70 members, and he expects to collect a pooled sum of ETB 1.4million (equivalent to US$70,000[4]). He would have needed a collateralizable asset worth ETB 3.28million to secure loan from banks because according to World Bank(2014) bank in Ethiopia use collateral to loan ratio of 234%. Another SME owner reported that he belonged to iqqub with 80 members each contributing bi-weekly ETB 40,000. Members in the iqqub were entitled to collect ETB 3.2mill(aprox US$158,000), and the corresponding collateral value that would have been required by banks were ETB 7.5mill(approx. US$369,000). In both cases, pooled sum is many times more than what they can periodically save. The money is often used for acquisition of commercial vehicles, machinery, equipment, or to undertake expansionary projects.

The other distinguishing characteristics of such type if *iqqub* is the care with which the sum is given out to the winner. Because membership is spread across large number of people and also due to the size of the money at stake, much care is taken in handling probable default by winners. As stated previously, half the job is done upon admission because a member needs to have at least three other incumbent members testifying his personal traits and trustworthiness. This helps in avoiding erroneously admitting those with an evil intent. The remaining job of averting default is done by requiring the winner to bring at least three members as guarantee. The guarantors should agree to take the responsibility to pay on his behalf in case of default. In cases where the winner is unable to bring the required number of guarantors, the pooled sum is kept in a bank account.

Iqqub and information asymmetry

Information asymmetry is what plagues the formal financial market and also the reason behind disenfranchisement of SMEs. Literature shows that informal institutions outdo formal financial institutions in managing the problem of information asymmetry (see Steel et al,1997). The fact that they are built on close friendship makes them better in enforcing repayment of credit. It is therefore expedient that we discuss how *iqqub* manages the problem of adverse selection and moral hazard, the twine ingredients of information asymmetry.

Iqqub is established among people who know each other very well, owing to working together, trading together, living in the same neighborhood, or due to family ties. They learn about each other through long and multifaceted interactions. In effect, members possess information about each other that

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[2] The word 'large' is used in this context to distinguish this group from small traders, and thus it does not necessarily reflect the size of their businesses.

[3] We learnt in our survey that business people, especially those who do business in a traditional way, have a considerable phobia against a bank loan following a massive foreclosure of defaulting borrower's property by commercial banks. Some traders fret that interest on bank loan may build up so large that their ordinary income may not be sufficient to service an outstanding debt.

[4] This is based on the exchange rate between USD and Ethiopian Birr of $1= ETB 20.2495 on January 22,2015

can hardly be obtained by financial institutions through their formal information acquisition techniques. This allows them to select out a potential member who is not as trustworthy as needed. Therefore, the problem of adverse selection is dealt with effectively. In *iqqub* where membership stretches to a large group of people, applicants are admitted only when they are recommended by at least three of the incumbent members. Where the applicant is unable to present a referee, he may still join provided he agrees to collect the pool only at the end of the cycle. In other words, such a member does not get credit from the scheme.

The resolutions to the problem of moral hazard are four folds. First, a defaulter faces social exclusion. There is a strongly held culture that if a person defaults he is not trusted for any responsibility any longer. Failure to repay debt has a serious consequence on a person's social life, hence people take much care in keeping their promises. Secondly, each winner must bring guarantors who are willing to take the responsibility to pay on his behalf in case of default. In case a debtor is unable to service his credit, these guarantors put pressure on him to relieve themselves of the potential responsibility. Thirdly, some *iqqubs* impose fines on members who fail to service their debts. A member who fails to pay the periodic contribution is penalized and required to pay a much higher amount in the next round. Fourthly, in case where all the above mechanisms fail, the defaulter is brought to court. The mechanisms described above are what *iqqubs* generally use to mitigate moral hazard; but the extent of emphasis on each differs based on the size of the *iqqub* and diversity of its members. For instance, smaller *iqqub* that are established within closely knit group rely more on social exclusion while larger ones rely on personal guaranty.

5. Conclusion

The problem of SME financing has received attention of policy makers in recent years owing to the role of the sector in reducing unemployment, narrowing income gap hence promote economic growth. Alternative financing schemes have been crafted but their success hinges to a large extent on the development of legal, informational, and institutional frameworks. These pre-requisites on the other hand are barely available in developing countries like Ethiopia, and are the principal missing factors that led to under-development of the formal credit market in the country. The extant body of literature grossly undermines SME ability in reacting towards financial restraint and generally assumes them to be passive participants in the credit market. Our study challenges this view and argues that SMEs can devise mechanisms wherein they circumvent financial restraints they often face.

Understanding the alternative financing schemes used in each country's SME sector paves the avenue for determining their economic soundness, setting up workable models that can enhance their efficiency, and also in standardizing them such that they are applicable elsewhere too. We argue that a closer study and analysis of those schemes helps in averting the severity of the credit market against small firms and can temporarily ease their financing problems. We also contend that a critical look at the informal credit market helps in forging a link with the formal credit market. Such a scholarly engagement will foster transformation of the informal markets from their rudimentary level to essential elements in the credit market of developing countries. Besides, it will help in widening financial services of the formal credit market to the hitherto neglected segments. This led us into the study of reaction of manufacturing SMEs in Ethiopia. Through a survey of 102 randomly selected firms across 10 industries in the manufacturing sector, we examined how the Ethiopian manufacturing SMEs cope with acute shortage of formal credit.

We found that SME owners actively react towards failure of the formal credit market to supply loan, and look for alternative financing mechanisms. Although the alternative financing schemes are not the best but they are useful in averting the impact of credit restraint on their operation and growth. The alternative financing schemes used by SMEs are grouped into three categories as customer-based, vendor-based, and peer-based schemes. It has been found that while customer based and vendor based schemes are exclusively used for working capital financing, peer-based schemes are used for financing start up as and growth as well.

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TOWARDS IMPROVEMENT OF ETHICS IN THE PUBLIC SECTOR IN ZIMBABWE

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Abstract

In Zimbabwe reports of abuse of public office have manifested in various forms resulting in public outcry; poor service delivery, and government losing millions of dollars. This study aims to undertake a reflective inquiry on the ethical conduct in the Zimbabwean public sector through content and process analysis in order to provide intervention mechanisms to the problem. Statistical analysis of corruption level is made to benefit the study. Results indicated some legislative gaps and an incapacitated Anti-Corruption Commission which has been unable to execute its mandate fully. Most senior public officials and politicians appear to have too much power and authority with no checks and balances in place. Practical implications of the widespread unethical practices call for the government to plug the glaring legislative gaps; take stern measures against offenders; empowering the Anti-Corruption Commission; term limits for senior public officials as well as for political appointments; and motivating political will to uphold ethical leadership. The recommendations will open a window for the Zimbabwean government and administrators to view how some advanced economies have propped up ethical behaviour in the public sector. It is the way to go for ailing economies like Zimbabwe. The paper demonstrated the importance of ethical awareness in another political and economic setting-Zimbabwe.

Keywords: Public Sector; Corruption; Public Official; Unethical Practice

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1. Introduction

Scientific debate has been intense in public administration on how to make the civil sector function in the best way, the role of government particularly its regulatory institutions and good governance in the developing world. The debate has sought answers to how much and what form of state intervention is needed to achieve economic development and political accountability, among other objectives. This debate has given a better understanding of the responsibilities of the public sector's interface with citizens, civil society, foreign organisations and private institutions. The debate has focused on good governance in which ethics and ethical principles become pivotal for public officials to make better decisions, and help those they serve to evaluate them (public officials).

Arguably, ethics has been a controversial area of study in public administration in as much as it has been controversial in other study areas like politics, philosophy and law (UCAN, 2009). Due to the complexion of ethics, practitioners tend to shy away from ethics and choose to stick to rules and regulations that define the scope of their work in the public sector.

But this seem to be losing ground as public officials no longer simply exist to implement policy decisions of the policy makers. Instead, public officials are increasingly exercising discretionary powers that affect peoples' lives. Unfortunately, the effect of the decisions benefit less the people and more to the public administrator. Economists have called this standard "*homo oeconomicus*" UCAN (2009:6), where a man attempts to pursue selfish interests, with little regard if any for ethics and others.

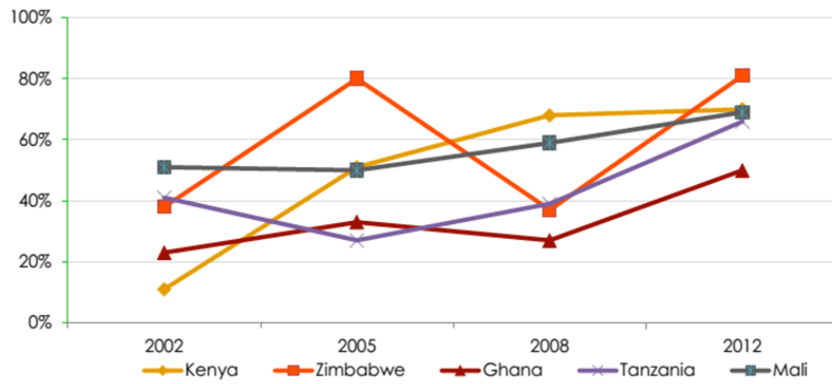
This paper discusses public sector ethics with a view to make a reflective inquiry on Zimbabwe. It provides a background and research issues/questions to Zimbabwe's ethical position in the public sector, methodology, conceptual framework, and statistical analysis of corruption levels over the years, codes of ethics, significance of ethical practices, contextualization of unethical practices, conclusions and recommendations.

2. Background, Research Questions and Issues

A privately owned daily newspaper in Zimbabwe (Newsday, 2014) reported on a decline in service delivery and called for ethical public managers. Clarion calls have been made by the public through the media for public officials to refrain from unethical practices in the discharge of duty. A daily state-sponsored newspaper in Zimbabwe (The Herald, 2014) carried a story on the alleged Rautenbach scandal of the Hwange Colliery, Unki Platinum and Chisumbanje Ethanol Plant involving senior public officials. In 2013 according to the Transparency International Corruption Index Survey, Zimbabwe was ranked one 157 out of 177 countries. In 2012 the country was ranked 163 out of 173 countries in terms of unethical practices. These positions portray gross unethical practices.As indicated by the newspaper articles, the corruption index rankings and the survey data; it seems some public officials are unethical to the detriment of the people they purport to serve. Questions that beg for answers are; what is government doing about it? What mechanisms if any are in place to safeguard the public? This calls for reflectivity on ethical matters in the public sector in order to proffer solutions.

A survey by Transparency International Zimbabwe (TIZ, 2000) reported that Zimbabweans regarded the public sector as the most unethical sector in the country. The police was ranked as being most corrupt followed by political parties, parliament/legislature, public officials and the judiciary. From October 2011 to June 2013, Afrobarometer, a research project which measures public attitudes on socio-economic and political issues in sub-Saharan Africa surveyed more than 5100 people. According to (*Afrobarometer*, 2013) Zimbabwe was the third most corrupt African country, after joint leaders Nigeria and Egypt. Zimbabwe stood at 81% while both Nigeria and Egypt were at 82%. Afrobarometer also reported that Zimbabwean corruption increased by 43% between 2002 and 2012. The figure below shows percentages of negative ratings Zimbabwe and some countries received for handling the fight against administrative malpractices and corruption.

Figure 1. Countries where corruption fight is failing, 2002-2012



Source: AfroBarometer, 2013

Findings from the (World Bank, 2012) presented in the Human Resources Management Actionable Governance Indicators (HRM AGI) that in Zimbabwe, high levels of discretion are afforded both politicians and senior public officials without the necessary checks and balances. This may imply that there are some legislative gaps. The lack of such checks and balances breed unethical conduct, which often bear severe economic consequences to the general public and to the country in the long run. Therefore, as has been indicated, public sector ethics in Zimbabwe is a matter that urgently needs informed discussion.

3. Methodology

The study is a reflective approach to research as borrowed from (Fook, 1996) and ideas from (Argyris, and Schon, 1978). It is an approach which enables one to reflect upon own assumptions and to influence a situation. In this way of thinking, reflectivity allows a practitioner to research the practice of others in order to change or improve it. This study makes a reflective inquiry into unethical practices in Zimbabwe's public sector in order to improve or change the status quo. This is done through content analysis of public sector ethics in general and Zimbabwe in particular.

4. Conceptual Framework

This section provides a discussion on definition of ethics, theories of ethics, public sector ethics, corruption and statistical analysis, governance and whistle blowing.

4.1 Understanding Ethics

According to (UCAN, 2009) people believe that public sector ethics is a term too weak and too nice to be of real importance. As such existence of ethics in what is regarded as the tough, dirty and unprincipled world of politics is seen as wishful thinking. Ethics is sometimes viewed as negative, impractical and meant for the believing innocent and not for the deliberate offenders. The term ethics has had various definitions but common to these definitions are aspects of ensuring that people live up to certain expectations as defined by institutions. For (Edwards, 2008), ethics and morality are often used to mean the same thing. These are principles meant to evaluate behaviour as bad or good.

According to ancient Greeks, the word ethos refers to morality. The word moral derives from the Latin word mos which is the same as the Greek word ethos. Moral is therefore used to refer to the current morality while ethics is used as the study of morality as asserted by (Lategan, 2003). For (Edwards, 2007) in Aristotle's view ethics implies the study and practice of good life Therefore, in Aristotle's view ethics is not a matter of gaining intellectual understanding but of practical hands on which he termed phronesis. Phronesis is a sort of ethical know-how of what action is most appropriate in a given situation. The Organisation for Economic Co-operation Development(OECD, 1996:12) defines ethics as "the rules that translate characteristics or ethos into everyday practice" Ethics refers to the sum of ideas which define an overall culture in the public sector while values may be seen as principles that guide judgement about what is good or bad. However, the relationship between these two is complex and overlapping. Several commentators have tried to explain them. For instance , Kernighan (Chapman, 1993:16) notes that the link between ethics and values is that ethical standards and principles can be applied to the resolution of value conflicts or dilemmas, while (Denhardt, 1989:187) argues that, the concepts have been difficult to apply to the daily lives of public servants because,

"Public administrators are still striving to develop an understanding of the ethics of their profession, not because it is new, but because the understanding of the profession and its role in government has changed dramatically over years."

Public sector ethics should be seen as an activity and not a status. Therefore, encouraging ethical behaviour should not be just about establishing a list of rules to be kept in offices but an on-going management process that underpins the work of government(OECD, 1996) . This is corroborated by (Thompson, 1992: 255) who says,

"Ethics may be instrumental, it may only be a means to an end, but it is a necessary means to an end. Government ethics provide the preconditions for the making of good public policy. In this sense, it is more important than any single policy, because all policies depend on it."

The ethical conduct of politicians and public officials is a critical ingredient in democratic governance. Ethics can be viewed as standards of accountability by which the public will scrutinise the work being conducted by the members of their organisations. No matter how complex the politics of the day can be the ethical standards of the public sector are seen to be at three different levels of practicality and in principle. The top most principles are some ethical imperatives, embedded in religion or in human rights; the internationally accepted principles for democratic and accountable governance for the public sector; and the contextual rules for the behaviour of public servants (UCAN, 2009). Ethics can be viewed from the traditional and modern moral philosophy perspectives.

4.2 Traditional Moral Philosophy

Moral theory is the study of what makes actions wrong and right from the traditional perspective. This philosophy is also known as the moral theory or normative ethics and offers principles to which public officials could appeal in resolving challenging moral issues. Normative ethics is the study of ethical action. It investigates the set of questions that arise when considering how one ought to act, morally speaking. As argued by (Foot, 1983) morality does not seem to have any special binding force. She adds that people only behave morally when motivated to do so by other factors. This notion should be embraced fully by the public sector in Zimbabwe. Descriptive ethics, on the other hand, is about peoples' moral beliefs. Meta-ethics seek to define moral language and the metaphysics of moral facts. Other scholars define normative ethics as prescriptive in nature, rather than descriptive. In this article, the discussion is situated in the normative ethics area. It seeks to examine standards for the rightness and wrongness of actions. Normative theories have several strands with three most well-known being virtue ethics, consequentialism and deontological ethics.

4.2.1 Virtue Ethics

These focus on the character of the public official and not on the formal rules of the organization or the consequence of actions. Virtue ethics are hinged on an account of the purpose of human life or the meaning of life. For Plato and Aristotle the Greek philosophers, the purpose was to live in harmony with others, and defined four cardinal virtues as prudence, justice, fortitude and temperance. Virtue ethics should be universally accepted.

4.2.2 Consequentialism

This theory holds that the consequences of a particular action develop the basis for any valid moral judgment about that action. For instance, a morally right action is one that produces a good outcome, or consequence.

4.2.2.1 Utilitarianism

This theory *is* a specific strand of consequentialist ethic in that, the moral worth of an action is primarily determined by its contribution to overall utility. This means its overall contribution to happiness or pleasure among all persons as opposed to sadness or pain. It is the satisfaction of preferences.

4.2.3 Deontological Ethics (Kantianism)

It is sometimes called duty or obligation ethics. Deontologists believe that ethical rules bind one to duty. The theory is concerned about the wrongness or rightness of actions in pursuance of duty and not the wrongness or rightness as a result of the duty. What matters here is the public official's fidelity to the principle and not the consequences for the individual or their usefulness to others. Duty is more critical in this theory.

4.3 Modern Moral Philosophy

Modern moral philosophy revolves around claims-based or rights-based ethics. These are ethical theories based on the fundamental principle of human rights which focus on people's freedom of speech, association, religion, civil rights, political rights and social/economic rights. The claims-based ethics implies that people have claims against somebody for instance the state, and that this somebody consequently has some obligations.

In the public sector, ethics address the fundamental premise of a public official's duty as a "steward" to the public. In other words, ethics is the moral justification and consideration for decisions and actions made during the completion of daily duties when working to provide the general services of government (Foot, 1983). For (Bass and Steidlmeire, 1999) the ethics of public officials rest on three pillars: firstly, the moral character of the leader, secondly, the ethical values embedded in the leader's vision and articulation thereof; and, lastly, the morality of the choices and actions within which leaders and followers engage and which they pursue to realise the ethical vision. These authors contend that corrupt behaviour is therefore not impulsive but rather it is a premeditated act.

(Van Wart, 2003:214) states,

"In the public sector, effective leadership provides higher-quality and more efficient goods and services. It provides a sense of cohesiveness, personal development and higher levels of satisfaction among those conducting the work. Effective leadership provides an overarching sense of direction and vision, an alignment with the environment, a healthy mechanism for innovation and creativity and a resource for invigorating the organisational culture."

Given that kind of leadership in Zimbabwe, the level of corruption could go down significantly in the public sector. The unethical leadership in Zimbabwe hatches corrupt practices and a lack of responsiveness to the needs of clients. According to (Naidoo, 2012) , unethical behaviour often starts at the top of the public sector, where public sector values are not personified and promoted. This may be attributed to lack of accountability, lack of transparency and lack of responsibility.

It can be suggested that by placing greater emphasis on accountability, responsibility and transparency and adhering to rules and procedures, effectiveness and efficiency in Zimbabwe's public sector can be improved. In the subsections to follow we discuss corruption, governance and whistle blowing in the realm of traditional and modern moral philosophy.

4.4 Corruption

In view of virtue ethics corruption is a break of several categorical imperatives which include avoiding injury and acting justly because corruption entails a favour to certain people. While deontological ethics is about commitment to principle it argues that corruption involves deception. This undermines the moral of those involved and therefore corruption is deemed unethical. The consequentialist theories and utilitarianism, however, may view corruption as ethical because some observers have argued that corruption is to "grease the wheels" and can make bureaucracies work more efficiently (which is useful to most people).While this argument is hardly seen today ,it can exemplify a perspective from which corruption can be seen as ethical. (World Bank, 1994) and (TI, 2005) define corruption as "the abuse of entrusted power for private gain" and (O'Leary,R,Gerard,C & Bingham, 2006:4) say that, it is a significant problem in much of the developing world. Some factors contributing to corruption are poor policies, and activities like procurement that are poorly managed; poverty; income disparities; inadequate civil service remuneration; unethical leadership and poor governance practices. It can be argued that unethical leadership breeds abuse of power.

4.5 Governance

The(World Bank, 1994) defines governance as the exercise of political, economic, administrative and legal authority in the management of a nation's affairs. Such authority may be acquired through election, appointment or delegation in the public sector (Siswana, 2007).According to (Farazmand,A and Pinkowski, 2007:313) governance is a value-laden normative concept, referring to how well governments govern or whether the government serves the citizenry well. As such, good governance implies (Edwards, 2008) a condition whereby such authority is discharged in an ethical, effective, transparent and accountable manner, while bad governance is associated with unethical practices in the public sector. Good governance practices allow for whistle blowing to alert the public on unethical behaviour.

4.6 Whistle Blowing

The assertion by (Masaka, 2007:33), that whistle blowing and the obligations of loyalty and obedience in Zimbabwe presents a classic case of competing moral values. These competing moral values are the basis of ethical or moral dilemmas. An ethical dilemma is a situation involving a choice between two opposing courses of action, where there are reasonable moral considerations in support of each course of action. This situation of conflicting moral choices calls for individuals who are courageous enough and prepared to make hard choices in which case they have to promote one or the other of the values, but not both. In Zimbabwe, cases of immoral practices in the public sector present moral dilemmas to the public officials, whether to blow or not to blow the whistle given these conflicting moral circumstances. In most cases the punishments meted out to the whistle blowers inflict pain, for instance, through victimisation (Shaw, 1999). However,(Bok, 1988), views whistle blowing as an act of disloyalty mainly because the whistle blower's public exposure of alleged immoral practices in the business is a violation of loyalty both to the firm and to his fellow employees. Therefore, according to Bok, whistle blowing violates public sector and collegial loyalty while at the same time it helps to inform the public about malpractices that are likely to injure their health and well-being. Masaka notes and we agree that while Bok castigates whistle blowing for violating public sector and collegial loyalty, he also defends it. What is important in this case is to determine whether collegial loyalty has more moral weight than loyalty to public welfare. This article argues that loyalty to the public interest should take precedence to that of the public sector entity.

The observation by,(Shaw, 1999:282) that the obligations of loyalty and obedience to one's employer are morally suspect because such obligations try to inculcate domination of the ethical sensitivities of employees and hence prey on the employees' autonomy and private lives. This holds true to a large extent to the public sector in Zimbabwe. The employer therefore, who does not cherish ethical values tends to corrupt the employee who sees the employer condoning corrupt tendencies. It takes a person of high moral fibre to report unethical practices like corruption even if it means risking the loss of his/her job. (Larmer, 2002:161) remarks that, "Loyalty does not imply that we have a duty to refrain from reporting the immoral actions of those to whom we are loyal." Loyalty that persuades employees to 'see no evil' and 'speak no evil' when immoral practices are an injury to the public, is misdirected.

5. Codes of Conduct and Codes of Ethics

Renowned codes of ethics include the International Code of Conduct for Public Officials adopted by the United Nations General Assembly in 1996 and the Model Codes of Conduct for Public Officials developed by the Council of Europe and adopted by the Member States in 2000. They serve as a reference point for states administration. Among other provisions, the codes state that the public officials should carry out their duties in accordance with the law, in a politically neutral manner and should not attempt to frustrate the lawful policies, decisions or actions of the public authorities. Equally important are provisions, which say that public officials should not allow their private interest to conflict public positions which they occupy. Further, in the exercise of his/her discretionary powers, the public official should ensure that public property, facilities, services and financial resources which are entrusted upon him/her are managed and used effectively, efficiently and economically. Well written Codes of Conduct provide that public officials should not accept a gift likely to, cause them to act with prejudice in the course of their duties.

6. Assets and Income Disclosure

Proponents of public sector ethics have argued that one of the key instruments for maintaining integrity in the public service is income declarations. This includes statements that show the assets and liabilities of all those in positions of influence and those of their immediate family members. This helps to identify what wealth is not fairly attributable to income, gift, or loan. It is a notion that is winning support from international agencies.

7. The Significance of Good Ethical Practices in Zimbabwe's Public Sector

Limited resources; citizen demands; departmental autonomy and managerial discretion all present challenges that require ethical consideration as will be shown in this section.For the majority of people in Zimbabwe, it may seem that they are approaching a moral crisis, more than an apparent crisis of confidence in the political authorities. This may also be a crisis of confidence in the representativeness and legitimacy of public sector management. This may pose a problem with a serious effect on the public service as it results in a loss of respect for the institutions and a lack of ethical and law enforcement role models.

7.1 Working with limited resources

When resources are limited, there may be pressure to cut corners or to bypass due process. If people feel underpaid and insecure, morale goes down, and then they may be less willing to work extra hard. It seems government is aware of the possible risks of these factors and acknowledges that the conditions under which public servants work are important in ensuring a climate conducive to ethical conduct.

7.2 Citizen demands

Making government more client-oriented is a central platform of public management reform in many countries. This means that, at the same time as having to manage with fewer resources, public servants also face pressures from increased public demands for more and better quality services. Conflict might arrive between client rights and the public servants' obligation to keep within economic limits. These conflicts of objectives and responsibilities manifest themselves as dilemmas that must be resolved directly by public servants. When high public expectations are not met, public servants meet the burden of the public's dissatisfaction.

7.3 Departmental autonomy

In Zimbabwe, departments now enjoy relatively more autonomy. As departments define their own standards and ways of operating; concerns have been raised that the inculcation of public service values are breaking down.

7.4 Managerial discretion

Within departments too, there is significant devolution of authority to individual managers. Considerable discretion is left with operational managers to choose inputs, and re-allocate funds between programmes or activities. Flexibility has also been given to managers in the management and deployment of human resources.

8. Contextualisation of Unethical Practices in the Public Sector

Unethical practices in Zimbabwe have become endemic within public sector entities. Those highly reported in the media and noted by (Yakamoto, 2014) include Willowgate scandal (1988); War victims compensation scandal (1994); Grain Marketing Board scandal (1999); Chiadzwa diamond scandals (2006-2014);the airport road scandal (2008-2014); and the salarygate scandals.

In 2012, Cabinet noted with concern that the Grain Marketing Board (GMB) had not realised a profit over the previous ten years owing to malpractice. At the Zimbabwe Broadcasting Corporation (ZBC), the Minister of Information (2014) dissolved a board running the entity for allegedly being embroiled in the corruption that saw the chief executive officer taking home over forty thousand American dollars when the shop floor staff went without pay for months The Office of the Auditor and Comptroller-General is believed to have unearthed a lot of rot in the government circles such as the Central Mechanical Department (CMED); the Tender Board of Zimbabwe; the Vehicle Inspection Department; Zimbabwe Revenue Authority (ZIMRA); Immigration; Passport Offices; traffic corps and in local authorities.

Table 1. GCI Ranking Comparison for 2012-2013 and 2013-2014 (the bottom 20)

Country	2012-2013	2013-2014
	Rank out of 143	Rank out of 148
Uganda	126	129
Benin	127	13o
Zimbabwe	**127**	**131**
Madagascar	128	132
Pakistan	129	133
Venezuela	131	134
Mali	132	135
Malawi	133	136
Mozambique	134	137
Timor-Leste	135	138
Myanmar	n/a	139
Burkina Faso	136	140
Mauritania	137	141
Angola	n/a	142
Haiti	138	143
Sierra- Leone	139	144
Yemen	140	145
Burundi	141	146
Guinea	142	147
Chad	143	148

Source: The Global Competitiveness Report 2013-2014:15

Unethical practices of this magnitude in the public service are disgusting because public service delivery should be a culmination of the extent to which moral dimensions of ethical practices are upheld (Morscher, E. Neumaier, O and Simon, 1998:145). In light of this (Masaka, 2007:32) asserts the importance of ethics in humanity's daily endeavours and interactions with public entities. It is difficult to conduct business with an unethical person, in that one cannot risk trusting him/her and the commitments and promises he/she makes(Trevino, and Nelson, 1995:290). According to (Masaka, 2007) a case in point is that of Zimbabwe where public sector malpractices are reported to be on a meteoric rise. People have lost faith in the way some public officials perform duties given a plethora of cases of malpractices that have beset Zimbabwe. Good public service delivery is only possible if the ones who engage in it do so in a manner that shows respect for the well- being of partners, clients and society at large.

9. Statistical Analysis

The Global Competitiveness Index (GCI) is a tool that assesses the competitiveness of 148 economies across the world in all stages of development including performance of public sector institutions. Table 1 above shows the position of Zimbabwe (in bold) in the bottom 20 of the 143 economies for the period 2012-2013 and bottom 20 of the 148 economies in the period 2013-2014.These positions are not pleasing for a country with a literacy rate soaring above 80% in the last decade. In table 2, public institutions in Zimbabwe continue receiving weak assessments due to corruption and favouritism. Table 3 shows the GCI for Zimbabwe in some detail with selected indicators that directly relate to public institutions. Indicators are expressed as scores on a scale 1-7 with 7 being the most desirable outcome.

Table 2. The GCI for Zimbabwe in detail: Selected Indicators

Measure	Year	Index/Ranking
Transparency International Corruption Index	2012	163/176
World Bank-Doing Business Millennium Challenge	2013	172/185
Corporation(MCC) government effectiveness	2013	-0.53
MCC control of corruption	2013	-0.43

Source: The Global Competitiveness Report 2013-2014

Table 3. Global Comparisons of Economic Competitiveness and Corruption: Zimbabwe's index / ranking

Indicator	Value	Rank/148
Judicial Independence	2.7	77
Favouritism in decisions of government officials	2.6	108
Wastefulness of government spending	2.6	112
Reliability of Police Services	3	123
Degree of customer orientation	3.7	133
Hiring and firing practices	2.4	146

Source: Bureau of Economic and Business Affairs Report (2013)

10. Bad Practices Going Unreported

Management in some sectors of the public service is intolerant of any employee who reports unethical practices. The employee is subjected to various forms of victimisation, open or latent, ranging from physical and verbal threats through to psychological traumatization in a bid to silence the would- be whistle blowers.

The vulnerability of employees to whimsical victimization by management is high in Zimbabwe's public sector. This is calculated to scale down the propensity for reporting malpractices by senior managers. The victims are then used as examples of bad apples by management when management instills fear in other employees. Therefore, unethical practice in Zimbabwe's public sector tends to be on the side of senior management. Any real or perceived unethical practice at lower levels is expeditiously dealt with by senior management. This helps senior management to mask their own unethical practice and bolsters their integrity in the eyes of the general public they purport to serve.

Evidently, instead of public entities taking a keen interest in the corporate misdeeds exposed by the employee, they undertake to harass the employee for making unauthorised disclosure of real or perceived corporate misdeeds. Whistle blowing should be allowed to provide checks and balances in the public sector. There can be no plausible reason to bypass good ethical behaviour in the public sector as corroborated by Ross in (Boss, 1999:27) who wrote that the moral duty of non-maleficence (duty not to cause harm) overrides the duty to maximise profits.

The Central Bank Governor of Zimbabwe established a Whistle Blower Fund in December (The Financial Gazzette, 2004). The fund was meant to reward those who reported corrupt practices although in the private sector. Here was a window of opportunity to learn and do the same for the public sector. Whether the fund achieved the intended objective in the finance sector is for others to comment. A similar fund for public sector ethics could have arrested the rate of unethical practices and corruption that have pervaded the corridors of power and authority in the public service delivery system in Zimbabwe today. Public officials however, must expose and report immoral business practices because it is the right thing to do. But the conditions to do what is right for its own sake in Zimbabwe may not always be possible. Some employees would say, “Why risk my life or losing my job?”, as a result they will not report any unethical practice. The complexity of the matter may lie in senior public officials possibly being political appointees as opposed to their being appointed based on merit.

Zimbabwe may need to develop uniform ethical standards that cut across the public sector. The upsurge in immoral practices in the public sector in Zimbabwe today primarily driven by greed puts Kantian moral theory to a stern moral test.

11. Impediments to Good Ethical Practices

Zimbabwe faces several challenges that militate against ensuring that public sector ethics are emulated by the public. These include legislative gaps on how to manage conflicts of interest in which senior public officials are politicians; and where there are delays in initiating investigations; delays in conducting and concluding the investigations; and delays in taking decisive action where investigations are concluded. Law enforcement agents often appear incapacitated to handle certain cases because some public officials appear to wield wide discretionary authority to determine investigation outcomes.

This is probably meant to enable weakening possible ‘ripple effects’ when the culprits are eventually brought to book with punitive action being taken. When audits expose unethical practices, management and other agencies that are required to follow up the cases to the logical conclusion, tend to develop cold feet In some cases a game of hide and seek may be played where senior management may appear to be waiting for a decision from the board or the minister. On one hand, the board or minister may bury their head in the sand and claim it is a management issue. On the other hand, they may claim to be preoccupied with policy issues.. There is an apparent need for political will to uphold ethical standards and reduce corruption levels.

12. Conclusions and Recommendations

The study indicates that public sector ethics are lacking as manifested by high levels of corruption and public outcry over maladministration of public institutions.Global Integrity (Global Integrity, 2011), reported that the Anti-Corruption Commission is highly inefficient, ineffective and “has very little authority to take steps aimed at stopping corruption in Zimbabwe”. Out of 147 corruption cases reviewed by the Commission in 2006, only 4 were completed.

Anti-corruption bodies would require shielding from undue political interference and need to be capacitated.There is need to plug legislative gaps that appear in the impediments as highlighted.The government needs to expeditiously give attention to public officials implicated and involved in corruption so that the public does not assume nothing is being done. Political will to improve ethical conduct will go a long way in improving ethical behaviour. Government sponsored entitlements like huge fuel allocations should be trimmed when the economy is weak. It may be worthwhile to consider establishing clients’ service charters in all public sectors. Term limits for political appointments in the public sector may eliminate the entrenchment of unethical behaviour unlike where open-ended tenure of office is allowed to prevail. A facility to offer rewards for providing evidence of corruption and other forms of practices that violate a comprehensive code of ethical conduct may improve ethical conduct. Treasury may require capacitation to monitor effectively and efficiently the flow of money. Government should develop stiffer punitive measures against those convicts of corruption, abuse of public office and other related offences.

Further research is needed to establish solutions sector by sector as no one solution may suit the entire public service.

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MAPPING THE GROWTH AND DIRECTION OF CORPORATE GOVERNANCE RESEARCH: A BROAD OVERVIEW OF LITERATURE BETWEEN 1930 AND 2014

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Abstract

In the past two decades, corporate governance (CG) literature has grown in leaps and bounds. The quick succession with which some corporate scandals surfaced in the early 2000s and their extensive media coverage have prodded the social science researchers to go back to their story boards and examine the reasons for such scandals. Interestingly, corporate behaviour was no more the exclusive preserve of micro-economists and finance researchers. Instead, researchers from different disciplines like philosophy, psychology, sociology and law too joined in examining issues related to what is today popularly known as corporate governance. Each scholar tested hypothesis and offered explanations in a language native to her own discipline. Given the pervasiveness of the social sciences, very soon corporate governance begun to be explained and understood in an increasingly multi-disciplinary perspective. Each discipline brought in its own unique flavour in picking and explaining the nuances of corporate governance. With so many disciplines contributing to a single overarching theme, it is no surprise that today there is a surfeit of corporate governance literature and more continues to get added every single day. This paper reviews the growth and development of CG literature over the past eight decades. In doing so, it studies 1789 published research papers to track how literature organized itself to build the CG discourse.

Key Words: Corporate Governance, Literature Overview, Evolution of Corporate Governance Research

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Introduction

Way back in the early 2000s, in the aftermath of the Enron debacle, when corporate governance (CG) has entered the research lexicon and also became a 'must write' story for the pink journalists, very little was heard or known of the concept in most countries, both developing and developed. Most authors, both academic and non-academic, built their first set of arguments drawing largely from the then bible of CG, The Adrian Cadbury Report.

Academicians from different disciplines jumped onto the new gravy train of management literature and each discipline attempted at appropriating the concept of CG unto itself. While finance researchers looked at CG from a financial performance perspective, the accounting fraternity tried to appropriate CG citing checks and balances as its exclusive territory. On the other hand, moral philosophers built the moral undertone to explain fiduciary responsibilities; political economists cited growing internationalization as the reason to converge to global best practices; behavioural economists argued that governance outcomes are largely driven by behaviours of individuals who run the corporations; stakeholder theorists have added a whole host of constituents, including the shareholders, as those having stakes in corporations; CSR theorists have vehemently argued the need for corporations to display humane emotions; firm theorists and economists have tried to strengthen the understanding of CG through their expositions on firm theory; legal theorists have looked at CG from the prism of contracts and associated value expropriation; and regulation theorists have advocated the need for regulation, both statutory and self-regulation and the list continues[5].

Today, a novice researcher of corporate governance finds herself in a fairly advantageous situation. She has multiple starting points to choose

[5] As more and more journals are getting published each passing year, the demand for content has increased. Today, researchers find it easier to share their perspective via multiple platforms and in multiple forms. With inter-disciplinary research taking huge strides in the recent past, it is no surprise that business researchers attempt at probing CG problems with a scientist's microscope. So of late, we have witnessed the growth and acceptance of hitherto unrelated terminology in CG research.

from. Based on where her research interests lie and her penchant to contextualize, she may pick from an array of CG sub-areas, for example, impact of ownership structures on firm performance, or say roles played by boards, or maybe she can look if regulatory bodies are successful in harnessing corporate anomalies and so on. Even within the selected sub-area, she still has multiple choices to pick from. Today, there is neither a dearth of governance literature nor that of a good starting point. Also, given that most sub-areas have, over the years, developed a literature lineage of their own, novice researchers do not find the need to depart much from their chosen sub-field to patronize an understanding of the precedents of the parent discipline. This the author feels slows down the scholar's process of intellectual assimilation early on in her research career. This is also the reason why most scholars graduate to become passive followers later on in their research careers. A sense of history if built into the research process helps the scholar sharpen her research skills as the direction of the discipline becomes more conspicuous. It also helps the researcher in shunning mindless usage of statistical tools and publishing work that largely remains unconsumed by a vast majority of her peers.

In this paper, I try to scan the extant literature on CG and make an attempt at chronicling its growth. While the initial research interest in CG may seem to have been built post the failures of corporate giants like Enron, Tyco International, Adelphia, Parmalat and the lot, in reality, as a concept it entered the contemporary academic lexicon way back in the 1930s with Berle and Means' separation of ownership and control argument[6]. However, it is important to note that right from the time the corporate form of business started, CG existed, though mute in its manifestation. If we push Berle and Means' separation hypothesis a bit backwards, CG had its predecessor in the theory of property rights and its delineation hypothesis. Likewise, one can go as far back as evolution of the homosapiens to contextualize current day governance problems.

For the purpose of this review, let us drop our anchor at the Berle and Means' hypothesis not only because it sheds a more contemporary light on today's CG problems but also because this hypothesis has been the starting point for the initial set of governance researchers.

A total of 1789 publications that include books, research papers and popular articles spanning eight decades of CG research, dating back to as far as the year 1932 to the current day and published in publications of repute have been picked for the purpose of this review. To a large extent, articles that reinforce established evidences and as a result add little value to the broader CG discourse have been dropped out of the collection[7]. The idea is not to overwhelm the reader with the stockpile of extant literature but to carve out the path and direction that CG research undertook in the past eight decades.

After a thorough sifting and sorting of the extant literature, I feel that CG literature has grown in *two phases* and over *five periods*. Generally understood, phase and period can be synonymous. However, for the sake of this paper I have tried to subtly distinguish them. *Phase*, for the purpose of this study indicates 'turning points' in CG research and therefore has a temporal and spatial connotation. A phase could include more than one contiguous time periods. As of today, I document two such turning points that have leapfrogged CG research in multiple directions. On the other hand, *period* has temporal and pattern connotation. I postulate that during a certain period CG literature has followed a certain pattern only to alter or extend its course in the subsequent period.[8]

[6] Readers may note that Berle and Means were not the first scholars to have forwarded the separation hypothesis. The original father of the separation hypothesis is Adam Smith who in 1776, in his epic tome, *An Inquiry into the Nature and Causes of The Wealth of Nations*, clearly articulated that the separation of ownership and control is the primary reason for all CG issues, thus:

"The directors of such companies [joint stock], however, being the managers rather of other people's money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master's honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company. It is upon this account that joint stock companies for foreign trade have seldom been able to maintain the competition against private adventurers. They have accordingly, very seldom succeeded without an exclusive privilege, and frequently have not succeeded with one. Without an exclusive privilege, they have commonly mismanaged the trade. With an exclusive privilege, they have both mismanaged and confined it."

[7] Suffice it to say that there are over 50000 research papers around the concept of CG. Of the stated number over two thirds are published in national, regional and school sponsored journals. Consumers of most such publications are by and large limited to peers contributing to these journals. The author has extensively studied the quality of published papers and is not surprised that most papers duplicate work done by contributing peers. Therefore, there is no new knowledge creation in CG. And for that matter, even papers published in peer reviewed international journals have not gone beyond the spectrum of 'ownership, board, audit, performance and capital markets' research. Such papers are published only to serve the archaic 'publish or perish' mandate adopted by academic institutions.

[8] This paper tries to build a sense of history in the way CG research has evolved over the past eight decades. For more incisive and extremely well-researched reviews, please

As will be discussed below, the five periods are subsumed in two phases. In the first phase spanning about seven decades (1930-1998) the actual crux of CG literature got developed. For a social science discipline to grow and make its impact felt, this is undoubtedly a very long time. The second phase (1999-2014) has largely focused on comparing the suitability of the extant governance models in the wake of globalization and a newer set of issues pervading modern corporations.

In the initial stages of literature scan, I consumed papers in no particular chronological order. Papers were picked at random and read for the perspective or findings they were to provide. In all this randomness though, I found that there emerged a certain pattern. Most papers either liberally picked from the Berle and Means' separation argument or extended it.[9] In more ways than one they tried to establish the supremacy of the capital oriented Anglo-Saxonic governance model, and rightly so.[10]

As I kept reading papers with more application, it was evident that despite the separation hypothesis being the original starting point for research, many sub-starting points began to emerge ushering in the growth of several sub-disciplines within the CG literature. Over the past two decades though, researchers have increasingly published on these sub-disciplines and most research output simply fails to inspire. Also, the excessive focus by academics on empirical research, in a bid to be counted as serious researchers, has led to a steep decline in augmenting incisive arguments around CG literature.

In a mad rush to publish papers, especially to remain relevant and survive the rigors of academia, academicians have done a huge disservice to the growth of CG literature. Duplication of empirical research abounds in CG. Papers have replicated previous publications by making cosmetic changes, like a small alteration in the statistical model used, or studying a different industry, or by changing a variable here or there or simply by manipulating sample sizes. Of what intellectual or scholarly consequence is a paper that examines how a sample of 87 firms in the manufacturing industry located in region 'X' performed against four accounting variables with a certain board composition vis-à-vis how a sample of 350 mid-sized companies in region 'Y' performed against five accounting and one market variable with the promoter also being the chairman of the board? As long as these are early studies in literature, they are relevant as they expose the subsequent researchers to the pointed differences that may or may not exist in such samples, industries, variables, locations chosen. However, when researchers who attempt similar studies four decades after the first such study, I feel, add to the unwanted burden to the extant literature. So while the so-called research output, in terms of volume, grows in leaps and bounds, our understanding of the research area remains stationary. Most research output, I contend therefore, is inconsequential in that it does not contribute a speck in furthering the understanding of CG discourse.

It is therefore, authors like Bowen (1953), Demsetz (1985), Friedman (1970), Alchian and Demsetz (1972), Jensen and Mekcling (1976), Fama and Jensen (1983), Freeman (1988), Arthur (1989), Oliver Hart (1995, 2001), Shleifer and Vishny (1997), Barzel (1997), Blair (1998), La Porta et al (1999), Bebchuk and Roe (1999), Roe (1994, 2003), Rajan and Zingales (2000, 2001), Jacoby (2001) who either fully or partially succeed in changing the direction of the discourse.

In addition, a whole host of CG recommendation reports published in the decade of 90s viz., Cadbury Committee Report (UK, 1992), Dey Report (Canada, 1994), Vienot Report (France, 1995), Greenbury Committee Reort (UK, 1995), Peters Report (Netherlands, 1997), Hampel Report (UK, 1998), Olivencia Report (Spain, 1998), Cardon Report (Belgium, 1998), Mertzanis Report (Greece, 1999), IAIM Guidelines (Ireland, 1999), Preda Report (Italy, 1999), Turnbull Report (UK, 1999), Cromme Commission Code (Germany, 2001), Nørby Commission Report (Denmark, 2001), Kumara Mangalam Committee Report (India, 2000), have spawned renewed interest in the examination of CG from a country perspective. While the originality of most of these reports is questionable, as some of them seem to be *content farmed* from earlier reports, yet, the reader may reckon that to a large extent these reports have been successful in nudging researchers to probe country-specific governance models. For a brief period, this helped researchers outside the US and UK markets to look at which governance models their home country's CG is patterned on. However, once the initial modelling was done, researchers got back on to their replication studies mode by appropriating hypothesis from published papers and contextualizing them to their research settings. For example, if a paper published by an American researcher examined if board committees have had any impact on firm performance, her Indian counterpart would examine the same issue albeit with the Indian market as her context. In reality, the Indian market might not fully mimic the behaviour of the American market. Yet, a study is done, results reported and paper published. In the length of the

refer Shleifer and Vishny (1997), Denis, D.K. (2001), Tirole, J. (2005), Adams et al., (2009).

[9] Technically, these papers made sense as there was no parallel or competing notion of CG other than the Berle and Means' hypothesis on which literature could be reasonably strongly built.

[10] In the second phase, as articulated in this paper, this model though was to be the centre of all governance maladies. Subsequently, researchers scurried around to find alternative competing governance models to explain away the vagaries of market-oriented governance model.

paper, I might be arguing on the same lines, just to expose the futility of a bulk of the scholarly output.

Two Phases, Five Periods of CG Research

CG literature as has been mentioned earlier has grown in two phases, over five periods spanning eight decades of research (see Figs. 1 and 2). Unlike other research areas, CG has the distinction of both ***'outside-in'*** (assimilating and appropriating research of other disciplines unto itself; for example, social responsibility or say corporate law,) and ***'inside-out'*** (spawning newer and newer sub-disciplines, like capital markets, accounting and audit, regulation, etc.) research. It is like a huge vortex that assimilates from, re-adjusts with and seeds other research areas.

Figure 1. Direction of CG Research during 1930-2014

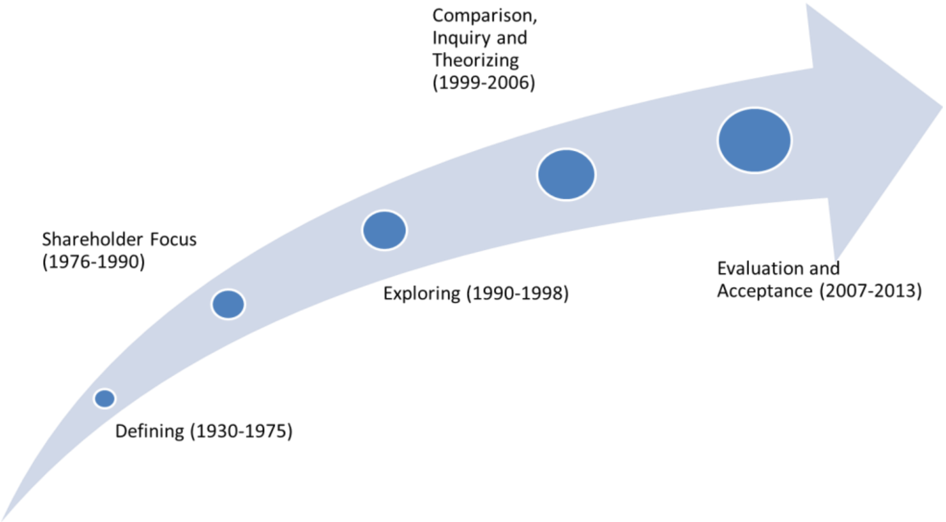
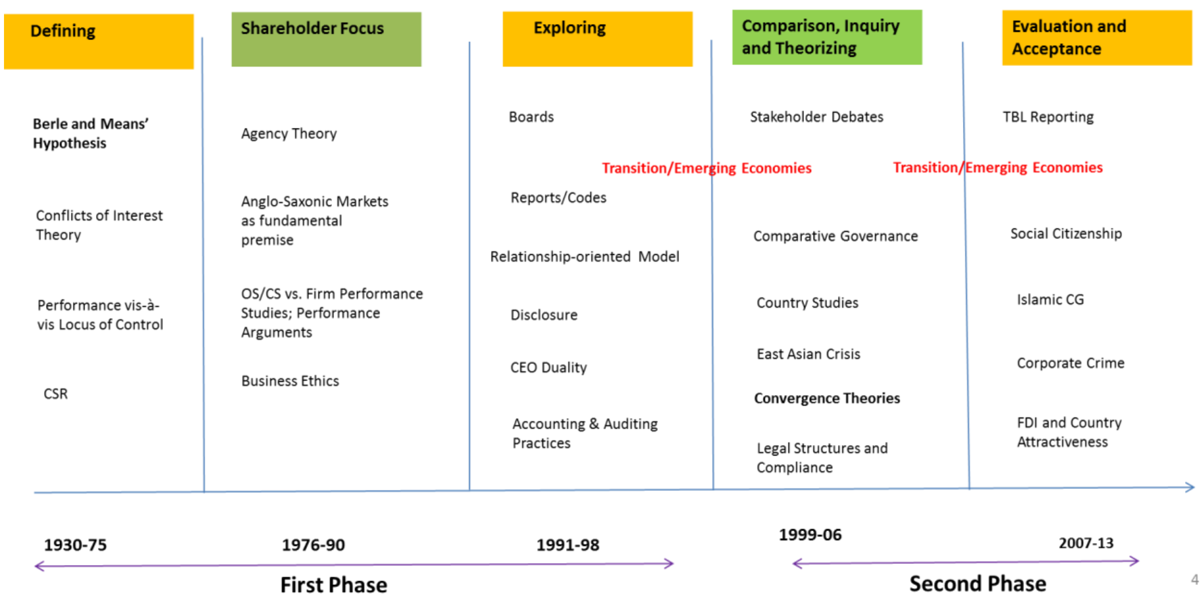


Figure 2. Broad areas of research during each period between 1930 and 2014



First Phase (1930-1998)

Between 1930 and 1998, CG research has more or less followed an organic script with the first period attempting to build the foundations for future research, the second period focusing on dominant research themes and the third period exploring themes other than the ones researched in the past. So essentially, the first phase of governance research comprises of the following periods – *defining* (1930-1975), *shareholder focus* (1976-1990) and *exploring* (1992-1998).

For a large part during this phase, CG research moved uni-directionally. Researchers conveniently assumed Anglo-Saxonic model to be the de facto governance model and most research centred around shareholders' gains and fiduciary responsibilities of boards. There could be multiple reasons for this research sclerosis. Social science researchers are as good as their access to relevant data. Market-oriented economies are more forthcoming in disseminating firm-level information, not because they practice it as a virtue but because of mandatory disclosures that they have to oblige to. Therefore a researcher in the lookout for both primary and secondary data is the happiest stakeholder given the level of access she has to of such data.

Given the ready availability of data in market-oriented economies, researchers churned more and more research output and therefore contributed to the unsaid advocacy of the primacy of capitalistic economies. It is also relevant to note that they had ready access to good quality research journals in which they could publish and reach out to larger audiences. On the other hand, researchers from other countries, especially from relationship-oriented economies and developing or under-developed countries had relatively neither free access to data nor to journals.[11] And those that published in international journals, found a better acceptance to their work, if they modelled it around contemporary thinking.

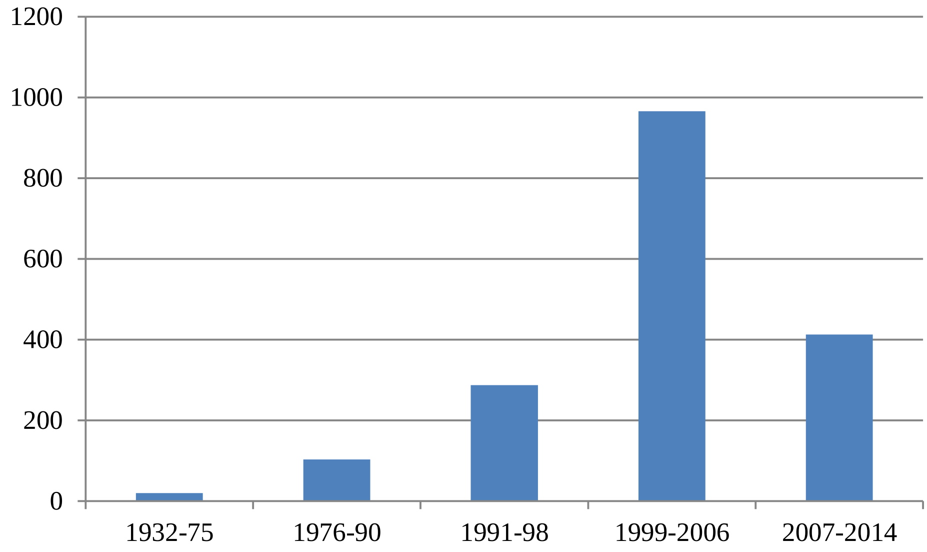
Suffice it to say that ‘publish or perish’ policy adopted by the academic world, globally, has to a large extent contributed to the burgeoning growth of CG research literature and unfortunately a major part of research output that found its way into journals lacked novelty in the true sense. Treatment and contemporariness of research far outweighed novelty and therefore led to a haphazard and valueless development of CG literature.

In the following sub-sections, an attempt is made to highlight the dominant sub-themes that dictated CG literature in each of the three periods during this phase. It is important to note that the periods do not follow a uniform time frame. Instead, they follow an observable pattern. Each pattern is succeeded by another, only when the starting point of the succeeding pattern has helped researchers break away from the previous period’s starting point, to start a slightly new line of thinking. This however does not preclude the assumptions made by previous period. Research in CG follows a certain continuum across these periods, with each new period ushering in a newer direction shaping future research output. Also, it may be noted that this paper will not give equal space to each of the periods, primarily because of the volume of research available in each period (see figure 3).[12] As far as possible, each of the periods would be dealt with at justifiable levels to flesh out the ‘pattern’ behaviour that they exhibit.

[11] This is also the phase when serious academics and budding researchers found US or UK as their primary labor markets. This phase is characterized by the movement of academics/researchers from developing countries to that of developed ones. On the other hand, post the year 2000, it is seen that most developing countries have to some extent been successful in plugging brain drain by establishing the requisite infrastructure to help their home grown researchers to engage in meaningful research. Migration and reverse migration/stapled migration of academics is an interesting phenomenon to be studied. However, it is not within the scope of this paper, and so barring a few generalized statements, this paper does not deal with it.

[12] Readers are to remain informed that the chart does not list the sum total of all CG papers published during the said periods. The author has picked a sample of 1789 research papers for the purpose of this study. The chart therefore indicates the number of papers published, from the sample, in each such period. The readers may also notice that the period between 1996 and 2000 saw an incredibly huge CG research output and this period’s publications far outnumber the sum of the papers published during the first phase (1930-1998) and the last period (2007-2014). One can safely attribute the high volume of research output during 1996 and 2000 to the post-Enron, post-SOX phenomenon and the East Asian crisis. However, following the initial interest in East Asian crisis, CG research output seems to have tapered down to a considerable level post 2007.

Figure 3. No. of CG papers published during each defined period



Defining (1932-1975)

The first reference point for most CG papers lies in the 'separation of ownership and control' hypothesis articulated by Berle and Means (1932). The authors in their paper "The Modern Corporation and Private Property" have argued that US corporations were growing bigger and bigger, both in terms of size and needs and therefore the promoter of the company could no more manage the corporation all by herself. Professionals with special skills were on-boarded to manage the ever growing corporations. And this is where the roots of corporate mis-governance lay. The interests of the managers were not in alignment with those of the promoters. This led to a conflict of interest. The manager by virtue of being in the thick of day-to-day operations had more information than the promoter. This helped her create information asymmetries and benefit from them.

On a closer scrutiny of CG research, post Berle and Means' argument, it is found that for about four decades from the time they published their work, there were not many takers who extended their line of argument. There could be multiple reasons for such neglect, most important among them being lack of delineation in management and economics research. Business research by and large was the realm of micro-economists and therefore 'theory of firm' was predominantly discussed and the larger issue of governance unassumingly neglected.

While management research, during this period, tried to articulate the primacy of the market system and the demands it placed on corporations, firm theorists dismissed the role of markets and instead emphasized on the importance of authority and direction that characterize the boundaries of the firm (Coase, 1937). The argument for the firm theorists did not lie in individual behaviour but in the nature of the firm per se. A firm is a sum total of its systems, policies, procedures and rules. So one cannot depart way too beyond the character of the firm to create governance challenges by herself.[13]

Even while the discourse on the role of markets vis-à-vis the boundaries of firms was still building up, some other strands of literature strengthened to contextualize what are today widely believed to be important CG issues. Property right theorists stand out in laying the foundation for the current CG discourse by deconstructing rights that individuals have over a piece of property[14] into either as economic rights or legal rights or a combination of both (Alchian 1965, Cheung 1969). In essence, they argue that the rights that individuals have on their assets or property is never absolute. The owners of property must make attempts to maximize their gains from their holdings and also it is incumbent upon them to protect themselves from being expropriated by other individuals. So essentially the governance issues lie in clearly understanding the attributes of the property owned by them and conferring appropriate decision rights to specialists that are hired to maximize the value of the property.

At around the same time, Bowen (1953) through his book "Social Responsibilities of the Businessman" tried to impress upon the fact that businesses do not exist in isolation. There are stakeholders that lie outside the internal boundaries of the firm and actions taken by firms might have a bearing on their welfare. It is therefore important that firms behave in socially responsible ways. Two decades hence, Friedman (1970) argued that the

[13] Modern day CG literature has heavily discounted the Coasian arguments in favour of the 'market efficacy' argument.

[14] In the context of the paper, property could be assumed to be a firm or shares in a firm or some level of ownership in a firm.

social responsibility of business is to increase profits and therefore firms should not be unduly weighed down by the burden of non-pecuniary societal demands.

Barring the property rights and social responsibility arguments none of the other arguments found any major traction in mainstream literature to supplement Berle and Means' *separation* hypothesis to contextualize CG. So after a major lull, CG research resurfaced in the late 1960s in major economic journals viz., *American Economic Review*, *Quarterly Journal of Economics*, *Economic Journal* and the like in what may termed as a tacit acceptance of the primacy of Berle and Means' hypothesis. Ownership structure became the focal point of research. Researchers attempted at deconstructing contemporary ownership and control structures and examined their impact on firm performance. In addition to understanding who owned corporations it was also important to examine if the owners really gave away control to managers and if they did whether manager controlled firms outperformed owner controlled firms. Most studies concluded that owner controlled firms performed better than manager-controlled ones (for e.g., Kamerschen 1968, Monsen et al 1968, Radice 1971, Boudreaux 1973, and Sorensen 1974). However some researchers found that there were no significant differences between owner-controlled and manager-controlled firms (Elliot 1972, Holl 1975), while some others found that manager-controlled firms performed better than the owner-controlled ones (Ware 1975). Conflicts of interest theory that came to dictate the separation hypothesis found its appropriate explanation in the empirical findings - be it in the control of conflicts through the incentive alignment mechanism or by way of efficient market functioning.[15] These studies somehow set the tone for the huge growth in current CG literature by blurring the boundaries between economics and business management researchers. Suffice it to say, *performance* or *impact* studies have to a large extent defined the shape of future CG literature and continue to dominate to this day in various manifestations.

Some seminal work like that of Alchian and Demsetz's (1972) characterization of the firm as a web of contractual relations and Ross' (1973) explanation of agency theory got lost under the heap of the more attractive empirical findings of *impact* research.

In summary, the period between 1932 and 1975 was characterized by the tussle to define and contextualize CG. Economists tried to explain their understanding of CG rooted in their nuanced research training. While different definitions were offered by different researchers, one can conclusively argue that the *separation hypothesis* offered by Berle and Means and the *conflict of interest theory* built both by Berle and Means and other property rights researchers has come to define the future of CG research.

Shareholder Focus (1976-1990)

The year 1976 in many ways resembles that of the year 1932. While Berle and Means can be credited of introducing CG to the future generation of researchers, Jensen and Meckling (J&M) through their path breaking article *"Theory of the firm: managerial behaviour, agency costs and ownership structure"* in 1976 steered CG literature to whole new heights.[16] Their discussion of the famous principal-agent problem -- a refined extension of the separation hypothesis – builds on the assumption that the agents (managers) would behave opportunistically to further their personal objectives and therefore the principals (owners) have to incur certain costs viz., monitoring costs, bonding costs and residual loss to align the agents' objectives with that of the principals' thereby reducing conflicts in interest. Interestingly, more and more empirical studies made their way into mainstream CG literature following J&M's principal-agent theory. While the methods, samples and tools adopted by researchers remained different, what is striking is the unilateral convergence of all the studies towards establishing the primacy of the 'separation' hypothesis. Studies emphasized the rapid growth of ownership dispersion and professional managers as the cause for all governance maladies. Performance arguments were built around this period with researchers finding enough evidence to extend the market efficiency argument or J&M agency cost hypothesis in more ways than one.

Some studies have concluded that firms in which managers owned substantial equity performed well indicating the convergence of interests between the owners and the managers. This argument is popularly known as the *incentive alignment* argument (see Steer and Cable, 1978; Thonet and Poensgen, 1979; Jacquemin and Ghellinck, 1980; Holderness and Sheehan, 1985; Lewellen et al, 1985). Some others have evidenced that firms that are characterized by high owner equity-holdings have performed better. Large blockholders are motivated to control management and therefore are better monitors (see Shleifer and Vishny 1986; Pound 1988).

The seeds of empirical research in CG were sown during this period with researchers showing remarkable inquisitiveness in understanding the different behaviours of individuals along the principal

[15] Incentive alignment argument and efficient market hypothesis gained more traction in the subsequent periods as CG literature matured. It is however important to note that these arguments were fleshed out as early as in the late 1960s and early 1970s in the cited studies.

[16] Agency theorists existed prior to Jensen and Meckling, for e.g., Ross (1973) but Jensen and Meckling's paper attracted unprecedented traction and therefore established them as the frontrunners in agency theory research.

–agent spectrum and by ably condensing such behaviours in patterns that can be explained with economic rationale. In addition, they have also extended our understanding of how the markets behave in response to, or as a method of disciplining, managerial actions. Be it the *entrenchment hypothesis* that argues that higher equity ownership negatively impacts firm performance (see Morck et al, 1988; Jarrell and Poulsen, 1987; Holderness and Sheehan, 1988; Agarwal and Mandelkar 1990) or the *cost of capital argument* that claims higher equity concentration increases the cost of capital thereby stunting firm performance (Fama and Jensen, 1983), or the *takeover premium argument* that managers are motivated to perform well to make hostile takeovers costlier (see Stulz, 1988; Stulz, Walkling and Song, 1990) researchers have tried to build varied perspectives into our understanding of the dominant CG issues of the time.

Through the length of this period the fundamental premise of the existence of Anglo-Saxonic markets with excessive focus on shareholder value maximization has been the dominant silhouette within which CG research was conducted. Most research output bordered around building a case for the need for stronger mechanisms to discipline unaligned and deviant managers. In studying the performance of firms, researchers have deconstructed firm ownership in three ways - *form* (capital structure), *class* (equity owning groups) and *locus of control* (location and degree of control enjoyed by the owners or managers). The focus of research in all of them has been in examining and understanding if shareholder value is maximized or expropriated. From unearthing the capital structure choice puzzle (Myers, 1984) to establishing relationship between debt ratio and managerial shareholding (Friend and Lang, 1988); from studying if ownership structure has a positive, negative or no relationship with firm performance to regressing the impact of ownership classes like large blockholders, institutional investors, financial institutions on firm performance (Cable, 1985; Demsetz and Lehn, 1985; Brickley et al 1988, Agrawal and Mandelkar, 1990); from exploring if strong-owner controlled firms performed better than weak-owner controlled firms vis-à-vis manager controlled firms (Holl, 1977; Steer and Cable, 1978; Bothwell, 1980; Madden, 1982; Cubbin and Leach, 1983 amongst others) --- most studies during this period have firmly established the current day suspicion that has come to characterize managerial behaviour and rightly so.

While only a small sample of empirical studies are mentioned in this paper, it would not be an exaggeration to contend that regression analysis of one or the other ownership variable on firm performance dotted the CG literature landscape. Herzel (1990) decried the excessive and incorrect use of statistical tools in contemporary CG research and cautioned CG researchers from rushing towards generalizations given the lack of new and significant information from such studies.

In addition, substantial literature on *business ethics* and *boardroom impact* started building up around the same period lending support to the performance empiricists' assertion of shareholder value expropriation by managers. Whether it is a quick survey conducted by of 1200 US readers to gain a perspective on how they perceive contemporary managerial action or Hull's (1979) exposition on varieties of ethical theories, the importance of the ethics in explaining the nuances of shareholder value expropriation was not lost on CG literature. Perhaps, the loudest cry in proposing ethical behaviour was made by George K Saul (1981) of the US Army in his *Academy of Management Review* paper titled "Business Ethics: Where are we going?" where he proposes a manager's guide to ethical decision making and also exhorts business schools to proactively embrace the teaching of ethics in their curricula.

Vance's (1978) study of boardroom attributes to contextualize CG was perhaps amongst the first concrete studies to have been made on board versus performance. Subsequently numerous studies poured into CG literature bringing with them the richness of different perspectives but the focus essentially hovering around the assumption of diverse ownership and the primacy of shareholder value. In examining the proxy contests for board directorships and their impact on performance (Dodd and Warner, 1983; DeAngelo, 1988, Harris and Raviv, 1988), or studying the composition of boards that registered or paid for greenmail (Kosnik, 1987) or even articulating the role of boards (Mueller, 1981; Molz, 1985) the period between 1976and 1990 successfully built the foundation for future board impact studies.

Exploring (1990-1998)

The last period of the first phase i.e., 1990-1998 has seen a dramatic increasing in contributions to CG literature and more importantly helped build a truly rounded perspective of the concept of CG.[17] While in the previous periods, CG was mostly an exclusive preserve of micro-economists and ethicists predominantly based out of the Western world, this period saw contributions from political economists, sociologists, regulation researchers, finance and behavioural finance experts, macro- and development economists, stakeholder theorists, accounting and audit researchers and business philosophers spread across different geographies of the world.

Literature on corporate governance that got built during this time assumed the form of exploration and testing. Constructs that emerged in the previous two periods were tested for generalization on a larger

[17] Notwithstanding the tautological empirical studies that add little value to the richness of CG discourse.

scale across different market forms. This form of exploratory research has been both a boon and bane to CG literature. While it helped bulking up research output and developed a quick understanding of contrasting governance models practised worldwide, it also paved the way for mindless and anachronistic mapping of established CG studies to different local contexts.

The myth of the diverse ownership structure, and therefore the Anglo-Saxonic market, was busted during this period and researchers have increasingly realized that even in the most so-called market-oriented economies, ownership concentration was common and therefore the assumption of managerial expropriation of shareholder value was more exaggerated in the previous periods than was needed. However, ready availability of corporate financial data in market-oriented economies incentivized researchers to quickly analyse data statistically and publish their papers. An unprecedented number of papers studying the impact of ownership structure on firm performance made way into mainstream CG literature. While some helped build incisive insights, most studies replicated existing studies by looking at different datasets, samples, industries or time periods.[18] While the research output scored on the 'publish or perish' mandate, it added little value in forming broad generalizations of corporate behaviour.

Relationship-oriented model of governance manifested itself with different features viz., ownership concentration, absence of strong capital markets, cross-shareholdings, two tier board structures, etc., in various interesting studies (see Packer and Ryser, 1992; Prowse, 1992; Osano, 1997 amongst others) and offered a contrasting view to the extant Anglo-Saxonic governance model. This certainly has been the most definitive contribution to the understanding of global CG. While in the earlier periods CG research was largely contextualized to the Western Anglo-Saxonic assumption of diverse ownership and its concomitant CG issues, the founding and articulation of a new model posed a healthy threat to the dominance of one-sided CG literature. In more ways than one, it helped in opening up the CG debate thereby leading to building a rich CG research repository. The German, Korean, Japanese and French models offered a layered understanding of relationship-oriented CG mechanisms. While each model is unique in itself, it contributes to the larger theme of relationship model of CG. Interestingly, this period lay the foundation for future CG debate on the advantage and supremacy of one model over the other.

The period beginning 1990 brought to the surface many CG scandals that gained notorious popularity with news media giving each scandal unprecedented column-inch space fuelling academic research on the importance of corporate stewardship and fiduciary responsibilities (see Donaldson and Davis, 1991; Hawley and Wiliams, 1997). Researchers began looking more closely at board compositions and how they influence various corporate actions (see for e.g., Mallette and Fowler, 1992), how boards in different countries fare against each other (Demb and Neubauer, 1992), if boards need to self-regulate or if legislation would help them perform their duties well (see Stiles 1993), role played by the board in strategy formulations (Tricker, 1994), significance of co-deterministic boards (Hopt, 1994), market valuation of companies with smaller boards (Yermack, 1996), impact of CG on board entrenchment (Sundaramurthy et al, 1996), role of outside directors in corporate control (Mayers et al, 1997; John and Senbet, 1998), board efficiency (Huther, 1997), impact of board size and structure on firm performance (Vafeas and Theodorou, 1998; Eisenberg et al, 1998), board-stakeholder relationships (Huse, 1998) among other board related studies. This led to a substantial interest in extending our knowledge of boards and their contribution to CG.

While board studies influenced CG research considerably, researchers were quick to identify an interesting development in the corporate world. Anglo-Saxonic markets seemed to have CEOs who also occupied the chairperson's position on the board in effect creating an interesting reporting relationship. As chairperson of the board, the CEO is in a unique position of reporting to herself and also largely accountable to herself. Researchers studied CEO duality very closely to examine if such duality offered any private benefits of control to the CEO or if it has had any significant impact on firm governance and performance (Forker, 1992; Conyon, 1997; Brickley et al, 1997).

This period also saw interesting developments in the space of corporate regulation. CG recommendations and codes were proposed or were adopted in most countries globally during this time and by themselves contributed heavily to the extant CG literature. The uniqueness of most such codes is suspect given that they offer similar recommendations despite contextual differences in existing governance practices. The near similarity of such reports though indicates at the common issues that are plaguing CG globally. In addition, their analyses and some early studies of their impact on companies (see Stiles and Taylor, 1993) set the tone for *code impact verification*[19] research engaged in the subsequent phase.

[18] So what essentially could have been suggestive research to the corporate stakeholders soon ended up becoming tautological research largely avoided by those whom the studies were meant for.

[19] By code impact verification research I indicate at studies that were undertaken to check if the CG codes were complied with by subject companies and the associated impact such compliance had on the performance of firms.

CG codes in conjunction with CG scandals provoked a good deal of accounting related research and studies examining extant accounting practices and impact of discretionary disclosures (Forker, 1992; Lewellen et al, 1996; Frost, 1997) entered mainstream CG literature thereby improving the general quality of CG debate.

In addition, some country-specific governance studies endeavoured during this period set the context for a deeper probe into the CG models of transition economies in the subsequent phase. Early studies on transition countries that moved from state-controlled enterprises to privatization either through mass voucherization programmes or through direct stake sales gained good traction in CG literature (see Boycko et al, 1994; Dittus, 1996; Palda, 1997; Konings, 1997; Wintrobe, 1998) and helped us gain a well-rounded understanding of the extant models of CG and their associated problems.

To sum up, the period between 1990 and 1998 offered a diverse understanding of the concept of CG primarily because of the exploratory methods adopted by researchers. In many ways, newer nuances got fleshed out during this period and the richness of CG literature manifests itself in the sheer breadth that it offers.

Second Phase (1999-2014)

In the early part of 1999, an incredible amount of research on CG was published with most papers attempting to compare extant governance models and trying to establish the relevance of competing and new governance models. The departing points for future research were already set in the previous phase. CG researchers during this period engaged in probing earlier strands of research more deeply and comparing them against different study contexts. The last decade and a half saw an increasing growth in foreign direct investments globally. Capital found its way into countries that offered attractive rates of return. In addition, countries with vibrant capital markets and robust legal infrastructure saw more inflows than those that failed on either or both counts. From a researcher's perspective, this kind of a scenario offered a research goldmine on a platter. Studies could be contextualized around the 'demand for' and 'lack of' corporate governance as a reason for the inflow and flight of capital. The efficacy of product markets was less delved upon to explain corporate performance or failure. Instead the focus was on explaining every nuance of corporate performance from the prism of corporate governance. A part of the reason could be that more and more mainstream journals found their way into academic libraries of developing and under-developed countries during this phase. With ready access to CG literature, researchers globally, found an easy start to contribute their understanding of the concept. In doing so, extant models got contextualized to different economic ecosystems, and anachronistically so. While on the one hand, the breakneck speed with which global CG literature grew helped us quickly understand and appreciate the huge variance in CG systems across the world, on the other hand, the quality of such understanding got poorer and poorer as replicative studies[20] simply failed to add any significant value to conceptual generalizations.

This phase though has exhibited some remarkable characteristics in the way literature organized itself. In addition to sample contextualized replicative empirical studies, researchers engaged on a larger debate to thrash out the features and advantages of one governance model over the other. This led to a wholesome shaping up of comparative CG literature. However, with more and more research output coming out of the portals of Western academia, CG theorists have advocated the imminence of convergence of CG models. Path dependence theorists provided their rebuttal with their argument citing historical reasons for divergence. The first period during this phase was that of *comparison, inquiry and theorizing* (1999-2006). The period following this i.e., *evaluation and acceptance* (2007-2014) tacitly accepted the fact that different models can co-exist and thrive together. As the paper is being written, the arguments and comparison of one model's supremacy over the others remain but in a more muted form. Researchers have come to realize that some socialistic economies may never possibly transition to capitalistic ones and vice versa. So advocating market efficiency hypothesis as the panacea for all corporate governance issues might not be relevant for all economies.

Comparison, Inquiry and Theorizing (1999-2006)

East Asian crisis, Eastern European transition and Newly Independent States (NIS) formed the dominant sub-themes of CG research during this period. East Asian banking crisis of 1997 busted the 'Asian economic miracle' myth by taking down with it multiple East Asian economies and exposed the gaping hollowness in the CG systems adopted by the failed nations. The financial collapse of Thai *baht* and the inability of Thailand to honour its international debt burden and the widespread panic exhibited by foreign investors by withdrawing credit spread like a financial contagion and exposed systemic weaknesses in currency management not only in Thailand but other East Asian nations like Indonesia, South Korea, Philippines, Malaysia and Laos. Crony capitalism, government directed bank lending, debt

[20] Numerous studies that dealt with the impact of governance variables on firm performance are a class of replicative research. While the initial studies helped one understand how CG mechanisms influence corporate performance, the latter studies add to the literature but fail to provide any significant insight.

mismanagement emerged as the focal points for CG research. The crisis was interpreted in different ways by researchers belonging to different sub-disciplines. However, an interesting contribution to CG literature was in the form of nuancing CG both from a micro and macro-economic perspective. Firm behaviour studies now assumed a larger canvas and macro-economics subtly got integrated with CG thereby re-contextualizing future research output.

Retrospective studies to identify the root-cause of the crisis were undertaken and signals of bad governance flagged. For e.g., Kawai et al (2000) study the movement of corporate foreign debt in countries like Indonesia, Malaysia, Philippines, Thailand and South Korea and evidence that firms with lower profitability borrowed more from foreign creditors than ones that were more profitable, indicating that foreign credit found itself parked in the wrong companies. Post-crisis diagnostic studies --- ascribing the failure of the East Asian corporations to the pyramidal and family or insider controlled ownership structures (Claessens et al, 2000; Lemmon and Lins, 2001; Wiwattanakantang, 2001; Du and Dai, 2005), examining the lack of legal protection and associated CG issues (Tabalujan, 2002; Mitton, 2002), describing the role played by banks in the reform process (Choe and Lee, 2003), denouncing weak CG systems in East Asian countries (Johnson et al, 2000; Dickinson and Mullineux, 2001), extended our understanding of the salient features of corporate ownership in those nations.

Beginning 1990, many Central and East European nations for example Poland, Hungary, Slovenia, Czech Republic, Romania and Bulgaria among others shed state control of economy and transitioned to market economies. Privatization, liberalization, macro-economic stabilization, globalization, legal reforms and corporate restructuring emerged as the dominant themes during the transition process. While some initial studies on post-transition performance were done in the previous period, studies done during this period reflected the true impact of privatization on the transition economies. In addition, governance variables used in other studies could more appropriately be mapped to transition economies during this period as CG maturity seemed to pervade corporations more effectively than in the previous period. CG discourse on transition economies witnessed an incredible breadth in that it discussed larger issues like that of social consequences of reforms in transitional economies (Kumssa and Jones, 1999); CG practices in post-privatized economies (Bohinc and Bainbridge, 2001; Uvalic, 2001); progress, development and reform of the post-transition financial and institutional systems (Estrin, 2001); performance (Walsh and Whelan, 2001; Estrin et al, 2001; Grosfeld and Tressel, 2001; Angelucci et al, 2002; Hrovatin and Ursic, 2002); and mass privatization (Tchipev, 2003; Backhaus, 2003) amongst others.

The period was also notable for its investigation and documentation of the CG journey of both transition-oriented Russia and the NIS countries. Both country specific CG studies as well as studies at an aggregated level found traction in academic literature. Russian and Ukrainian studies (Buck et al, 1999; Vasilyev, 1999; Hedlund, 2000; Perotti and Gelfer, 2001; McCarthy and Puffer, 2002; Pivovarsky, 2003; Puffer and McCarthy, 2003; Buck, 2003; Zheka, 2005) though found more prominence as their appeal far outweighed the smaller NIS nations.

This period has been the most productive amongst all periods in terms of research coverage, cross-disciplinary pollination of ideas, cross-functional complementarities as fleshed out by management researchers, comparative governance analysis and commentary, framework farming and theoretical generalizations. Separation hypothesis of Berle and Means and the conflicts of interest theory articulated in the early 1930s finally seemed to pervade corporations across geographies and most country-specific studies irrespective of the national economic context have chosen the Anglo-Saxonic model to explain away phenomenon observed in their results. Whether emerging economies or under-developed ones, the canvas of market oriented CG model remained stationary and factory models of country-specific CG impact studies were undertaken. Barring the African continent, save for a few countries, most countries had their own CG scholarship built during this period. A range of issues like investor protection, disclosures, role of boards, CEO compensation and duality, role of institutional investors and block holders, regulation, influence of capital markets, insider trading, political structures and institutions were examined in addition to the impact of ownership, capital and board structures on firm performance.

China-focused CG research attracted the attention of both native Chinese academicians as well as their Western counterparts. Studies examining the transition of state-owned enterprises to private ones; the performance of state-owned enterprises in themselves or in comparison to public firms; CEO duality and associated CG issues; CEO compensation and its impact on CG and the role of politics in shaping and reshaping CG in China, amongst others, helped us gain a perspective on the interesting CG developments in the country (Xu and Wang, 1999; Huchet and Richet, 1999; Shirley and Xu, 2000; Parker, 2000; Liu and Woo, 2001; Lin, 2001; Schipani and Junhai, 2002; Wei et al 2002; Watanbe, 2002; Bai et al, 2004; Aivazian et al, 2005; Liu, 2005; Liu and Sun, 2005; Wei et al, 2005; Liu, 2005; Su, 2005; Chen et al, 2005; Allen, 2005 among others).

Alongside the economic arguments of corporate governance, a huge amount of literature contextualizing the importance or irrelevance of stakeholders and stakeholder theory (see Sternberg, 1999; Beaver, 1999; Cragg, 2002; Boatright, 2002;

Culpan and Trussel, 2005), the rigidity of path dependent behaviour as an explanation to institutional persistence and the reasons thereof (see Bebchuk and Roe, 1999; Hedlund,2000; Carney and Gedajlovic, 2001; Zukowski, 2004; Buckand Shahrim, 2005), the impact of politics and political systems on various CG variables and firm behaviour (Pagano and Volpin, 2001 and 2005; Gourevitch et al, 2003; Bonardi et al, 2005; Dinc, 2005; Bell and Trillas, 2005), and a wide variety of review, comparison and trends-based studies touching various aspects along the CG research spectrum (see Bevan et al, 1999; Emmons and Schimd, 1999; Cheffins, 2000; Gilson, 2000; Berndt, 2000; Gregory, 2001; Denis, 2001; Vinten, 2001; Osterloh and Frey, 2003; Perotti, 2003; Dennis and McConnell, 2003; Hofstede, 2004; Gillen, 2006; Jungmann, 2006) augmented the richness in CG debate.

Research output during this period therefore contributed heavily to the comparison of the different governance models of the time and succeeded in fleshing out insights from multiple perspectives thus making theoretical generalizations both easy and difficult.

Evaluation and Acceptance (2007-2014)

Novelty, to a large extent, has eluded CG research in the recent times. Studies with meaningful insights have been few and far between. Country-studies got extended along dimensions that were not studied earlier and the primacy of market-oriented model of governance is being advocated more vehemently than ever. Early researchers of CG that included economists, sociologists, philosophers, legal experts and political commentators moved on after building the boundaries of CG research. Current day CG literature is largely a reiteration of concepts thrashed out by them. Concepts like triple bottom-line reporting, social citizenship (Moreno, 2010), Islamic CG (Ismail and Tohirin, 2010) and corporate crime (Brody and Luo, 2009; Tomasic, 2011) though have entered the CG lexicon and only future research would highlight if they are worthy of longer discourses.[21]

CG research during this period has failed to depart far from the classic *board-ownership structure-capital structure-institutional investor-firm performance* framework. However, some interesting new dimensions continue to get built around the framework to understand current CG contexts. For e.g., renewed focus on female representation on boards and gender studies (Henrekson and Stenkula, 2009), employee representation in executive positions (Conchon, 2011), BoD dynamics in family owned firms (Oba et al, 2010), or the peculiarities of Nordic boards and board committees (Lekvall, 2012) has come to characterize latest board related CG research.[22] In addition, reviews of CG systems (Epstein, 2012) and of variables that characterize CG mechanisms (Hiester, 2012), or discussions of the reasons for corporate flaws and failure (Hopkin, 2012; Sharfman, 2012) are creating new starting points for future research. Researchers though implicitly indicate at the acceptance of the Western models of boards and board committees as the right recipe to provide oversight and governance. Also, some new strands of study establishing linkages between different business functions and CG have started slipping into CG literature. For e.g., studies like the relationship between innovation and CG (O'Connor and Rafferty, 2012), the role of communication in CG (Davis and Lukomnik, 2012), the impact of media on CG (Bednar, 2012; Dash, 2012), linkage between intellectual capital and CG (Saifeddine et al, 2009), etc are veering CG research in multiple directions. Whether insights obtained from such studies have useful practical implications to business and policy makers currently seem to be questionable though. As the literature gets further reshaped with more and more cross-disciplinary researchers contributing to the CG discourse from the context of their parent disciplines, newer insights are likely to emerge and those that dominate for a longer period would set the context and direction for future research.

The period between 2007 and 2014 has seen researchers evaluating, reconciling and accepting the different facets of CG. In addition, it has also seen researchers trying to investigate and establish both conceptual and practical connects between CG and other related or unrelated corporate functions.

Conclusion

CG literature owes its huge growth to the scholarly inquisitiveness shown by researchers belonging to different disciplines. Not being recognized as a separate discipline in itself has its advantages as seen in the breadth that CG research has to offer. No social science theme in the past eight decades has attracted as much attention from various disciplines as CG. Also, no social science theme has benefited as much as CG in concerted research cross-pollination efforts made by scholars. CG literature has grown richer by seeking and assimilating perspectives from a wide array of scholarship – economics, philosophy, politics, sociology, law, finance, and management to list a few.

Today, more and more CG-centric research papers seem to be pouring in into academic literature

[21] All these concepts have an established and independent research lineage outside of CG literature. Today, they are being increasingly probed from a CG perspective.

[22] Studies on these themes have been published in the previous periods. However, the freshness and insight of these reports/studies have renewed academic interest on these themes.

than ever. Not every paper would have 'corporate governance' in its keyword, but the context remains very much CG focused. CG has become both invisible and all pervading. As a classification keyword in journal papers CG may no longer find a separate existence, yet the essence of most management and economics papers broadly indicate the pervasiveness of the concept.

While on the one hand our understanding of CG has grown richer in more ways than one, yet on the other hand 'replication' studies have out-contextualized the sharpness of the CG discourse. Anachronistic contextualization of published studies coupled with needless investigation into phenomenon that are either well-established or are self-evident simply adds unnecessary layers of burden to the CG literature. This then masks issues that need immediate research attention and prohibits the scope to fan and build contemporary issues into the debate thereby pushing the CG discussion a few years backwards. The richness and sharpness thus gained from contributions made by different disciplines is therefore offset by inadvertent research duplication that adds no value to the larger debate. However, it would be interesting to see if in the years to come CG literature succeeds in shedding its path dependent behaviour and opens up arguments that help decision makers look beyond the obvious. The future of CG research would be much brighter only if the excesses of duplicative 'impact studies' give way to more rounded and sharper debates. At least then, academic researchers can claim that their research provides insights that can be picked by business decision-makers and policy makers – the stakeholders that matter the most -- for improving the quality of global corporate governance.

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THE PERCEPTION OF CORPORATE SERVICES DIRECTORATE IN A METROPOLITAN MUNICIPALITY ON KING III GOOD GOVERNANCE COMPLIANCE IN BUSINESS AND PROJECTS

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Abstract

Good governance has been and is a growing phenomenon for many business organisations regardless of size, profit margins and purpose for existence. The South African Metropolitan municipality Metropolitan Municipality is one such organisation that has adopted good governance models to business practices. The challenge was how to effectively and efficiently implement governance issues around projects and business organisations. A number of people, committees and institutions have developed different governance frameworks that can be adopted by organisations as a guide to good governance. This research is based on King III guide to good governance. The objective was to establish the perceptions of the corporate services directorate in the South African Metropolitan municipality municipality on King III good governance compliance by interviewing some employees orally and through a questionnaire. The responses were captured and analysed using IMB SPSS software. Problems were identified in governance training and understanding in general. Another major finding was poor communication internally and externally. To overcome these shortfall recommendations were made. Communication models, communication plan, governance models and training were recommended. The major challenges facing the South African Metropolitan municipality Metropolitan Municipality are poor effective governance communication and lack of governance training.

Key Words: Corporate Service Directorate, Good Governance, South African Metropolitan Municipality

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1. Introduction

The Cadbury Committee triggered a change in the way businesses are supposed to operate. It shifted the focus from maximisation of profits using any means possible to maximisation of profits through smart partnership, caring for the environment, honest business dealings, no business conflictof interest, audit controls and many more. This is what business organisations are now battling to implement and maintain and the South African Metropolitan municipality Metropolitan Municipality is not an exception.

1.1 Background to the Research

The research was conducted at the South African Metropolitan Municipality in the Corporate Services directorate. In preparation of this research, the researcher carried out a participative preliminary research into the handling of business and projects within this organisation. The issues around the Nelson Mandela Municipality, Makana Municipality in the Eastern Cape and Mantsopa Municipality all point to a lack of good corporate. There had been many service delivery strikes and demonstrations in South Africa and they all relate to maladministration and poor governance. According to the Institute for Security Studies (2005), many reasons for these protests are offered. The primary reason appears to be dissatisfaction with the delivery of basic municipal services such as running water, roads, electricity, toilets and houses. Professor Nico Le Roux from the school of Public Management and Administration at the University of Pretoria in his article 'The Reason behind Service Delivery Protest in South Africa' pointed out that all leads to poor governance

Other reasons that tie to poor governance include rampant corruption and nepotism within local government structure. The then Minister for Cooperative Governance and Traditional Affairs, Sicelo Shiceka, speaking to the South African Local Government Association in East London on Wednesday 22 April 2009, admitted that "many of our municipalities are in a state of paralysis and dysfunction" (Institute for Security Studies, 2009).

According to the Minister Shiceka, local governments are perceived to be incompetent, disorganised and 'riddled with corruption and maladministration', (Institute for Security Studies, 2009). The general public have a perception that municipalities because of their nature do not practise good governance in their day-to-day business operations.

The King III guide is a new offering into ethics and governance and is influenced by the Cadbury Committee report in the United Kingdom in 1992. After that the King Committee on Corporate Governance was formed in 1993 under the auspices of the Institute of Directors.

Corporate governance was institutionalised in South Africa in 1994 after the first King Report on Corporate Governance was published in November 1994. The basis of Corporate Governance is good financial, social, ethical and environmental practice. Corporate governance advocates an integrated approach to good governance in the interest of a wide range of stakeholders. The King I report formalised the need for companies to recognise that they no longer act independently from the society and environment in which they operate.

From its inception the Committee published three reports, i.e. King I -1994; King II – 2002 and King III – 2009.

1.2 Statement of research problem

The nature of municipalities is complex; they have to provide a wide range of services, water, sanitation, housing, education services, electricity and many others. Coordinating and managing all these is a big challenge since all cut across many different department and other private stakeholders. The public perceives municipalities as practising corruption, nepotism, deploying ANC 'comrades' without qualification and skills to manage and governance effectively (Institute for Security Studies, 2009

1.3. Research objectives

The general objective of this research was to determine the perception of employees in the Corporate Services directorate within the South African Metropolitan Municipality on good governance issues as stipulated by the King III framework on governance issues.

The objectives of this research are stated below:

1. Establish the extent to which management and the general workforce within the South African Metropolitan Municipality Corporate Services directorate perceive the corporate governance guidelines and good practice as stipulated by King III.

2. Determine which governance model(s) is (are) used by the South African Metropolitan Municipality Corporate Services directorate and to what extent they are being adhered to in projects and business governance.

3. To make some recommendations if necessary regarding the governance models used by the South African Metropolitan Municipality Corporate Services directorate.

1.4 Data analysis methods

Data was collected via survey questionnaires. Data collected from survey was analysed in terms of a descriptive analysis. Participants in this research have given the researcher informed consent and privacy of information will be respected.

1.5 Delineation of the research

The research was limited to the Corporate Services directorate of the South African Metropolitan Municipality located in the Western Cape.

2. Literature review

Much research has been undertaken to try and establish what the challenges really are that Municipalities face in pursuing good corporate governance. Municipalities across the globe tend to have similar challenges because of their nature. Provision of services to the publicis a major problem, given the operational dynamics, resource limitations, skill shortage, lack of focus, the large number of clients to service; this coupled with the lack of wisdom and willingness to serve people becomes a disaster (Kaselowski E, 2008).

The level of corruption and nepotism in municipalities is very high; hence the ever increasing number of service delivery protests in the Republic of South Africa and the world over. Given the high number of researchers who have spent valuable time making recommendations to municipalities, it remains a mystery why municipalities do not change their governance approach to provide a better service to the community.

2.1 The Cadbury Report

The Cadbury Committee was set up in May 1991 by the Financial Reporting Council, the London Stock Exchange and the accountancy profession to address financial aspects of corporate governance, (Cadbury Report, 1992). Adrian Cadbury was appointed Chairman of the Committee. The purpose of the Cadbury Committee was justified for the following reason:

- The economy of the country depended on the drive and efficiency of its companies. Thus the effectiveness with which their boards discharged their responsibilities would determine Britain's competitive position.

- At the heart of the Committee's recommendation was a Code of Best Practice designed to achieve the necessary high standards of corporate behaviour. The London Stock Exchange intended to require all listed companies in the United Kingdom to abide by the code.
- By adhering to the code, listed companies would strengthen both their control over business and their public accountability. This would strike a balance between meeting the standards of corporate governance then expected of them and retaining the essential spirit of enterprise.
- Bringing greater clarity to the respective responsibilities of directors, shareholders and auditors would also strengthen trust in the corporate system.
- To strengthen the unitary board system and increase its effectiveness. All directors were responsible for the stewardship of the company's assets.

The Cadbury Committee made a number of recommendations on the following:

1. The board – the role of the board, the structure of the board, the role of the chairman, directorship i.e. executive and non-executive directorship, remunerations, audit committees and internal controls
2. Auditing – professional objectivity of auditing, appointment of auditors and rotation of auditors, internal controls, fraud and illegal acts, auditors' liability and confidence
3. Shareholders – accountability and responsibility, communication and influence.

2.2. Corporate and project governance

Corporate governance can be defined as the system by which an organisation or company is directed and controlled in order to achieve its objectives. (CPA Audit, 2007)

Project governance is a process of structuring and managing all of the relationships/interactions between all stakeholders who are party to the project

This system provides the mechanics for the organisation to operate effectively and efficiently towards its predefined organisational objectives. It also provides the foundation and structures on which organisational rules and policies are developed, which conduct is acceptable and what is not acceptable and how the organisational performance and compliance is monitored and measured (Kaselowski, E. 2008). The Queensland Government (2002) stated that corporate governance is the "glue" between the organisation and its objective (Kaselowski E, 2008). Without good corporate governance there is very little assurance that the organisation will function properly, efficiently and effectively as it will have planned.

Poor corporate governance can have extremely negative effects on the organisation (Tarimo, J.2006).The lack of sound corporate governance principles in organisations such as Parmalat, WorldCom, LeisureNet and others has been stated as the major cause for accounting fraud and poor organisational performance (Ramaswamy, V. 2005).

2.3 Importance of good governance

Sound corporate governance is vital for organisations to remain competitive (Centre for Business Research, 2004). Corporate governance addresses more than just disclosure and compliance. Other issues such as effectiveness and efficiency of operations and the safeguarding of assets also form part of effective corporate governance strategies (CPA Audits, 2007).The main objective of corporate governance is to enhance the well-being of any organisation providing it with the four key governance aspects (Kurkure, A P. 2006).

Some of the benefits to be derived from good governance models and practice will include improved trust and good working relationships among stakeholders, improved transparency, improved accountability, increased profit margins, better decision-making processes and increased end-user productivity. On the other hand good governance practices encourage environmentally friendly practices, increase social responsibility and improve business effectiveness and efficiency. The general economies of scale are also going to improve (OECD, 2007). If an organisation achieves all the above improvements, then the greater public is going to benefit. Hence there will be a reduction in the number of service delivery protests.

2.4 Introduction to King I, II and King III

In 1993 the King Committee on corporate governance was formed here in South Africa under the auspices of the Institute of Directors. This was a direct response to the Cadbury Committee report into the financial aspects of corporate governance in the United Kingdom. The purpose of the King Committee was to look at corporate governance in the context of the Republic of South Africa. Of interest were the social and political transformation and the readmission of South Africa into the international community. The first report (King I report) was published in November 1994 and this led to the institutionalisation of corporate governance in South Africa.

The King I Report advocates an integrated approach to good corporate governance in the interest of a wide range of stakeholders. It embraced the fundamental principle of good financial, social, ethical and environmental practice (Ernst & Young, 2003).In adopting a participative corporate governance system of enterprise and integrity, the King Committee in 1994 formalised the need for companies to recognise that they no longer act independently from the society and environment in which they operate (IOD, 1994).Since the publication of the Cadbury Report it has become fashionable to refer to corporate governance as "the system by which companies are directed and controlled" (Smerdon,R.1998:1).

2.4.1 King I - 1994

The emphasis in King I Report was on:
- Advocating an inclusive approach
- Separating ownership and management
- Moving to the triple Bottom Line, i.e. Environment, Profit & Revenue and Social Responsibility.

The King I report was very critical. South Africa was going through a number of social, political and economic transformations (IOD Report, 2002).Of particular interest are the Labour Relations Act (No. 75 of 1997), Employment Equity Act (No. 55 of 1998), Basic Conditions of Employment Act (No 75 of 1997), National Environment Management Act (No. 107 of 1998), Companies Act (No. 61 of 1973), Insider Trading Act (No. 135 of 1998) and the Public Finance Management Act (No. 1 of 1999).The above legislation led to the review of the King I Report of 1994. This was followed by the publication of the King II Report of 2002.

Figure 1. Factors influencing a review of King I

2.4.2 King II – 2002

The development of the King II report was in partnership with a number of organisations including the JSE, Deloitte & Touche, KPMG, Anderson, SASOL, ESKOM, Transnet and others (IOD Report, 2002).King II is an improvement of King I and the following are critical:

1 Characteristics of good corporate governance
- Discipline; transparency; independence; accountability
- Responsibility; fairness; social responsibility(Malan D, Rassouw G, Van Der Watt A, 2009)

2 Critical issues in King II
- Board of Directors – the most critical factor in sound corporate governance
- Risk management – there is need for adequate disclosure of risk
- Internal audit
- Integrated sustainability
- Accounting and auditing
- Compliance and enforcement
- Communication (Malan D, Rassouw G, Van Der Watt A, 2009)

The above is applicable to all companies on JSE, banks, finance and insurance entities and of importance to public sector enterprises and agencies that fall under the Public Finance Management Act and the Local Government, Municipal Finance Management Act. The researched South African Metropolitan Municipality falls under the last three; hence it is also governed by the recommendations of King II (Institute of Directors, 2002).

2.4.3 King III – 2009

The need for King III is seen in the context of:
- The Companies Act, which was to become effective in 2010
- The King Committee and its sub-committees being prepared to complete the Report, without any remuneration.
- A growing emphasis on the need for comprehensive reporting (Summary of report on Governance for South Africa 2009, South African Institute of Chartered Accountants)

Legislation which governs companies falls under many headings. Amongst such statutes are the following:
- The Companies Act
- The Public Finance Management Act
- The Municipal Finance Management Act

The Public Finance Management Act and the Municipal Finance Management Act relate directly to the South African Metropolitan Municipality.

This framework applies to all entities, regardless of the manner and form of incorporation or establishment (IOD, 2009). According to King III (IOD, 2009) "the terms 'company', 'board' and 'directors' refer to the functional responsibility of those charged with governance in any entity and should be adapted as appropriate". The effects and recommendations of King III to the public sector organisations should be read in conjunction with the Public Finance Management Act (PricewaterhouseCoopers Report, 2009). Of particular interest is that, while King II stated "may", King III states "must". The King III Report has key principles and the Report places great emphasis on:

- Leadership, sustainability; and corporate Citizenship(Summary of report on Governance for South Africa 2009, South African Institute of Chartered Accountants)

3 Research design

According to Leedy (2001:102) there are two research design approaches, namely:

3.1 Qualitative or Phenomenological

Involves the use of words to describe and explain a phenomenon. It is informative and can be conducted on a small sample using data collection methods such as observations and interviews.

3.2 Quantitative or Positivistic

Involves the use of numbers to explain and predict a phenomenon. It is representative and can be conducted on a large sample. In this research, the researcher made use of both qualitative and quantitative research design methods.

Welman and Kruger (2000:191) defined case study research as the research method that requires the researcher to conduct fieldwork when investigating a group or organisation. In this research, the researcher will conduct case study research at South African Metropolitan Municipality. One of the reasons for selecting case study research for this research project is that it uses multiple methods of data collection, which may be qualitative and quantitative (Yin 1994:89). Hussey, R. and Hussey, J. (1997:66) described the types of case study research, as follows:

In the instance of this research study, existing theories for corporate governance within business and projects was used for the South African Metropolitan Municipality. For the purpose of this research a mixture of approaches was adopted. The descriptive and explanatory approaches were adopted for the bulk of the research and the illustrative approach will be used toward the end of the research.

3.3 Data collection

To collect the necessary information for this research the researcher developed a questionnaire that was distributed to the Corporate Services directorate in the South African Metropolitan Municipality. In addition to the questionnaire oral interviews were conducted with employees in the Corporate Services directorate within the South African Metropolitan Municipality.

3.4 Audience

Thirty four (34) employees in the Corporate Services directorate within the South African Metropolitan Municipality were targeted as the respondents. The majority of the employees who were selected deal directly with projects while some deal with the project office indirectly.

Five out of the thirty-four (34) respondents were also targeted for oral face to face interviews to get a deeper understanding and to cover issues that might have been difficult to address through a questionnaire.

3.5 Oral Interview

Oral interview were conducted with five employees in the Corporate Services directorate of the South African Metropolitan Municipality.

All five employees agreed that the South African Metropolitan Municipality understand the importance of good corporate governance in business and projects. However, they all agreed implementation was a big challenge since the Council does not have a proper governance model of its own. The Council relies of general governance frameworks making it difficult to follow and implement on exceptional issues that relate specifically to the Councils operations but not covered by the general framework

The researcher recorded the interview proceedings as supplementary notes that were used to augment the responses from the questionnaire. Out of the total population of 34 in the Corporate Services directorate of the South African Metropolitan Municipality 28 questionnaires were collected, some fully completed while others were partially completed. The responses were captured in a statistical analysis package (IBM SPSS)

4 Results, Findings and Analysis

Data was collected through a questionnaire that targeted a population of 34 participants. 28 completed questionnaires were returned, representing an 82% response rate. The collected data was analysed using IBM SPSS version 2.0. The data collected, when put into the statistical analysis programme, gives varied outputs which can be interpreted in various ways, one being the belief that municipal governance in the South African Metropolitan Municipality(and of course other municipalities) is poor because of a number of factors.

4.1. Understanding governance issues

All of the 28 respondents work with projects, more than 32% having done so for more than 10 years, as illustrated in Table 1.

Number of years working with projects

Table 1. Number of years working with projects

		Frequency	Percentage	Valid Percentage	Cumulative Percentage
Valid	1 - 3 years	5	17.9	17.9	17.9
	4 - 6 years	6	21.4	21.4	39.3
	7 - 10 years	8	28.6	28.6	67.9
	More than 10 years	9	32.1	32.1	100.0
	Total	28	100.0	100.0	

More than 60% of the respondents had been working on projects for more than seven years. One expected this to translate into a vast wealth of experience and, in turn, into effective and efficient project management through lessons learnt. Of importance to note is the response from management.

Table 2. Management Level * Number of years working with projects (Cross tabulation)

		Number of years working with projects				Total
		1 - 3 years	4 - 6 years	7 - 10 years	More than 10 years	
Management Level	Lower	5	3	4	2	14
	Middle	0	2	3	4	9
	Top	0	0	1	2	3
	Knowledge staff	0	0	0	1	1
Total		5	5	8	9	27

It is encouraging to note that the bulk of middle and top management had been with the South African Metropolitan Municipality for a long time, hence their expertise can be utilised fully by the lower level management.

The researcher noted that employees with more than 10 years are still at the lower management level. This shows a lack of progression and career development.

Table 3. Rate your understanding of governance

		Frequency	Percentage	Valid Percentage	Cumulative Percentage
Valid	Not Familiar	6	21.4	21.4	21.4
	Rough Idea	9	32.1	32.1	53.6
	Moderate	8	28.6	28.6	82.1
	Very Clear	5	17.9	17.9	100.0
	Total	28	100.0	100.0	

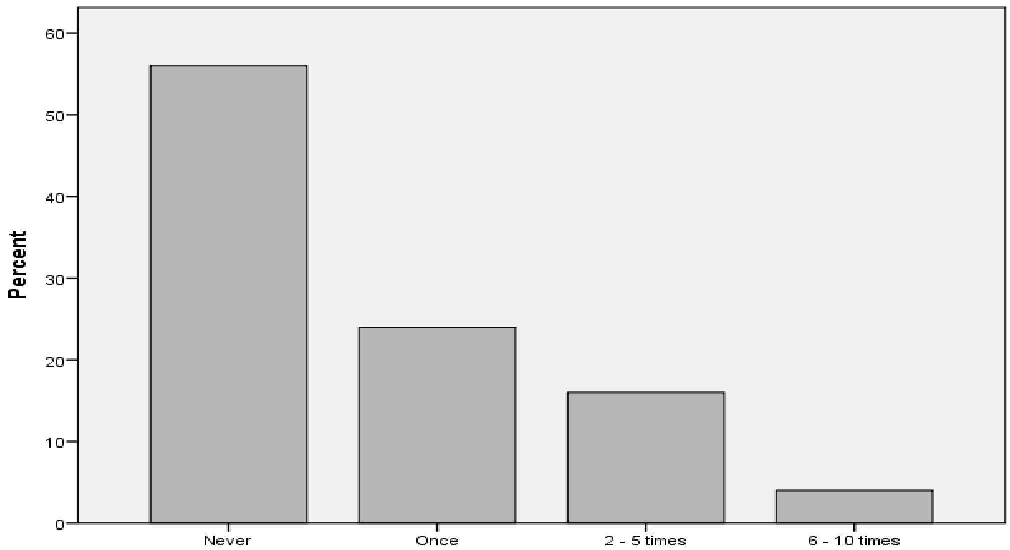
The relationship between the numbers of respondents with a very clear understanding of governance seems not to tally with the number of years respondents had been involved with the planning and implementation of projects. This suggests that very little is learnt during and after the implementation of projects. This weak relationship is further shown by the fact that issues of governance do not often arise during meetings yet they should form the backbone of the implementation of projects. The number of respondents in management is shown in Table 4 below.

Table 4. Management Level * Rate the general understanding of governance within your team or department (Cross tabulation)

		Rate the general understanding of governance within your team or department				Total
		Not Familiar	Rough idea	Moderate	Very Clear	
Management Level	Lower	4	7	2	1	14
	Middle	0	3	4	2	9
	Top	0	1	2	0	3
	Knowledge staff	0	0	1	0	1
Total		4	11	9	3	27

Of importance to note here is that top management does not have a clear understanding of governance issues. The almost 20% who indicated "Most of the time" might also be those who said they understand governance issues very clearly. Hence they can recognise issues of governance when they arise. Of importance to note is that issues of governance had stopped the execution of projects as depicted by Figure 2 below.

Figure 2. How many times did issues of governance stop the execution of projects?



This definitely should have made the South African Metropolitan Municipality relook at governance issues and arrange training to capacitate the respondents with a general understanding in a bid to effectively and efficiently manage governance issues.

4.2.3 Governance Model

Participants tend not to understand whether there is a model or not within the South African Metropolitan Municipality Corporate Services directorate. The responses to this critical question are given in Table 5 and Table 6 below.

Table 5. Does the South African Town Metropolitan Municipality have a governance model?

		Frequency	Percentage	Valid Percentage	Cumulative Percentage
Valid	Yes	9	32.1	36.0	36.0
	No	16	57.1	64.0	100.0
	Total	25	89.3	100.0	
Missing	System	3	10.7		
Total		28	100.0		

Table 6. Management Level * Does the South African Metropolitan Municipality have a governance model? (Cross tabulation)

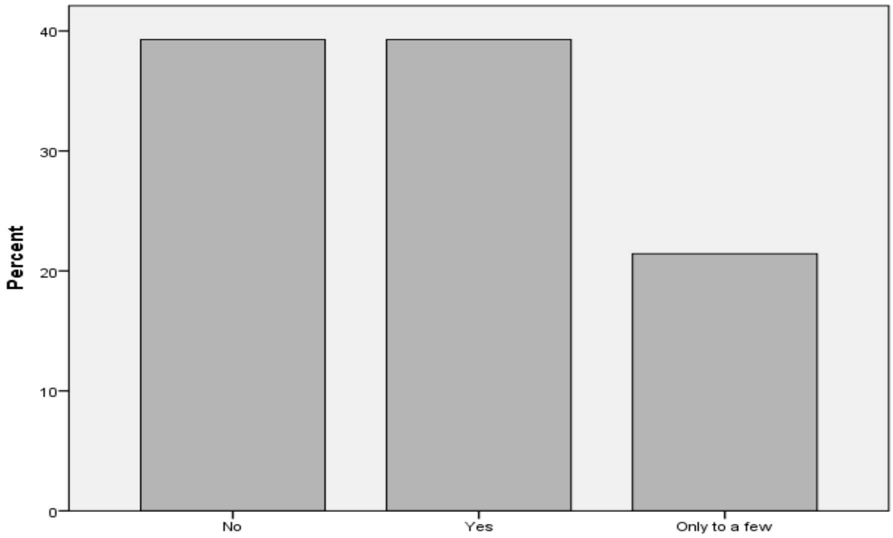
		Does the South African Metropolitan Municipality have a governance model?		Total
		Yes	No	
Management Level	Lower	4	9	13
	Middle	4	4	8
	Top	1	2	3
Total		9	15	24

Out of a population of 34 employees only 9 responses were positive (32%); the bulk of the participants gave a negative response. Those in management positions are also not clear whether the South African Metropolitan Municipality has a governance model.

4.2.4 Effective communication - internal

Of importance to note is that the governance model that exists within the organisation has 38% availability to all with 20% saying it is available only to a selected few.

Figure 3. Is the organisation's governance guide available to all employees



4.2.5 Application of and adherence to the model

32% of the participants indicated that the South African Metropolitan Municipality has a governance model while 38% indicated it is available to all. But is it being adhered to? This question is answered in Table 7 below:

Table 7. Do you think the South African Metropolitan Municipality is abiding by the models, based on your experience?

		Frequency	Percentage	Valid Percentage	Cumulative Percentage
Valid	Legislation dictates to the South African Metropolitan Municipality in many instances (Finance - MFMA; System Act) what can be done and what not	1	3.6	3.6	3.6
	No	3	10.7	10.7	14.3
	No idea	1	3.6	3.6	17.9
	Not all the time	1	3.6	3.6	21.4
	Not applicable	2	7.1	7.1	28.6
	Not sure	1	3.6	3.6	32.1
	Prefer not to say	13	46.4	46.4	78.6
	Sometimes they do	1	3.6	3.6	82.1
	Yes	5	17.9	17.9	100.0
	Total	28	100.0	100.0	

18% of the participants agreed that the South African Metropolitan Municipality Corporate Services directorate is abiding by the governance model they have in place, while 10% indicated otherwise. Of importance is the number of participants that prefer not to say anything (46.4%). This implies either fear of victimisation or being entangled in organisational politics that might hamper promotion opportunities and progress. It might also affect employment security.

4.2.6 Training

Only 17% of the participants indicated that they have a very clear understanding of governance issues while 100% indicated they are working on projects. More than 60% have more than 5 years working with projects. This shows that there is a big gap between the knowledge level required for effective implementation of projects and the actual expertise available.

The rate at which the South African Metropolitan Municipality Corporate Services directorate conducts governance training is very low, as depicted by both Tables below.

Table 8. How frequently does management conduct governance training workshops?

		Frequency	Percentage	Valid Percentage	Cumulative Percentage
Valid	Never	19	67.9	70.4	70.4
	Once in a year	4	14.3	14.8	85.2
	Once in a while	4	14.3	14.8	100.0
	Total	27	96.4	100.0	
Missing	System	1	3.6		
Total		28	100.0		

The table shows almost 68% of the participants say the South African Metropolitan Municipality has never conducted governance training workshops. This automatically shows there is a gap that needs to be filled. Some of the participants in that 68% are employees who have been with the South African Metropolitan Municipality Corporate Services directorate for more than 10 years. The fact that they have never had governance training workshop despite working with projects every day is cause for alarm.

If participants (employees) are not aware of governance issues, the possibility of overlooking them when they occur is very high. Management was not very clear when issues of governance arise during the execution of projects. The conflicting statistics are clear on all levels of management.

The responses given by the participants differ greatly for almost every question, signifying a huge deviation from the norm. This might be as a result of poor communication within the Corporate Services directorate in the South African Metropolitan Municipality. Another important factor that might cause a huge variation is the knowledge level. Where there is effective communication, continuous training, a high level of knowledge and people are pulling in the same direction, the deviation is small.

5. Recommendations

The responses to the questionnaire highlighted a number of areas of weakness and strength. The weaknesses can easily be converted to strengths, thereby improving service delivery through better project management and administration. The recommendations are going to be based on critical factors that affect the organisation in terms of good governance. The factors are going to be derived from the weak points highlighted by the results.

5.1 Communication

Communication is vital for the survival of any business organisation. However effective communication is critical for profit maximisation and growth. The South African Metropolitan Municipality is a very large organisation in terms of number of employees, suppliers, debtors, functions etc., hence both internal and external communications become very important. Though internal communication is the bloodline of functionality within the organisation, external communication is very important, given the size of the South African Metropolitan Municipality in terms of functions and people

A proper External Communication Plan needs to be drafted that can be used as a guide to all communications emanating from the South African Metropolitan Municipality.

Having a communication model would definitely help the South African Metropolitan Municipality to clearly define communication channels and improve both internal and external communication. This would directly impact positively by improving governance in projects and in the business organisation. The ultimate benefit would be improved service delivery, the beneficiary being the greater population of the South African Metropolitan

5.2. Training

Training is the act of up-skilling people. When employees are well trained they will improve productivity and increase profits. Within the South African Metropolitan Municipality training would definitely improve governance and service delivery. Training should be an on-going process within any business organisation. In modern and complex environments governance training is vital if employees have to cope with the dynamics relating to successful project implementation. The South African Metropolitan Municipality needs to include training in its strategic plans. Training needs a high priority.

The Corporate Services directorate in the South African Metropolitan Municipality seems not regard training as a key factor to successful implementation of projects as far as project governance is concerned, as depicted by Table 8

5.3 Governance model

It is not very clear whether the Corporate Services directorate in the South African Metropolitan Municipality has a governance model. There are poor training initiatives that will directly affect skills; this might even lead to employees not realising that they have or that they do not have governance model. This confusion is depicted by Table 4.2.3.1.

While 57.1% of the population said there was no governance model, 32.1% said it existed. Those who said it does not exist might be linked to those who need training in governance issues. For the governance guide to be useful it needs to be available to all employees. Effective communication requires that all documentation of this nature, Quality Policy, IT Policy and frameworks, Health & Safety manuals, Company performance documents etc., should be available to all employees. This enhances effective communication and helps to educate employees about their own organisation.

The Corporate Services directorate in the South African Metropolitan Municipality needs to start by defining factors for enforcement of processes and procedures.

Project governance is built up of many elements. Project governance needs to take into consideration the quality aspect of the project, the nature of the project itself, project specifications, the business case and the project management plan. All these impact on the project success in terms of governance.

The Corporate Services directorate in the South African Metropolitan Municipality could improve its processes and procedures by implementing some of the recommendations given above.

Conclusion

There are mixed perceptions from the participants within the South African Metropolitan Municipality. A lot of work had been done in terms of understanding governance trends and incorporating certain components within their day to day and project operations.

Having a proper governance model is critical for project governance success. Most organisations develop governance models that will help them to provide a general framework for implementing and managing projects. It becomes much easier to manage and implement projects if one has a framework as a guidance pillar.

Research developments in the field of governance have resulted in the recommendation of different frameworks for different industries. Frameworks like the King I, II and III for general business governance issues and ITIL and COBIT for the information technology management and governance have been developed to help organisations manage governance issues more effectively. The South African Metropolitan Municipality had adopted some components of the frameworks e.g. it uses ITIL and COBIT components.

On the quality management side different ISO standards have been developed that will assist in the enforcement of quality standards. ISO standards will require organisations to define and follow specific processes and procedures for compliance certification. The South African Metropolitan Municipality and adopted some ISO standards to quality assure their work.

Poor project governance and poor governance in general in business organisations have a very severe impact on the organisation itself, the stakeholders and the environment. Poor governance within the South African Metropolitan Municipality Corporate Services directorate will affect service delivery.

When governance structures are not in place it becomes difficult to control and manage the tender process, internal business operations, conflict resolution and other issues that underpin good governance practices.

The South African Metropolitan Municipality Corporate Services directorate tends to not consider training critical to successful project implementation. This needs to change since it will eventually affect service delivery. Training is integral to the continual development of staff in order to improve productivity and effectiveness.

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BACKGROUND TO THE FOUNDATIONS OF BUSINESS ETHICS AS A UNIVERSITY COURSE: A SOUTH AFRICAN PERSPECTIVE

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Abstract

In this article on the background of business ethics and business ethics education, the following important questions, discussions and issues will be addressed:
Firstly, a brief overview on the development of philosophy will be provided since business ethics can be viewed as a subdivision of philosophy. An exposition of how business ethics links with philosophy will (among others) be provided. Due to the fact that this article largely concentrates on the accountancy and auditing professions, referral will also briefly be made to how the so-called "professional ethics" of the concerned professions fit into the comprehensive discipline of philosophy.
The second aspect to be addressed will be regarding one of the main challenges in presenting business ethics courses, namely to keep the subject pragmatic and practically applicable – which may be difficult, possibly due to the discipline's development from philosophy. If the pragmatic and practical focus is not maintained, business ethics may result in a mere philosophical and theoretical course that has little to do with ethical challenges encountered in the real accountancy profession and business world. Reasons are mentioned that may result in business ethics courses being irrelevant and impractical and therefore possible solutions to this problem are also suggested. Other challenges that may prevent lecturers from presenting business ethics courses in an optimal manner are also briefly discussed in this section.

Key Words: Business Ethics, Higher Education, Professional Ethics

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1. Introduction And Background

Humanity holds the highest order of all living creatures on earth. The reason for this can be ascribed to humanity standing at the top of intelligence and development of all species. The so called "sacred" writings of several of the largest religious schools of thought also acknowledge the preceding. In Christian writing, man (where there is referred to the masculine [e.g. man or he/his], the feminine [e.g. woman or she/her] is also implied, were applicable) is for instance described as the "crown" of creation. According to Christianity, man consists of different "dimensions" (body, soul and spirit) that also exalt humanity above the animal and plant kingdoms.

In connection with the above, it can be mentioned that man is a "thinking and searching" being. Concisely, it can be said that man is in search of the meaning of his life. In the following statement, the renowned French philosopher, Albert Camus (1955, p. 3), even went so far as to suggest that the search for meaning in life, is the only truly important concern in man's life: "[t]*here is but one truly serious philosophical problem and that is suicide. Judging whether life is or is not worth living amounts to answering the fundamental question of philosophy*."

From the preceding (without further debating the cynical, fatalistic statement by Camus), it is clear that the question as to what the meaning of life is, stands central to man's existence (especially in the Christian tradition).

One of the most important aspects in the search of the meaning of life is probably man's search for what constitutes right (good) and wrong (bad). Subsequently, the question can be asked as to where the search for what constitutes right or wrong originated. To answer this question with certainty is surely impossible. One of the main goals of the great religions of the world (e.g. Hinduism, Buddhism, Islam, Judaism and Christianity) is to teach followers of the religion what is right ("acceptable") and wrong ("unacceptable") through the concerned religion's dogma, doctrines and "sacred" writings.

Apart from religious followers, philosophers probably played the greatest role in deliberating about e.g. what "right and wrong", "good and bad", "virtue and vice", "meaning" and "truth" involves. Especially the ancient Greek philosophers such as Socrates, Plato and Aristotle made vast contributions in this respect. "Ethical conduct" is one of the most important pillars of any orderly, civilized and sustainable society. If "wrong", "bad" and "vice" within a society were to prevail and escalate, consequences such as chaos, deterioration, suffering and revolution would most likely culminate. The renowned philosopher, Thomas Hobbes, referred to life in such a degenerate society as *"solitary, poor, nasty, brutish, and short"* in his 1651 publication, Leviathan.

Business ethics is one of the many disciplines that flowed from the millennial old discipline of philosophy (Rossouw, 2004, p. ix). Similar to philosophy, business ethics is also concerned with the question of right and wrong, with the distinction that it focuses specifically on business and economic aspects.

Lovell (2005, pp. iii, 2) states that although ethics in business has been a concern for as long as trade and commerce have taken place, the development of business ethics as "*a field of enquiry*" did not effectively commence until approximately 1920. In this initial stage of the development of business ethics, the concerns were mainly focused around issues of corporate governance[23] (Lovell, 2005, p. 3). The reason for this can possibly be traced back to the factory replacing the home as the principal place of work, organisations' sizes expanding to the extent that required managers (who were not members of the founding families or principal shareholders) to be appointed and the eventual establishment of limited liability companies during the mid-nineteenth century (Lovell, 2005, p. 1). Limited liability companies resulted in the split between management and ownership/shareholders (with management acting as stewards of shareholders' money and other interests) and a possible conflict of interest, e.g. a member of management seeking to maximize self-interest (such as to spend excessive funds on personal benefits) at the expense of shareholders' interest.

Business ethics as an academic field[24] was only established in the 1970s in North America (Lovell, 2005, pp. 6, 7). From North America, it spread to Western Europe and eventually the rest of the globe, including Africa (Serenko & Bontis, 2009, p. 391; Jeurissen, 2007, p. 9; Rossouw, 2004, p. xi), which makes it a relatively young academic field. According to Rossouw (2004, p. ix, xiii) *"[i]n the process of maturing as an academic field… [business ethics] is becoming more self-conscious about its development, identity and purpose… The process of maturation… will imply improving the quality and effectiveness of research, teaching and interaction and, finally, it will mean the institutionalization of the scope and activities in the field in ways that will promote the visibility and credibility thereof."* One of the maturity signs of an academic discipline is the existence of a set of discipline-specific, peer-reviewed journals that informs the academic community and practitioners about the existence of the particular scholarly domain and that offers a space where scholars can read new works, exchange ideas, share theories and accumulate references (Serenko & Bontis, 2009, p. 391; Wikipedia, 2012a). In 2009, sixteen academic journals dedicated to various aspects of business ethics existed, the most cited being *Journal of Business Ethics* and *Business Ethics Quarterly* (Serenko & Bontis, 2009, p. 395; Wikipedia, 2012a).

The main focus of this article falls on business ethics in South Africa, a region in which this field has only relatively recently been introduced[25]. With the establishment of business ethics as an academic field in the 1970s, a hot topic for debate in North America and Europe was whether it was ethical to invest in South Africa, where apartheid reigned at the time (Jeurissen, 2007, p. 9). Similar occurrences later took place in other African countries such as Zimbabwe and Libya, where international sanctions against regimes were instated as punitive measures against e.g. human rights violations and despotic governments (McVeigh, 2012; Cooper & Landler, 2011). The South African economy flourished in certain spheres due to sanction pressure on the former apartheid regime. The most well-known example is probably the establishment of Sasol and the fact that South Africa became the world leader in the field of oil production from coal (Dubey, 2007, p. 1). Sasol could, however, not provide in all of South Africa's former fuel requirements and "resourceful unethical practices" were invented by the apartheid government to circumvent international sanctions and oil embargos.

South Africa's achievements in the fields of accountancy and auditing are remarkable, especially considering the fact that the country was excluded from global accounting integration and was academically isolated during the 1980s due to international sanctions aimed against the country's apartheid policy (Verhoef, 2012, p. 25). Although the standard of South Africa's accounting and professions does not seem to have suffered due to the

[23] The relationship between corporate governance and business ethics (for definitions of business ethics refer to sections 2.1 and 2.2.4) is clearly discernible in the description of corporate governance by Ramachandran (2007): *"Corporate Governance represents the moral framework, the ethical framework and the value framework under which an enterprise takes decisions… [It] is concerned with the ownership, control and accountability of companies, and how the corporate pursuit of economic objectives relates to a number of wider ethical and societal considerations."*

[24] The distinguishing features or characteristics of an "academic field" can be found in Rossouw, 2004, pp. xii – xiii.

[25] The first, and as far as could be established, still only peer-reviewed journal on the African continent dedicated to the specialised field of business ethics, was only established in 2004 (AJoBE, 2009). The *African Journal of Business Ethics* (AJoBE) is the official journal of the *Business Ethics Network of Africa* (BEN-Africa) (AJoBE, 2009; BEN-Africa, 2012).

consequences of apartheid, South Africa's development in the field of business ethics possibly did suffer and lag behind due to apartheid, since apartheid was essentially also an unethical economic and social practice. However, South Africa did later achieve much success on the front of corporate governance (refer to footnote 1 for an explanation of the relationship between corporate governance and business ethics), which can mainly be ascribed to the work done by the King Committees on Corporate Governance in South Africa.

During approximately the same period that apartheid came to an end, the Institute of Directors in Southern Africa (IoDSA) established the King Committee on Corporate Governance with former Supreme Court judge, Mervyn King, as chair (IoDSA, 2011; Stewart, 2010; King, 2012). King viewed this as an opportunity to educate and provide guidance to the newly democratic citizens of South African on the best practice for operating in a free economy (Stewart, 2010; Wikipedia, 2012b). Since its establishment, the King Committees has authored the King I (1994), King II (2002) and King III (2009) Reports on Corporate Governance (Stewart, 2010; IoDSA, 2002; IoDSA, 2009; IoDSA, 2011). According to the IoDSA (2011) "*[t]he first King Report was recognised internationally, when published, as the most comprehensive publication on the subject [of]… corporate governance"*. King III has been described by Sir Adrian Cadbury, as *"the future of corporate governance"* (Malan, 2010; Stewart, 2010).

After 1994, the South African government attempted to incorporate many of the principles of good corporate governance into legislation (e.g. the Companies Act, No. 71 of 2008, the Public Finance Management Act, No. 1 of 1999 [PFMA] and the Municipal Finance Management Act, No. 56 of 2003 [MFMA]) as minimum legal requirement of compliance[26] (Lubbe, 2012; PwC, 2010, p. 2; RSA, 1999; RSA, 2003; RSA, 2009). Compliance to the principles of King III is also a listing requirement for companies on the Johannesburg Stock Exchange (JSE, 2012; IoDSA, 2009, p. 4).

From the above, it is clear that corporate governance and business ethics have a significant influence on auditors and accountants. The work performed by auditors and accountants are, amongst others, concerned with companies' compliance to listing requirements of the JSE and the Companies Act, No. 71 of 2008 and government's compliance to the PFMA and MFMA (regarding the South African context). Since it is thus necessary for accountants and auditors to possess thorough knowledge of corporate governance and business ethics, these professionals should be educated in the principles and practical application of these fields. These facts were also the main reasons for pleas for change needed in accounting education, specifically in the form of broadening the accounting curriculum by including courses such as business ethics[27] and the ethics education requirements of International Federation of Accountants (IFAC)[28] and the South African Institute of Chartered Accountants (SAICA)[29].

2. Philosophy, Ethics, Applied Ethics, Business Ethics And Professional Ethics – An Overview

2.1 Introduction

As mentioned in the title, this section of the article concerns philosophy, ethics, applied ethics, business ethics and professional ethics. For the purposes of this article and by way of introduction to this section, the relationship between these five disciplines can be presented as follows schematically:

[26] Refer to Lubbe (2013, pp. 27 – 31) for details on the seemingly downwards spiral in South Africa from the initial political will and strong ethical leadership that appeared after 1994 which made it possible to fight corruption and fraud through firm corporate governance (Lubbe, 2012).

[27] For a detailed discussion on this topic refer to Lubbe (2013, pp. 76 – 83).

[28] For further details on this topic refer to Lubbe (2013, pp. 87 – 101).

[29] For further details on this topic refer to Lubbe (2013, pp. 101 – 106).

Figure 1. Diagram of disciplines relevant to the study

The above schematic representation is merely a theoretical outlay for the purposes of this article. The lines of partition between these five disciplines and what they constitute are not always clearly set and overlapping between disciplines do occur. The schematic representation and its components can be explained briefly as follows:

Philosophy can be described as the "mother discipline" from which the other four disciplines developed. Moreover, in academic literature, philosophy (which is essentially the search for "wisdom" and "truth"), is generally regarded as the foundation of all disciplines. This is for instance illustrated by the "inner workings" of other disciplines being called the "philosophy of" the specific discipline e.g. the "philosophy of science" and the "philosophy of history" (Pigliucci, 2009). As further illustration can be mentioned the title of D.F.M. Strauss's magnum opus on philosophy significantly titled, *Philosophy: Discipline of the Disciplines*, which was awarded with the *Herman Dooyeweerd Prize* by the Vrije Universiteit Amsterdam (SA Akademie, 2011; Strauss, 2009).

The word "ethics" is etymologically derived from the Greek word "ethos", which means "character" or "manners" (Skorupski, 2003, p. 203; BBC, 2012). Simplistically stated, ethics is a system of moral principles that is concerned with what is "good" for the society as well as individuals, affecting how people make decisions and lead their lives (BBC, 2012). General ethical questions are for instance, "how does one lead a 'good' life" and "what is virtue".

Since the twentieth century, many areas of human activity have been subject to ethics, or more specifically, applied ethics (Haldane, 2003, p. 490). According to Lane (2012) *"applied ethics is the branch of ethics that asks relatively concrete questions about the morality of specific controversial actions and policies."* Sub-branches of applied ethics include, for instance, business ethics, environmental ethics, "bioethics", "genethics", and gender ethics (Haldane, 2003, p. 490). For purposes of this article, the only sub-branch of applied ethics to be focused on is business ethics. General questions on applied ethics can, for instance, include whether abortions, capital punishment or the generation of nuclear power are ethically justifiable (Van Wyk, 1985, p. 1).

As business and economics have increasingly become key driving forces in contemporary societies, the urgency to ensure that they develop in the "right direction" has also increased (Enderle, 2003, p. 531). Business ethics (being the main focus of this article) is thus a sub branch of applied ethics, concerned with business and economically related ethical issues. A general business ethics questions can, for instance, deal with whether Broad-Based Black Economic Empowerment (B-BBEE) and the manner in which it is applied in practice in South Africa, is ethically justifiable.

Professional ethics (e.g. medical ethics or journalism ethics) plays a governing role, which is influenced by the nature of the profession, its place in society and the resulting application of general ethical principles to the profession (Skorupski, 2003, p. 203). If professional ethics are not viewed as an earnest matter by members of a profession, there is a high risk that members of the profession may act unethically and unprofessionally, which may lead to reputational damage to and loss of public trust in the specific profession as was, for instance, the case with the accounting and auditing profession - specifically the "Big Five" audit firm, Arthur Andersen, due to the Enron scandal[30]. A general professional ethics question with the regard to the auditing professional can, for instance, be whether an auditor should be allowed to lead an audit of a company if the auditor's parents are the majority shareholders in the company.

Subsequently, the five "disciplines" of (and including) philosophy set out in schematic representation 1 and briefly discussed above will be considered in more detail.

2.2 Philosophy

2.2.1 Introduction

The etymological origin of the term "philosophy" is derived from the Greek word "philosophia" - the roots "phileo" and "sophia" respectively meaning "to love," and "wisdom" (McKeon, 1964, p. 239; Kimura, 2006, p. 1). In ancient Greece, a person who devoted himself to "logos"[31] was considered a "lover of wisdom", hence the term "philosopher" (Palmer, 2006, p. 2).

Before the ancient Greek philosophers began attempting to explain natural phenomena based on reason and evidence, the traditional, mythological approach, that attempted to explain natural events in terms of supernatural origins, reigned (Berg, 2012; IEP, 2012; Palmer, 2006, p. 2). In the case of the ancient Greeks, this involved tracing natural events (such as lightning) to the capriciousness of the gods of Mount Olympus (e.g. lightning supposedly being a weapon of Zeus) (New World Encyclopedia, 2008; Berg, 2012). Through the fertile imaginations of poets such as Homer and Hesiod, mystic epical narratives that explained, among others, the origin of the world and the genealogy of the gods, were created (New World Encyclopedia, 2008; Palmer, 2006, p. 5). The ancient Greek philosophers, however, attempted to discern patterns and principles that could uniformly, consistently, and comprehensively explain natural phenomena in terms of natural causes (New World Encyclopedia, 2008; Berg, 2012). Palmer (2006, pp. 6, 7) states that "*these early Greek philosophers… tended to demote cosmogony (theories about the origins of the world) and promote cosmology (theories about the nature of the world). This new direction represents the beginnings of a way of thinking that the Greeks would soon call 'philosophy'.*"

Socrates (469-399 BCE), an imperative figure in philosophy, made a principal contribution in shifting the central focus of philosophy from cosmology to ethics and morality (New World Encyclopedia, 2008; Berg, 2012). He considered the study of "natural philosophy" and the materialistic worldview as futile compared to seeking a real and true understanding of the highest values in life, which one needs in order to live a "good", "worthy" life according to the highest ethical standards (New World Encyclopedia, 2008; Berg, 2012; Kimura, 2006, p. 1). Socrates did not agree with the Sophists, specifically Protagoras (as quoted in *Theaetetus* by Plato) that "man is the measure of all things", nor did he agree with the "natural philosophers" and the value they attributed to materialism, which eventually led to the modern materialistic ideology according to which "*man and money are the measure of all things*" (Van der Ploeg, 1959, p. 4; quoted by Malan, 1984, p. 6), (Palmer, 2004, p. 1; Palmer, 2006, p. 54). Instead, Socrates attached value to "virtue" and pursued virtue through self-examination and self-reflection of which the aphorisms "*the unexamined life is not worth living*" and "*know thyself*" (commonly attributed to Socrates) are indicative. One of the central themes/theories of Socratic ethics is that "virtue is knowledge".

Socrates was born during a period when a cultural shift towards placing high value on political power (as opposed to the study of cosmology) was taking place in Athens (Van Bart, 2002; Palmer, 2006, p. 48). The pursuit of political power and the study of rhetoric (which was an imperative "skill" for politicians of that era who relied mainly on their oral persuasiveness to gain public support) were widespread (Palmer, 2006, pp. 5, 6). The demand for instruction in rhetoric and the means to achieve political success gave rise to a group of philosophers known as Sophists, who travelled from city to city and charged admission to their lectures (Van Bart, 2002; Smith, 2009, p. 31; Palmer, 2006). The word "Sophist" is derived from the Greek word "sophia", which, as mentioned, means "wisdom". However, the word "Sophist" adds a negative connotation to wisdom and has come to mean "wise guy", as in someone who thinks he is smarter than others or someone who is clever but ethically questionable (Palmer, 2006, p. 48; Smith, 2009, p. 30; Evans, 2010, p. 232). The Sophists' lectures were not on the nature of reality or truth but instead they instructed

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[30] For more regarding the Enron scandal refer to Lubbe (2013, p. 8) and for elaboration on loss of trust in the accountancy and auditing professions refer to Lubbe (2013, pp. 8, 37 - 38, 72 – 75 and 91 – 101).

[31] According to Palmer (2006, p. 2) "*[t]he Greek word 'logos' is the source of the English word 'logic' as well as all the '-logies' in terms like 'biology,' 'sociology,' and 'psychology,' where 'logos' means the theory, study, or rationalization of something. 'Logos' also means 'word' in Greek, so it involves the act of speaking, or setting forth an idea in a clear manner. 'Logos,' therefore, designates a certain kind of thinking about the world, a kind of logical analysis that places things in the context of reason and explains them with the pure force of thought. Such an intellectual exercise was supposed to lead to wisdom…*"

their students in what would most likely lead to political success (which of course is not necessarily "truth") e.g. the nature of power, eloquence and persuasion (Palmer, 2006, pp. 48, 49; Van Bart, 2002; Smith, 2009, p. 31; Evans, 2010, p. 232). According to Van Bart (2002) this led the deterioration of the objective standard of the truth that ended in socio-political and moral decay.

Socrates pursued that which is universally "good" and "true" and without subjective agendas such as gaining political power (Van Bart, 2002). In a non-violent manner, he revolted against the value system of his contemporaries and the teachings of the Sophists. According to Palmer (2006, p. 56), Socrates queried every person he met on the streets and market places of Athens on whether that person knew anything, while Socrates himself ironically professed to know nothing. This dialectic investigation led to so-called "Socratic dialogues" (that was later published by Socrates's student Plato) in which Socrates's discussion partner came to new intellectual and moral insights through Socrates's guidance (Van Bart, 2002; Palmer, 2006, p. 56; Evans, 2010, p. 234).

Socrates's questioning of the then existing structures, by which he offended many of the powerful figures of Athens, resonated especially with the youth, since Socrates was an inspiration and source of knowledge for them (Palmer, 2006, p. 57; Van Bart, 2002). Herein resided the core of the accusations (teaching false doctrines, impiety and corrupting the youth) of which Socrates was unjustly found guilty and sentenced to death (Van Bart, 2002; Palmer, 2006, p. 58; Evans, 2010, pp. 229, 239; Smith, 2009, p. 11).

The teachings of Socrates are still known today due to Socrates's most renowned student, Plato (427-347 BCE), who recorded the Socratic dialogues (Evans, 2010, p. 229; Smith, 2009, p. 11). The important role that Plato has played in the history of philosophy is depicted in the well-known quote by the mathematician Alfred North Whitehead (1979, p. 39) stating that all of Western philosophy "*consists of a series of footnotes to Plato*" (Pigliucci, 1999). Plato's *Crito*, takes the form of a dialogue between Socrates and his friend, Crito, in Socrates's prison cell during the last days before his execution (Evans, 2010, p. 229). Socrates refuses Crito's offer to finance his escape from prison and explains why he has to accept Athens' death sentence (Pigliucci, 2011; Wikipedia, 2012c). According to Pigliucci (2011) Socrates stated that *"he owes his life and all he has been able to do to the fact that Athens is governed by the Laws, and that it would therefore be unfair for him to disobey the Laws when it is no longer convenient to follow them, even though the citizens of Athens are thereby about to commit an injustice. Essentially, Socrates is saying that he is party to a social contract, and that he is bound by it even when things don't go well for him."* Socrates kept to his principles and drank the hemlock, and as stated by Palmer (2006, p. 58) in death becoming *"the universal symbol of martyrdom for the Truth"*.

The foundation of the university system in the western world is widely attributed to Plato, who founded a school of learning in 387 BC in Athens which he called the "Academy" (European Graduate School, 2012; Palmer, 2006). This further facilitated the search for "meaning" and "truth" through wisdom as this quote by Ochs (1982, p. 467) (as quoted by Botha, 1987, p. 65): *"Education is the transmission of wisdom and of the means of achieving wisdom… [and] subjecting received wisdom to critical discussion and pragmatic testing."* According to a biography of Plato by the European Graduate School (2012) "*Plato hoped the Academy would provide a place where thinkers could work toward better government in the Grecian cities".*

Except for his contribution to the university system and education, Plato also made a considerable contribution to political philosophy, as the preceding quote alludes to. In Plato's seminal work, the *Republic*, the importance of only highly and properly educated 'guardians', being endowed with state authority, is emphasized (Brown, 2003, p. 607; Johnson, 2009, p. 8). According to Kemerling (2011) *"Plato held that guardians should own no private property, should live and eat together at government expense, and should earn no salary greater than necessary to supply their most basic needs. Under this regime, no one will have any venal motive for seeking a position of leadership, and those who are chosen to be guardians will govern solely from a concern to seek the welfare of the state in what is best for all of its citizens."* Plato was hundreds of years ahead of his time if one takes into consideration that his "guardians" reminds one of the roles that independent, non-executive directors should play in a company according to the *King Report on Corporate Governance* (King III).

2.2.2 Subdivisions of Philosophy

As can be deduced from the pre-Socratic philosophers' emphasis on nature and physics, it is difficult to make a distinction between "science" and "philosophy" during the pre-Socratic period of Western philosophy (Pigliucci, 2009; Palmer, 2006, p. 8). Science in fact originated as a branch of philosophy, namely "natural philosophy" (Berg, 2012; New World Encyclopedia, 2008; IEP, 2012; Pigliucci, 2009). However, in the modern world, science and philosophy are two distinct fields of study (Pigliucci, 2009).

Broadly speaking, science deals with the study and understanding of natural phenomena (Palmer, 2006, p. 8; Pigliucci, 2009). Science is further concerned with empirically (either observationally or experimentally) testable hypotheses that should account for those phenomena (e.g. explaining how natural laws are causally related to natural phenomena) (Palmer, 2006, p. 8; Pigliucci, 2009). Philosophy, on the other hand, deals with problems that require a speculative approach through conceptual analysis (the logical scrutiny of general ideas) rather than an experimental approach through observation or data gathering (Palmer, 2006, p. 8; Pigliucci, 2009). Professor Massimo Pigliucci (2009) of the City University of New York, states that it should be noted that although philosophy and science are seen as two distinct activities that work by different methods, "*they inform each other in an inter-dependent fashion (science depends on philosophical assumptions that are outside the scope of empirical validation, but philosophical investigations should be informed by the best science available in a range of situations, from metaphysics to ethics and philosophy of mind).*"

The main fields within the comprehensive field of philosophy include, but are not limited to, the following:

- Ontology - the theory of being;
- Epistemology – the theory of knowledge and the limits to our understanding;
- Axiology – the theory of value, which includes
  - Ethics, or moral philosophy – the theory of "right" behaviour;
- Logic – the theory of rational thought and correct inference (Palmer, 2006, p. 8; Pigliucci, 2009).

This article however only focuses on ethics, as will now be further discussed.

2.2.3 Ethics And Applied Ethics

The terms "ethics" and "morality" are often used interchangeably. In South Africa, reports on the "moral-ethical" crisis in the country and the country losing its "moral compass" appear on a regular basis (SAPA, 2012; Raga & Taylor, 2005, p. 11; Shumba, 2011, p. 88). Bowie & Schneider (2011, p. 2) state that *"[a]cademics often distinguish between morality and ethical theory – 'morality' being the social practices that define right and wrong and 'ethical theory' being the field that aims to discover how people determine what's right and wrong. But most people consider the two terms to mean the same thing."* In the handbooks of Rossouw, et al. (2010, p. 17) and Rossouw & Van Vuuren (2010, p. 4), being the two handbooks that are mostly prescribed for business ethics students in South Africa, the same conclusion as Bowie & Schneider is reached and the two terms are also used as synonyms. Thus, in this article, the terms "ethics" and "morality" and their derivative forms may be used interchangeably.

Literally thousands of definitions for "ethics" exist, but for purposes of this study, the following three definitions will be considered:

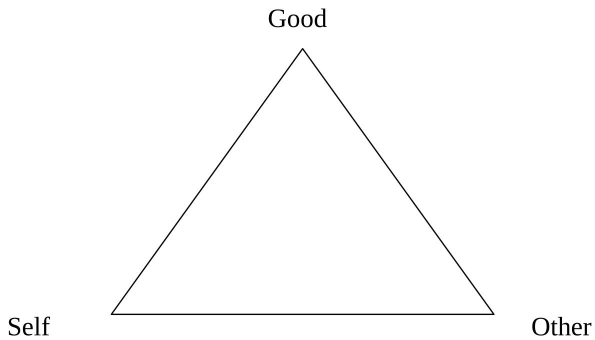
a.) According to Velasquez (2006, p. 8) *"ethics is the study of morality".* This definition relates well with the preceding discussion about the interchangeability of the terms "ethics" and "morality".

b.) Bowie & Scheider (2011, p. 10) defines ethics as "*the code of moral standards by which people judge the actions and behaviours of themselves and others.*"

c.) The definition of ethics that is probably most well known in South African tertiary business ethics education, is the definition according to Rossouw & Van Vuuren (2010, pp. 4, 5): *"Ethics concerns itself with what is good or right in human interaction. It revolves around three central concepts: 'self', 'good' and 'other'. Ethical behaviour results when one does not merely consider what is good for oneself, but also considers what is good for others. It is important that each of these three central concepts be included in a definition of ethics."*

These three "central concepts" to ethics can be schematically represented as follows (Rossouw & Van Vuuren, 2010, p. 5):

Figure 2. The three central concepts to ethics



Source: Rossouw & Van Vuuren, 2010, p. 5; Rossouw, et al., 2010, p. 18

In the above definition c.) and the schematic representation 2, the reciprocation between "self" and "other" is simplistic. It represents interaction between, for instance, two or more individuals, institutions, business enterprises or countries. However, for the purposes of business ethics the main concern is whether this "interaction" is "good"/"bad" or "right"/"wrong".

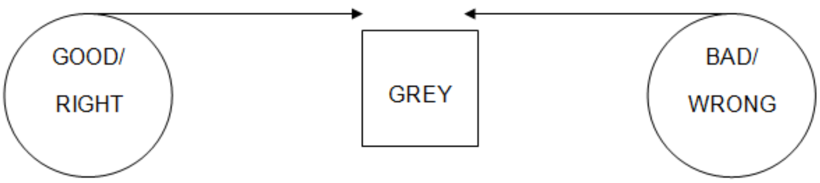
In 1970, the American economist and Nobel Prize laureate, Milton Friedman, published his seminal paper *The Social Responsibility of Business is to Increase its Profits* in the *New York Times Magazine*. Herein Friedman relied upon (and might even have abused) ethical reasoning (specifically the concept of "corporate social responsibility") to defend his position in favour of a capitalist-based market economy (Lovell, 2005, p. 5). In the paper he came to a similar conclusion as the Harvard history professor, Henry Adams, who stated that "*[m]orality is a private and costly luxury,"* (Maxwell, 2003, p. 7).

Similar to Friedman, ethical reasoning and cultural relativism has been abused by the previous South African government, certain Islamic governments and the Communist government of the Soviet Union to justify respectively apartheid, the disparagement of women's rights, and basic human rights violations (Zechenter, 1997, pp. 319, 322). Even the atrocities of the holocaust perpetrated during the Second World War were "justified" with ethical and cultural relativistic reasoning (Zechenter, 1997, p. 319). Also, Socrates was unjustly found guilty and sentenced to death due to the shamelessly tortured ethical reasoning, unsupportable claims and insinuating his guilt by association (Van Bart, 2002; Palmer, 2006, p. 58; Evans, 2010, pp. 229, 239; Smith, 2009, p. 11; Brickhouse & Smith, 1989, p. 66; Siegel, 2001).

Ethics is not a simple matter of something being either "right or wrong" or "good or bad", nor simply a set of "universal rules" that can be applied to all relevant situations. Numerous practical ethical dilemmas are too complicated for such simplistic quick-fixes. As an example can be stated the case of lying: telling a lie is commonly agreed to be "wrong", but if a person lies in order to save another person's life, the act of lying may be seen as acceptable (even though it is generally still agreed that telling the truth is regarded as "good"). This illustrates that a.) a general ethical principle, such as "one should not lie", cannot consistently and mindlessly be applied in all cases where relevant ethical reasoning is needed and b.) an action that is generally regarded as "wrong", such as lying, may be seen as "good", dependent upon the specific circumstances under which the action were performed.

When the border between "right" and "wrong" are unclear, as in the above example on lying, it results in ethical "grey" areas. These ethical "grey" areas are especially common in applied ethics due to the use of casuistry. Casuistry (also known as case-based reasoning) is the application of *general* ethical principles to *particular* cases and is often used as a critique of principle- or rule-based reasoning (Dictionary.com, 2012; Princeton University, 2012). Ethical "grey" areas and casuistry can be further elucidated with the following schematic representation:

Figure 3. "Poles" of ethics



In the above schematic representation, the two circles can be seen as the two extreme "poles" of good/right and bad/wrong. Certain actions are seen as good/right regardless of people's differing traditions, religions and cultures. Examples of such universally approved, good/right deeds would be to offer a poor person, which may starve of hunger, a meal, or to help an elderly, blind person to safely cross a busy street. This can be contrasted to the bad/wrong acts of brutal murder or rape which is universally disapproved of and unacceptable. The closer one moves to the middle, away from the two ethical "poles" just mentioned, the more "grey" and less explicitly good/right or bad/wrong a deed may become. As an example, the ethically ambiguous practice of polygamy in both the forms of one husband having many wives (polygyny) and one wife having many husbands (polyandry) can be mentioned.

Some of the reasons that unethical practices are perpetrated under the cover of "ethics", are because of the abuse of this "grey" area, casuistic reasoning and cultural relativism. According to John Maxwell (2003, p. 8) *"[m]any people choose to deal with… situations by deciding what's right in the moment, according to their circumstances. That's an idea that gained legitimacy in the early 1960s when dr Joseph Fletcher, dean of St. Paul's Cathedral in Cincinnati, Ohio, published a book called 'Situation Ethics: The New Morality'. In it he said that right is determined by the situation, and love can justify anything – lying, cheating, stealing… even murder. Since the 1960s, situational ethics has become the norm for social behaviour. After spreading rapidly through the worlds of education, religion and government, it has penetrated a new area – the business world. The result is ethical chaos. Everyone has his own standards, which change from situation* *to situation… Where once our decisions were based on ethics, now ethics are based on our decisions."*

This further illustrates the complicated matter of ethics: although the application of ethics should not be strictly rule-based, every person cannot create his/her own relativistic ethical standards either.

2.2.4 Business Ethics

According to Bowie & Schneider (2011, p. 10) business ethics is "*the application of a moral code of conduct to the strategic and operational management of a business*." Rossouw (2004, p. xii) describes business ethics as *"any discourse about the ethical dimensions of business"*. It is often stated that "business ethics" is a contradiction in terms because an inherent conflict exists between ethical conduct and the self-interested pursuit of profit (Velasquez, 2006, p. 5). However, according to Maxwell (2003, p. xi) *"[t]here is no such thing as business ethics – there's only ethics. People try to use one set of ethics for their professional life, another for their spiritual life, and still another at home with their family. That gets them into trouble. Ethics is ethics. If you desire to be ethical, you live it by one standard across the board."*

There exists a big difference between business ethics practice and business ethics theory (Bowie & Schneider, 2011, p. 1). Just as it is not the case in ethics, in business ethics it is also not that case that *"the only thing that is needed to come to a moral decision when faced with a moral choice is to apply a legitimate moral rule to that specific situation and then deduce the appropriate moral response from that moral rule,"* as stated by Rossouw (2004, p. 44). Philosophers who are involved in teaching business ethics are often criticized for allegedly favouring a rule-following approach to business ethics (Rossouw, 2004, p. 44).

2.2.5 Professional Ethics

Professional ethics focuses mainly on understanding the historical development of professions and the difference between professional and non-professional occupations, the nature, typical structure and value of professional and disciplinary codes of conduct for the profession and compliance with technical standards (Taylor, 2011, pp. 37 – 40; IFAC, 2010, p. 55, SAICA, 2010, pp. 139-143). Professional ethics within the accounting and auditing professions also deals with well known concepts within business ethics such as professional behaviour, independence, scepticism, accountability, confidentiality and public expectations (IFAC, 2010, p. 55). Since the focus of this article falls on business ethics, professional ethics will not be addressed in further detail.

2.3 Keeping Business Ethics Courses Relevant, And Other Challenges to Business Ethics Educators

A business ethics course should be presented in a pragmatic and practically applicable manner so that it does not result in a mere philosophical and theoretical course that has little to do with ethical challenges encountered in the real accountancy profession and business world. According to an article by Bennis and O'Toole (2005, p. 96) in the Harvard Business Review (quoted by Diamond & Robison, 2008, pp. 2, 9), business schools and the education provided by them are increasingly criticised for their lack of curricular relevance to the present-day economic and social market and their failure to translate business knowledge into applicable, useful skills. The same shortcomings may come to (or all ready do) exist in certain business ethics courses presented to accountancy and business majors at South African universities.

There are numerous reasons that may result in business ethics courses being irrelevant and impractical. One of the reasons includes that business ethics lecturers (especially at accountancy departments in South Africa) are seldom experts in the specialised field of business ethics. Mostly, either a chartered accountant (CA) or a philosopher presents the course (Lubbe, 2013, p. 142).

Generally, CAs have been soundly grounded in the narrow, highly-specialised received sufficient exposure to formal training in philosophy, ethics, business ethics, accounting history and the social and ethical implications of accounting and business to make them truly knowledgeable about business ethics and confident in presenting the course at tertiary level (Massey & Von Hise, 2009, p. 492; Merino, 2006, pp. 377, 378). Philosophers, on the other hand, normally have undergone specialised training in philosophy and ethics, but mostly have limited knowledge of business, management and the accounting and auditing professions. Bennis and O'Toole (2005, p. 104) (quoted by Diamond & Robison, 2008, p. 9) argue that to be really effective, *"business schools need a diverse faculty populated with professors who, collectively, hold a variety of skills and interests that cover territory as broad and as deep as business itself."*

Many accounting faculties seem to fail to recognise the value of business ethics education, dismissing it as a nonessential[32] component of a

[32] In South Africa, business ethics is not regarded as one of the four, sole "traditional" third year and Certificate in the Theory of Accounting (CTA) subjects (namely financial accounting, cost and management accounting, taxation and auditing) although within tertiary accountancy programs, business ethics is often regarded, presented and assessed as a subcategory of auditing. (Passing CTA is one of the

program in accountancy (Russel & Smith, 2003, p. 49; Chu & Man, 2012, p. 125). Merely requiring students to take business ethics because it prescribed as part of the syllabus by SAICA[33], will not serve the course's purpose and in fact may cause much harm, especially if the course is taught in a perfunctory manner by educators whose main interests lie elsewhere (meaning with one of the four "traditional" subjects in an accountancy program, as named in footnote 10) (Bowen, 1960). In all likelihood, such educators would also prefer the "traditional" technical method of lecturing on "how to" (which they would perhaps feel more comfortable with)[34] instead of, for instance hosting a debate with the students on "why" (which may be a more suitable method to present business ethics) (Chu & Man, 2012, p. 125; Nelson, 1995, pp. 70, 71). According to Nelson (1995, p. 70. 71) *"[i]t is neither overly time-consuming nor difficult to present a technical lecture filled with official rules to be memorized, assign students to read a detail-laden text and to do some highly structured exercises for homework, then test students' abilities to parrot back what they memorized with exam questions that always have a single, correct answer."*

The above scenario can be contrasted with educators engaging students in social critique that raises provocative questions about the role of accounting in present-day society and that challenges students to be both experts and critics[35] (Merino, 2006, p. 375). Educators who present business ethics lectures like this – away from the notions that there is "always only one correct answer" to every question, may help improve accountants' skills to reason about and deal with complex and original questions and situations in which ambiguity and uncertainty are involved - such as ethical dilemmas (Nelson, 1995, p. 65). A business ethics classroom offers indefinite opportunities to cultivate students' ethical reasoning and behaviour by encouraging debate about business ethics issues and the social implications of accountancy (Smith, 2003, p. 49). This kind of debate should also encourage students to read media articles on a regular basis, so as to stay current with and informed about real-world ethical issues that are of concern to the business world and accountancy profession. This may help ensure that business ethics does not remain a mere theoretical subject that lacks relevance to what is actually taking place in the world, but that instead focuses on pragmatism and practical applicability.

Subsequently, a few challenges that may prevent lecturers from presenting business ethics courses in an optimal manner will be discussed briefly (although such challenges probably justify a dissertation in itself). According to Nelson (1995, p. 71) (converted to Chu & Man, 2012, p. 125), because critical thinking takes students out of their comfort zones, most educators who have experimented with innovative teaching methods designed to improve students' skills, find that teaching evaluations suffer. As a result of student evaluations possibly inhibiting innovative teaching methods, educators have an incentive to "play it safe" (Nelson, 1995, p. 71; Chu & Man, 2012, p. 125).

Strait and Bull (1992, p. 69) (cited by Chu & Man, 2012, pp. 124, 125) explain that the reward structure in the current accounting educators market places a premium on research over teaching and that as a result, faculty members at many institutions would be committing academic suicide to devote substantial time and effort to a major curriculum project. Without further discussing the topic in any detail, it should, however, be noted that it appears that the preceding situation is peculiar to the university system in the USA and that it is not traditionally applicable to accounting departments at South African universities. An extremely close relationship exists between the professional body, SAICA, and accountancy departments at SAICA-accredited South African universities. Over the years, this may have led to South African accountancy academics being too involved in highly specialised technical training and education of prospective CAs, while the volume and quality of research output suffered the consequences of neglect.

Other important challenges that may act as disincentives for lecturers to present business ethics courses optimally are, according to Meyer (2010, p. 5), *"the large classes in university business faculties with the highest student to staff ratios ... difficult[ies] for universities to fill vacancies in accounting and finance… heavy teaching and preparation loads, increased level of administration [and] limited time and support for research"*. To this Diamond & Robinson (2008, p. 10) add university salaries, which cannot compete with salaries offered by noteworthy firms, and a shortage of faculty graduating from PhD programs as challenges.

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admission requirements to write SAICA's qualifying professional examinations).

[33] Refer to Lubbe (2013, pp. 101 – 106) for more detail on SAICA's requirements for business ethics courses in SAICA-accredited university programs.

[34] According to Nelson (1995, p. 71) (cited by Chu & Man, 2012, p. 125) accounting educators probably favour teaching in a technical manner, because *"they have not been adequately prepared to teach in a non-technical manner. In fact, the vast majority of accounting PhDs have received little or no formal training in how to teach in any manner… It seems ironic that kindergarten teachers have more formal training in learning processes and pedagogy than do accounting professors. Perhaps the difficulty in convincing accounting faculty that they need to teach writing, speaking, critical thinking and learning-to-learn in their classes stems from a feeling that they are not qualified to teach such skills."*

[35] Refer to Lubbe (2013, pp. 84 - 86) for more detail on this topic.

3. Conclusion

From the preceding sections, it is clear that terms such as "philosophy", "ethics", "applied ethics", and "business ethics", and to a lesser extent "professional ethics", are very hard to define, (and maybe even undefinable) partially due to the comprehensive range of concepts that are implied by these terms. Ethics can, for instance, be the measure of virtually every dealing and interaction between individuals, countries, institutions, etc. Taking this into consideration, it is not surprising that the eminent philosopher, Pigliucci (1999), perhaps tongue-in-cheek, used words of a well-known USA court judgement to elucidate the "indefinableness" of philosophy when he stated the following: "*Philosophy is difficult to define precisely, but - as American Justice Potter Stewart once famously said of pornography - one recognizes it when one sees it".*

One of the main challenges in presenting business ethics courses is to keep the subject pragmatic and practically applicable – which may be difficult, possibly due to the discipline's development from philosophy. If the pragmatic and practical focus is not maintained, business ethics may result in a mere philosophical and theoretical course that has little to do with ethical challenges encountered in the real accountancy profession and business world. In section 2.3, reasons are mentioned that may result in business ethics courses being irrelevant and impractical and therefore possible solutions to this problem are also suggested. Other challenges that may prevent lecturers from presenting business ethics courses in an optimal manner, are also briefly discussed in this section.

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THE IMPACT OF CAPITAL MARKETS ON THE ECONOMIC GROWTH IN SOUTH AFRICA

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Abstract

Capital markets are institutions that actively play a role in the development of an economy. This study investigates the impact of capital markets on economic growth in South Africa from 1971-2013. The results indicated that there is a positive relationship between economic growth and capital markets in South Africa. Furthermore, the country should focus on factors that contribute to the development of capital markets, such as the development of financial institutions. The study contributes to the existing body of empirical literature with regards to economic growth and capital markets, especially with reference to stock markets as South Africa has one of the largest stock markets (JSE) in the world.

Key Words: Capital Markets, Economic Growth and Exchange rates, Cointegration approach, South Africa

JEL Classification: B22, C01, C12, C22, D53, F21, F43

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1. Introduction

Capital markets have over the years proven to be of high regard in South Africa. South Africa's unique level of growth forms part of the fastest developing countries in Africa. The country's gross domestic product (GDP) is largely accounted for by its stock market, which far exceeds that of other developing economies such as Mexico and Indonesia which also have economies that are growing quite well (Hassan, 2013). Stock markets have a substantial impact on growth and the case for South Africa is no different, from where it all began to date. According to De Kiewiet (1941) the greatest discovery and opportunity for development ever discovered was that of gold mines in South Africa. In the year 1887 large deposits of gold were unearthed in the Witwatersrand area. The discovery created a gap in the growing economy, making a potential opportunity a struggle with the lack of funds being the root cause of the challenges faced in those days. With that in mind, the establishment of the Johannesburg Stock Exchange (JSE) was the best sought after decision to try and curb the situation, which created a better platform for trade (Hassan, 2013).

Kock (2009) discovered that the JSE forms part of the largest stock markets in the world. The JSE ranks as the sixth largest as compared to its counters in the developing countries globally which have South Korea as the largest, followed by Taiwan, India, Brazil and China being the fifth in terms of their stock markets. A highlight in the development of the South African stock markets took place when it had a surplus of 900 billion US dollars in the form of market capitalization, with above 400 firms listed in the stock market making it a developing country with the largest stock market in Africa (Kock, 2009). The mining sector contributed immensely to the establishment of the stock market which further encouraged growth and helped with the improvement of the financial sector in South Africa. South Africa relied mostly on the extraction of the precious metals for the enrichment of its economy as opposed to the traditional system of generating growth and development through agricultural processes. The mining sector also had a short-coming, because according to Trevor et al., (1999) it incurred a lot of expenses that required capital to be raised in order to maintain the blooming sector, in particular the deep-level gold mines. The growing market developed a path for a proper capital market to be put in place.

Alile (1984) defines a stock market as an institution that actively plays a role in the development of an economy, an emerging economy and developed economy. The main function of the market is to link surplus funds to its counter deficit sector. The link is a form of resource mobilization and includes activities such as promoting reforms to modernize the financial sectors, and most importantly developing a channel for savings for various uses in the economy to enhance efficiency and growth in the economy (Alile, 1984). Capital markets allow emerging firms to be able to make loans that allow a contribution to productivity in the form of capital investment and growth which encourages job creation and growth in the economy. Alile (1997) and

Ekundayo (2002) suggest that in order for a nation to be able to gain sustainable economic growth and development; it would require large volumes of investments both locally and internationally. The capital market makes the process possible in the financial and or monetary sector. Capital markets are drivers of any economy as argued by Osaze (2000) given that it is vital for long-term growth capital formation. They are also an important channel for savings and directing savings to profitable self-liquidating investment.

Adebiyi (2005) is of the view that in everyday life, money is a vital tool used to satisfy a need or want in society whether it is worked for or sourced as a loan. The use of money promotes the growth of capital and the growth in turn boosts the economy. For the existence of capital markets, money is raised in various ways, which could be under the intervention of government as a regulator, the proper administration of service by various financial institutions or market operators. In every economy, the rate of growth is largely determined by its maturity in the financial market, particularly the capital market. Dominant financial markets enable nations from across the world to grow in terms of the economy and development by assisting them to generate much needed financial resources and skills needed to achieve their economic goals. Listed equity stock or markets in third world countries suffered gravely in the early 1980s due to classical defects of bank dominated economies. The economies were short of capital equity, absence of liquidity, minimal foreign direct investors and a low confidence by investors with regards to the stock markets.

Initiatives that are aimed at encouraging growth and investment in the sub-Saharan countries are growing in demand day by day. On the contrary, a factor that might delay the growth in these areas would be the lack of monitoring in terms of the capital markets in these developing areas. The market systems at hand would include, among others, banking systems, insurance and security schemes, pension fund schemes, and finance from Small Medium-sized Enterprises. A proper tool put in place to govern these financial resources would then contribute to a proper management system for current financial resources and those that are to be employed in future (Applegarth, 2004). With the limited literature on the empirical work that has been conducted in South Africa, it supports the notion that there is little effort put towards ensuring a proper working system is in place to keep track of the capital markets.

Various authors have investigated the relationship between capital market development and economic growth in different countries such as Nieuwerburgh et al., (2006) in Belgium, Hondroyiannis et al., (2005) in Greece, Liu and Hsu (2006) in Taiwan, Korea and Japan. Naceur, and Ghazouani and Omran (2007) also conducted a study on the influence of stock markets and bank system development on economic growth using a sample of 11 Arab countries. Closer to South Africa, the relationship was investigated by Bolbol et al., (2005) in Egypt and Adaramola and Kolapo (2012) in Nigeria. Enisan and Olufisayo (2008) also conducted a study on the stock market development and economic growth on seven sub-Sahara countries, however, a focus on the case of South Africa is what this study seeks to establish. The research findings of this study will contribute to the decision made by policy-makers with a desire to grow the capital market sector and to develop the economy. The study itself is significant with regards to the capital market scope, as it will contribute to the growing body of knowledge around capital markets in developing countries such as South Africa. Information gathered in this study will also determine the role capital markets have on economic growth since the literature in this area of research is still minimal in the South African context. The subsequent sections will focus on the literature review followed by the methodology, the data analysis and the interpretation of the results and the last section is the conclusion.

2. Literature Review

In the capital market, there are risks associated with transactions made. The market offers financial instruments that enable economic stakeholders to exchange, pool and price risk. As the asset values increase, such as in the form of capital acquisition and stocks, financial savings are enhanced. Al-Faki (2006) defines capital markets as a network of specialised financial institutions, series of mechanism, process and infrastructure that, in various ways facilitate the bringing together of suppliers and users of medium to long term capital for investment in economic development project. According to Harrod-Domar's growth model, savings and investment are a necessity for growth to take place. The growth of a country would depend on the level of Savings (S) and the productivity of capital investment which is also known as the capital-output ratio. Aghion and Howitt (1998) emphasised that the principle is that a low capital output ratio automatically suggests that the output will be high with only a low capital input. On the contrary, a substantially high capital output ratio would produce a low level of output using a high level of capital input.

Over the years, developing countries have been receiving portfolio equity flows. In time, a change is expected due to countries' trade openness, with the main focus being on the domestic state rules that govern capital and income (Williamson, 1993). In light of Goldstein et al., (1991) the appropriate dividends and capital may be the most crucial factor in encouraging significant foreign equity flows. According to classical literature in economics, the high risk assets are priced in such a way that they yield a higher return. Furthermore, as the international financial system adopts a diverse nature, in terms of integration and portfolios, asset prices are prone to change with the aim of restoring disequilibrium (Taylor and Sarno, 1997). This therefore, explains the exchange rate parity condition. Bekaert (1995) states that major industrial and developing countries show a large and high increase in the interest rate differentials, which suggests that there is also an increase in the capital mobility in these developing countries. Rates of return are often found to be higher in developing countries and countries that have a weak financial system as compared to many other markets in other countries that have an industrialised economy, the rate of return generally has a risk of volatility occurring associated to it. In a small economy, the output is anticipated to be higher with limited capital stock, given that there are diminishing returns on capital.

Another component of significance in the capital markets, as looked into by Bekaert (1995) is the rates of credit granted to countries and the secondary-market prices of sovereign debt, which often influence the investor confidence in that particular country. The valuing of the exchange rate is also a contributing factor to capital flight. The more overvalued an exchange rate is, the more likely it is for the currency to depreciate in future. The volatility of the exchange rate then propels residents to house their assets abroad to avoid any capital losses that might occur due to the volatility of the currency. Harvey (1995) and De Santis (1993) stated that the growth and world wide scale of developing countries has improved positively over the years. In the year 1994, developing market's net capital worth was estimated at about \$1.9 trillion which showed an increase from the \$0.2 trillion net worth that was recorded in the year 1985. At the time, over \$39 billion was transferred into developing markets in the year 1994, as compared to the \$0.1 billion that was transferred in 1985. The growth in these markets raised eyebrows and caused focus on them by various scholars, researchers, practitioners and policy makers. A significant number of studies focus on assessing the privileges of holding an internationally broadened portfolio. In addition, more of those countries are trying to review their policies to try and encourage capital market development in their countries.

In the case of South Africa, during the mid-1990s, the relaxation of capital accounts and broader economic reform encouraged improvement in the balance of payments. Shortly after democracy was introduced in 1994, the African government introduced policies that were intended to regulate the foreign exchange market (FOREX) and international relations. The foreign debt crisis that was accumulated from historic debt of the previous government was a propelling factor to the resolution to start with the exchange controls (Leape, 1991). In late 1994, South Africa was already paving the way for re-entry into international bond markets after the sanctions. As a way to properly re-introduce the country into the market, sovereign credit ratings were established. The South African government has developed a system that keeps record of loans that are made abroad and attain a longer maturity profile for foreign currency debt and providing a scale for other South African borrowers to access international capital. The scale is perceived as a primary goal for external loans, given that a well-developed domestic bond market is an essential source of public sector financing.

The concept that financial development enhances economic growth was first made known by Schumpter in the year 1911 (Schumpter, 1912). The necessity was also emphasised by authors such as Goldsmith (1969), Mckinnon (1973) and Shaw (1973) among others. There are views that commissioned the relationship between financial development and economic growth. Demand following argument is of the view that financial development is perceived as a stimulant for economic development which does not take into consideration the demand of financial services in a growing economy. The development in the real sector of the economy helps to smooth the growth in the financial sector. In contrast, the feedback hypothesis suggests that a bidirectional relationship between financial development and economic growth largely depends on the various stages of economic development.

A well developed and effective financial sector grows domestic savings and mobilises capital for productive projects that encourage economic growth. In the cases where there are inefficiencies in the financial sector, productive projects are often unexploited for developmental purposes. Capital markets act as a link between monetary and real sector and therefore smoothen the process of growth in the real sector and economic development. Although stock might impact growth in a positive manner, there are however factors that are key role players such as the size, liquidity and efficiency of the market as well as the quality of the environment. The quality of the environment is regarded as the social and economic conditions of the countries involved. In countries where there is high political instability and perceived risks, stock markets would be constrained (Agbetsiafa, 2003). Al-Awad and Nasri Harb (2005) further state that capital markets also attract foreign portfolio investors who are critical in supplementing the domestic savings levels. It facilitates inflows of foreign financial resources into the domestic economy. Recent empirical research linking capital market development and economic growth suggests that capital market enhances economic growth and development. Countries with well-developed capital markets experience higher economic growth than countries without. Evidence indicates that, while most capital markets in African countries are relatively underdeveloped, those countries which introduced reforms that are geared towards development of capital markets have been able to grow at relatively higher and sustainable rates.

In a growing economy, the demand driven hypothesis states that as the income levels increase, the need for new financial services increase as well. Garcia and Liu (1999) found that in a sample of Latin and Asian countries, income levels have a positive effect on stock market development. Inflation has over the years, upon various observations of study, been a tool used to try and maintain macroeconomic stability (Nacuer et al., 2007 and Garcia and Liu, 1999). Stock market development has also shown traces of effects contributed to by macroeconomic stability, although there remains no trace of the form of effects. Researchers seem to come to a dilemma when a decision has to be made with regards to the relationship between financial sector development and economic growth. Berthelemy and Varoudakis (1996) and Christopoulos and Tsionas (2004) state that banking sector development has a positive impact on economic growth, whereas Singh (1997) has a different view and suggests that the banking sector might not be beneficial for economic growth. Another uncertainty is the relationship between banking sector development and the stock market. Although the view might not be clear, the banking sector is crucial for any economy and the development of its stock market. This is because it creates room for investors with liquidity through credit allowances and also spirals out a better channel for savings.

A study conducted by Minier (2003) looked into the influence of the stock market dimension on economic development by employing three techniques. It was discovered that the positive influence of stock market development on economic growth was only viable for developed stock markets in terms of their turnover, whereas in the cases of underdeveloped stock markets the influence is negative. Another study on the impact of financial structure on the economy during the period 1980-1995 by Ergungor (2006) concluded that in countries with rigid judicial systems, the development of the bank-systems generates the strong impact on economic growth. On the contrary, countries with more elastic judicial systems have a greater influence because of the development of their capital markets. Various authors have investigated the relationship between capital market development and economic growth in different countries. The long run relationship between stock market development (measured by market capitalization and number of listed shares) and economic growth was studied by Nieuwerburgh et al. (2006) in Belgium. In their study, they adopted the Granger causality tests and highlighted that stock market development had a causal impact on economic growth in Belgium, with the focus period 1873-1935 not excluding the actual analysis period (1800-2000) with disparity taking place due to institutional changes that have an impact on the stock exchange.

In Greece, from the year 1986 – 1999, Hondroyiannis et al. (2005) discovered that the link between capital market development and economic growth is bidirectional. There are several other factors that are key role players with regards to the impact of capital markets on economic growth in countries. Liu and Hsu (2006) focused on the effects of different components of financial systems on economic growth in Taiwan, Korea and Japan. They looked into the impact that a positive stock market development system (measured by market capitalization as percentage of GDP, turnover as percentage in GDP and stock return) has on economic growth. A study on the effect of financial markets (measured by the ratio of market capitalization on GDP and the turnover ratio) on aggregate factor productivity and growth (the per capita GDP growth rate) in Egypt (1974-2002) was conducted by Bolbol et al. (2005). In their study, they they found that a well-developed capital market had a positive impact on factor productivity and growth.

Empirical studies that investigate the correlation between financial development and economic growth also show that in terms of the direction of causality, as a general trend, financial development causes growth. The causal relation is more significant in developing countries which can be explained by two channels; the growth of productivity and fast accumulation (Calderon and Liu, 2002). Rajan and Zingales (1998) stand in agreement with Calderon and Liu, (2002). They suggest that financial development is a forecast for economic growth; given that value of potential economic growth opportunities are as a result of the present value of financial development. A study on five developed countries was also done by Arestis et al. (2001). They adopted the autoregressive vector for an empirical analysis and discovered that capital markets do in fact have an effect on economic growth, however financial systems in terms of the banking sector has a greater impact on economic growth. Literature suggests that a more developed country has the potential to have a better financial market which entails a well off capital market.

3. Methodology

Data sources, description and methods of analysis

The study employed the annual time series data from 1971 to 2013. The data was collected in the following manor; market capitalization and value of transactions were obtained from the Quantec data warehouse, exchange rate and gross domestic product was collected from the South African Reserve Bank (SARB). Market capitalization, value of transactions and gross domestic product are collected in millions while exchange rate is in percentages. Economic growth is proxied by Gross Domestic Production while Capital market only caters for Value of Transactions and Market Capitalization. The standard equation is expressed as follows:

$$GDP = f\left(MCAP, VLT, EXCHR\right) \quad (1)$$

Where; GDP = Gross Domestic Product (proxy for economic growth) MCAP = Market Capitalization, VLT = Total value for Transactions and EXCHR= Exchange rate

A detailed form of equation (1) will be as follows:

$$GDP_t = \beta_0 + \beta_1 MCAP_t + \beta_2 VLT_t + \beta_3 EXCHR_t + \mu_t \quad (2)$$

In the equation, β_0 represents the intercept or constant of the relationship in the model where β_1, β_2 and $\beta_3$are coefficients of each of the independent variables and the μ is the stochastic or error term. The linear representation of the equation expressed as logarithms will be in this manner:

$$\mathbf{L}og\left(GDP_t\right) = \beta_0 + \beta_1 Log(MCAP_t) + \beta_2 Log(VLT_t) + \beta_3 Log(EXCHR_t) + \mu_t \quad (3)$$

3.1 Unit root

As a norm, before an econometric model can be designed, there has to be a test of stationarity to check for the order of integration. In a broader term, Gujrati (2003) states that a data series is stationary only if the mean and the variance are constant over time. Moreover, the rate of the covariance between two time frames under study relies on the span in which the covariance is calculated. A customised version of the Augmented Dickey-Fuller (ADF) was developed by Dickey and Fuller (1981). Phillips Perron slightly differs from ADF in terms of the heteroskedasticity in errors and the serial correlation. It uses a different approach to approximate the ARMA structure of errors in the test regression; it ignores any serial correlation as compared to the ADF that uses a parametric auto regression.

The ADF has a minor limitation where the test itself has a lower power; the KPSS test on the other hand assumes that y_t is stationary at the null. In the case where the results are contradictory using both the ADF and the KPSS for instance, the KPSS test is opted for instead, given that presumptions are that the KPSS test caters for the drawbacks produced by the ADF test Kwiatkowski et al. (1992). The ADF test adopts the following model;

$$\Delta Y_t = b_0 + \beta Y_{t-1} + \mu_1 \Delta\beta Y_{t-1} + \mu_2 \Delta\beta Y_{t-2} + \mu_3 \Delta\beta Y_{t-3} \ldots\ldots \mu_p \Delta\beta Y_{t-p} + \varepsilon_t \quad (4)$$

3.2 Johansen cointegration test

It is imperative that one makes sure all series in the data sets contain the same order of integration *I (1)* before proceeding to a cointegration test. Unit root tests have limited ability to distinguish the difference between a pure unit root and a close alternative; moreover the results are often based on subjective rather than theoretical and empirical facts. The Johansen test builds cointegrated variables directly on maximum likelihood estimation instead of relying on OLS estimation. The Johansen test adopts two different likelihood tests namely the trace test and the maximum Eigen value test. A primary benefit of the Johansen test is that it can identify or estimate multiple cointegration relationships if the proposed data set contains two or more time series as compared to its counterparts being Engle-Granger and the Phillips-Ouliaris methods. Furthermore, the Johansen test is a vector cointegration test method and it adopts the following model;

$$y_t = \mu + \beta_1 y_{t-1} + \beta_2 y_{t-2} + \ldots + \beta_k y_{t-k} + \mu_t \quad (5)$$

3.3 Granger causality test

According to Brooks (2002) Granger causality is an econometrics tool based on the standard F-test framework to determine whether one time series is useful to predict the future of another series. The Granger causality can then be said to only represent a correlation between the present value of one variable and the previous value of others. Furthermore, Brooks (2002) argues that this does not necessarily suggest that the activity of variable is a result of another. The Granger causality adopts the following model;

$$\Delta y_t = \sum_{j=1}^{n} b_j \Delta x_{t-j} + \sum_{j=1}^{n} c_j \Delta y_{t-j} + \varphi e_{t-1} + w_t \quad (6)$$

$$\Delta x_t = \sum_{j=1}^{n} b_{*j} \Delta y_{t-j} + \sum_{j=1}^{n} c_{*j} \Delta y_{t-j} + \varphi e^*{}_{t-1} + w_t{}^* \quad (7)$$

3.4 General Impulse Response Function

General Impulse Response Function (GIRF) is a tool that is employed to evaluate the persistence and relative effects of several macroeconomic shocks. Furthermore, the empirical observations made are also used for the development of various theoretical models. A vector autoregressive (VAR) model is used to characterise the effects of the macroeconomics.

3.5 Vector Error Correction Model

Error Correction is a part of the model that looks at how fast the past deviations from equilibrium are corrected. Error Correction Models (ECMs) are a category of multiple time series models that directly estimate the speed at which a dependent variable - Y - returns to equilibrium after a change in an independent variable - X. ECMs are useful for estimating both short term and long term effects of one time series on another. ECMs are useful models when dealing with integrated data, but can also be used with stationary data. In order to explain the complex interrelationship between stationary variables in empirical observations, a VAR model is used as a framework. The VECM test adopts the following model;

$$\Delta Y_t = a_1 + p_1 e_1 + \sum_{1=0}^{n} \beta_i \Delta Y_{t-i} + \sum_{i=0}^{n} \sigma_1 \Delta X_{t-i} + \sum_{i=o}^{n} \gamma_i Z_{t-i} \quad (8)$$

4. Data analysis and interpretation

In this section, the study focuses on the analysis of data and the interpretation of the findings. A test of stationarity is conducted adopting the ADF and KPSS unit root tests. To check for the causality, the Engle Granger will be employed and the VECM test follows shortly after that.

Table 1. ADF Unit root test for variables at levels and 1st difference

Variables	ADF test statistics at levels	Remarks	ADF tests statistics at 1st difference	Remarks
LMCAP	-2.471526	Nonstationary	-6.470559	Stationary
LVLT	-1.582098	Nonstationary	-5.631937	Stationary
LEXCHR	-6.228681	Stationary	-7.536682	Stationary
LGDP	0.128823	Nonstationary	-5.268702	Stationary

All the variables are non-stationary, with the exception of exchange rate which is stationary at levels. The test shows that all the variables are stationary after the 1st difference. The results furthermore suggest that the variables are cointegrated in the order one (1). Therefore, the null hypothesis of nonstationary is rejected.

Table 2. KPSS unit root test for variables at levels and 1st difference

Variables	KPSS test statistics at levels	Remarks	KPSS tests statistics at 1st difference	Remarks
LMCAP	0.118885	Stationary	0.115847	Stationary
LVLT	0.112445	Stationary	0.133552	Stationary
LEXCHR	0.052887	Stationary	0.325609	Nonstationary
LGDP	0.218692	Nonstationary	0.098993	Stationary

The variables are stationary at levels, with the exception of LDGP which is nonstationary. Moreover, all the variables are stationary at the first difference, except the exchange rate which is nonstationary at the first difference. The results furthermore, suggest that the variable is cointegrated in the order one (1).The ADF and PP test confirmed the proposed output that gross domestic product, market capitalization and value of transactions were non stationary at levels. In contrast, the KPSS showed a different view. The test revealed that only gross domestic product was stationary at levels leaving all other variables non stationary. Ultimately, all the variables were stationary at their first difference (1st) for both the unit root tests.

Table 3. Cointegration test results: Trace test

Hypothesized No. of CE(s)	Eigen value	Trace Statistic	5 % Critical value	Probability**
None*	0.579794	79.79452	47.85613	0.0000
At most 1*	0.516822	45.98113	29.79707	0.0003
At most 2*	0.314574	17.61371	15.49471	0.0236
At most 3	0.071253	2.882819	3.841466	0.0895

Trace test indicates 3 cointegrating eqn(s) at the 0.05 level
* denotes rejection of the hypothesis at the 0.05 level
**MacKinnon-Haug-Michelis (1999) p-values

Table 3 shows the number of cointegrating equations. The results show that the trace test indicates that there are 3 cointegrating vectors at 0.05% level. The results suggest that there is a long run relationship between the 4 series in the form of a linear combination.

Table 4. Cointegration test results: Maximum Eigen

Hypothesized No. of CE(s)	Eigen value	Max- Eigen statistic	5% Critical value	Probability**
None*	0.579794	33.81339	27.58434	0.0069
At most 1*	0.516822	28.36742	21.13162	0.0040
At most 2*	0.314574	14.73089	14.26460	0.0422
At most 3	0.071253	2.882819	3.841466	0.0895

Max-eigenvalue test indicates 3 cointegrating eqn(s) at the 0.05 level
* denotes rejection of the hypothesis at the 0.05 level
**MacKinnon-Haug-Michelis (1999) p-values

Table 4 also produces the number of cointegrating equations. The maximum Eigen test shows that there are 3 cointegrating vectors at 0.05% level. The results are in agreement with the trace test that there are three cointegrating vectors and that there is a long run relationship between the 4 series. The statement is validated by an argument based on a view given by Barnerjee; Dolado; Galibraith and Hnery (1993) that even if there were variations in the results produced by the trace and maximum Eigen tests, the maximum Eigen test results are more reliable.

Table 5. Vector Error Correction Model

Error Correction:	D(LOG_GDP)	D(LOG_EXCHR)	D(LOG_VLT)	D(LOG_MCAP)
CointEq1	-0.012465	-0.350802	-0.029515	-0.016705
D(LOG_GDP(-1))	0.171990	-43.03842	-1.799309	-1.092170
D(LOG_GDP(-2))	-0.141722	63.63944	-0.283642	-1.296091
D(LOG_EXCHR(-1))	0.000615	-0.461804	-0.008155	-0.011137
D(LOG_EXCHR(-2))	0.000219	-0.331780	-0.017616	-0.022200
D(LOG_VLT(-1))	-0.010612	-6.480851	0.206411	0.218782
D(LOG_VLT(-2))	0.032722	13.70430	0.179293	0.247980
D(LOG_MCAP(-1))	0.019719	12.82838	-0.053090	-0.191756
D(LOG_MCAP(-2))	-0.002090	-12.52819	-0.081433	-0.198260
C	0.117734	-3.345204	0.383046	0.549685

The projected coefficient of VECM of -0.124 is significant with theory that suggests that the sign of a VECM coefficient in an output should be negative. The results further indicate that any short term changes in the relationship between the dependent and independent variables will be easily corrected to a stable long run relationship among the variables. Furthermore, given that the VECM test indicates the cointegration relationship of the variables, the output is in agreement with both the trace and maximum eigenvalue tests. The tests suggested that the variables are cointegrated and have at most three (3) cointegrating vectors, which also show that the model is correctly specified. This supports the findings that capital markets do have an impact on economic growth in South Africa. In definite terms, the projected coefficient of -0.124 indicates that about 1.2% of the disequilibrium of the past year comes back to the long run equilibrium in the following year.

Although it is relatively low, it is in agreement with Agbetiafa (2003) who stated that even if capital markets might have an impact on growth, factors such as political instability and low efficiency levels in the financial market, which is found in South Africa, reduces the ability to increase and attain these levels of growth. In addition, the results show a long term causal relationship between the exogenous and endogenous variables. About 50% of the growth is explained by capital markets in South Africa, which is given by a fairly positive R^2 that stands at -0.50. The other 50% can be accounted for by the variables that were not part of the model (omitted).

Table 6. Ganger causality test

Null hypothesis	F statistic	P-value	Decision
LOG_MCAP does not Granger cause LOG_GDP	1.42832	0.2521	Accept the null hypothesis.
LOG_GDP does not Granger cause LOG_MCAP	5.94226	0.0023	Reject the null hypothesis
LOG_EXCHR does not Granger cause LOG_GDP	0.11805	0.9489	Accept the null hypothesis
LOG_GDP does not Granger cause LOG_EXCHR	0.89992	0.4516	Accept the null hypothesis
LOG_VLT does not Granger cause LOG_GDP	1.25348	0.3063	Accept the null hypothesis
LOG_GDP does not Granger cause LOG_VLT	4.24734	0.0121	Reject the null hypothesis
LOG_EXCHR does not Granger cause LOG_MCAP	5.93907	0.0023	Reject the null hypothesis
LOG_MCAP does not Granger cause LOG_EXCHR	1.89172	0.1502	Accept the null hypothesis
LOG_VLT does not Granger cause LOG_MCAP	0.93604	0.4343	Accept the null hypothesis
LOG_MCAP does not Granger cause LOG_VLT	1.14654	0.35448	Accept the null hypothesis
LOG_VLT does not Granger cause LOG_EXCHR	1.57206	0.21147	Accept the null hypothesis
LOG_EXCHR does not Granger cause LOG_VLT	5.08899	0.0053	Reject the null hypothesis

Decision rule: reject the null hypothesis if P-value is less than 5% significance level or; Reject H_0 $if\ P - value is < 0.05$

The causality test shows a unidirectional causation between LGDP and LMCAP. It further indicates that there is no causality between LEXCHR and LGDP. However, it also shows that LGDP granger causes LVLT, although LVLT does not granger cause LGDP, which suggests a unidirectional causation. The same applies for LEXCHR and LMCAP, where LEXCHR granger causes LMCAP and LMCAP does not granger cause LEXCHR. In contrast, there is no causality between LVLT and LMCAP, whereas LVLT granger causes LEXCHR and LVLT fails to granger cause LEXCHR. The results clearly suggest that there is a positive relation between capital markets (in the form of LMCAP and LVLT) and economic growth in South Africa. Moreover, the results are in agreement with the previous cointegration results that showed three cointegrating vectors in the model.

5. Conclusion

Theoretical literature highlighted that there are various factors that contribute to the long term economic growth of any country, especially developing countries. It is suggested that countries such as South Africa should focus on the key economic objectives such that they improve their low economic conditions. The literature further showed that an added advantage is exploiting areas of abundance as suggested in the introduction. Authors such as Schumpeter (1911) highlighted that financial sector development is essential for any economy to attain sustainable growth. The author noted that the more developed a financial sector is, the more capable it is to absorb and utilize capital markets in the long run. Moreover, the author pointed out that not only is financial development essential and good for economic growth, it in actual fact causes economic growth. Although Schumpeter (1911) emphasized the significance of financial sector development, which includes the banking sector (Berthelemy and Varoudakis, 1996) other authors brought forward factors such as macroeconomic stability, income levels (Gracia and Liu, (1999), (Nacuer et al., 2007) that also contribute to sustainable economic growth.

The Johansen cointegration test was adopted in the study and it shows 3 cointegrating vectors. The VECM test was conducted right after the cointegration test, which lead to a Granger causality test to detect the direction of the causality. Although South Africa forms part of the fastest growing countries in Africa and the world, empirical review shows that the lack of facilities such stability in the macro economy, developed financial systems and political stability, to mention a few, hinders any progress to grow the economy. In conclusion capital markets have a long term positive impact on developed countries than they do on developing countries.

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