Corporate governance in South Africa: The role of Institutional Investors

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I hereby declare that I have read and understood the regulations governing the submission for the Masters of Financial Management dissertation, including those relating to plagiarism and length, as contained in the rules of the University, and that this dissertation conforms to these regulations.

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Abstract

Corporate governance has become the slogan of the global investment arena over the past decade. Corporate scandals and collapses with major loss to shareholders have noted a change in investors’ attitude towards this topic. Corporate governance has not only become important for the survival of companies in the global economy, a set corporate governance framework too is required to merely attract capital for start-ups.

This study focuses on the institutional investors in South Africa, and their attitudes towards current corporate governance standards in South Africa, and attitude to governance reform.

The aims of this study:

- To accentuate the significance, features and benefits of corporate governance in light of the empirical analysis;
- To understand South African institutional investor environment better, and their monitoring and participating roles in corporate governance for investment in listed corporate entities;
- Review the key criteria factored into investing, and how these are monitored on an on-going basis. Corporate governance criteria in specific was used;
- Highlight the attitudes of South African institutional investors to corporate governance in South Africa, and their perception on corporate governance reform;
- Review weakness in findings in light of the empirical study and analytical framework and summarise recommendations given the outlook for this sector.

We introduce the topic of corporate governance and the concept of agency theory which highlights the reasons behind opportunistic behaviour which occurs at different levels within corporate organisations. We further discuss the change in attitudes of institutional investors on the back of corporate scandals, as well as the reasons and remedies of institutional activism. A background of South African institutional investors is also conducted, with a review of current legislation and corporate governance reform mechanisms applicable to South Africa. Following this is a broad literature review on the quantitative as well as qualitative information needs of institutional investors; this forms the basis for the structure of our questionnaires conducted.

The last section draws on the critical findings and insights (including quotes from the interviews) on the role of institutional investors in South Africa, followed by the summary and limitations of this study.
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CHAPTER 1: INTRODUCTION

Historically, institutional investors based all investment decisions solely on the financial performance of a target investment firm using the firm’s financial reports and key financial metrics as a yard stick. Corporate scandals over the past decade have reviewed numerous manipulation tactics in financial reports – misleading actual performance.
Investor focus has broadened and investors not only focus on companies with key financials, however those which too provide strong investor protection mechanisms and internal controls by means of corporate governance characteristics of fairness, transparency, accountability and responsibility.

The definition of corporate governance was defined by Sir Adrian Cadbury\(^1\) as follows:

"Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The corporate governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society".

At its most elementary, corporate governance is simply about the interaction and relationship among the various participants, or stakeholders, in determining both the performance and the direction of companies (Keong, 2005).

Selected key features of corporate governance are noted as follows (Jean Jacques du Plessis, 2005):

- Is the system of regulating and overseeing corporate conduct
- Takes into consideration the interest of internal stakeholders and other parties who can be affected by the corporation's conduct
- It aims to ensure responsible behaviour by corporations.
- Corporate governance’s ultimate goal is to achieve the maximum level of efficiency and profitability for a corporation.

These factors are noted as key drivers for the implementation of corporate governance rules and principles (Derman, 2004):

\(^1\) Former chairman of Cadbury-Schweppes and former chairman of the Cadbury Committee (Committee on the Financial Aspects of Corporate Governance)
• Financial crises and corporate scandals;
• Globalization and international capital market integration;
• Liberal market economy and deregulation;
• Foreign Direct Investment;
• Privatization;
• Mergers and acquisitions trends and takeovers;
• Company Ratings;
• Growth of institutional investors such as pension fund and mutual funds.

The modern corporate landscape has developed extensively, and the emergence and presence of institutional investors such as insurance companies, pension funds, and provident funds is globally notable. The term “institutional investor” ordinarily refers to an investor who has funds managed by a professional manager, such as a firm that invests on behalf of a group of individuals and organisations (Judy Tsui, 2003).

Portfolio investment of institutional investors has grown and continues to. With this increased investment there more attention drawn to the monitoring role of institutional investors on behalf of their clients who may be less informed. This monitoring role raises question as to whether the institutional investor who manages the assets is an active participant in the corporate governance of the invested firm (investee companies). Also does this active role benefit the ultimate shareholder via improved performance and protection?

The modern corporate environment has resulted in the division of ownership and control in many companies so that a company’s directors have taken the place of its de facto owners (its shareholders) in directing and controlling the affairs of the company. Traditional corporate doctrine has assumed the separation of ownership from control as the core problem of corporate governance (Naidoo, 2002). In this view, the primary function of corporate law is to devise strategies and mechanisms to ensure that those in control of shareholders’ property apply it strictly for the benefit of shareholders. This separation of ownership and control together with the increasing involvement of other stakeholders who have an interest in the business of the company – financiers, surrounding communities and employees for instance – has accordingly given rise to the need for a predictable, uniform and comprehensive system of control based on the overarching principles of transparency, fairness, responsibility and accountability (Naidoo, 2002).
Agency theory is the central outline to understand the role of institutional investors in the modern corporation. Separation of ownership by shareholders (the principals) and control by managers (the agents) gives rise to the agency problem. Shareholders will provide (or invest) their economic resources to the companies with the aim of maximizing a return on their investment. As a result of information asymmetry, managers are probable to act opportunistically at the expense of shareholders’ benefits in order to maximize self-interests (Jensen, 1976) (Fama, 1983).

Agency theory is based on the incompleteness of contracts and the separation of ownership (shareholders) and control (management), which is the main characteristic of corporations nowadays. Incomplete contracting theory posits that problems arise because of the difficulties shareholders face in writing contracts to cover every contingency in the organization and the difficulties of enforcing and monitoring contacts. (Jensen, 1976)

New theories of economic governance can be viewed from the perspective of Olivier Williamson. Williamson’s theory is a top down analysis that presumes people ultimately cannot trust another. He explains the modern firm as an evolved structure of contracts as a solution to this problem of opportunism in the context of asset specificity. His work which was awarded a Nobel Prize in 2009 covers contractual relationships between firms, bureaucracies and independent agents that result from doing deals in markets, and relationships inside organizations that are shaped not merely by the contractual terms under which employees join them but also by hierarchical reporting arrangements. (Williamson, 1979)

According to the “Theory of the Firm”, the firm can be viewed as a “nexus” of a set of contractual relationships with multitude of parties and individuals and the objective of the firm being to draft or plan the contracts in such a way as to minimize contracting costs including agency costs. Enforcement and monitoring the contracts to ensure managers act in the interest of shareholders are costly and can affect the firm’s profitability. (Jensen, 1976)

Without any mechanisms to avoid agency issues discussed, there is a risk that the managers may expropriate shareholders’ investment. Opportunistic behaviour may be seen in terms of non-disclosure, lack of transparency, and manipulation of accounting earnings to increase accounting based remuneration.

The law and corporate governance structures (including institutional investors’ engagement) are important ways of handling the agency problem and relieving issues associated to incomplete contracting. The below mechanisms if implemented effectively are a few which can assist to improve monitoring and reduce opportunistic behaviour.
There are extensive mechanisms of good corporate governance, including but not limited to the following:

- Board structure - Unitary board structure with executive directors and non-executive directors interacting in a working group;
- Composition of the board - balance of executive and non-executive directors;
- Board committees - All companies should have, as a minimum, audit and remuneration committees. (PWC, 2009)

Good corporate governance implies the following benefits for companies:

- Low capital cost;
- Increase in financial capabilities and liquidity;
- Ability to overcome crises more easily;
- Enhanced level of shareholder protection. (CMB, 2005)

In this study it is interesting to note that large shareholding has led institutional investors to become interested and more involved in the corporate governance of investee firms to protect their investments.

Shareholder activism (Investor activism) is determined by European Corporate Governance Institute (ECGI) as the way in which shareholders may pronounce their power as owners of the company in attempt to influence its behaviour. Large institutional investors, in particular, have traditionally tried to restrain themselves from criticising a company’s board in the public domain. Increasingly, shareholders are now prepared to come out into the open when criticism falls on deaf ears (TaylorWessing, 2012).

The following are some key reasons why investors may wish to pursue investor activism:

- to procure a return of capital;
- to ensure a different corporate strategy is pursued so as to realise improved performance and profitability, e.g. seeking to recognise value by de-merging businesses;
- to ensure changes to a company’s board;
- in pursuit of a special interest, i.e. groups aligned with environmental, social or ethical agendas;

Note: these points are the main characteristics we noted as important from a longer list.
• to increase company efficiency by procuring the disposal of under-performing assets;
• to influence the outcome of a takeover or other M&A activity (TaylorWessing, 2012).

The next chapter provides a comprehensive review of the existing institutional investment literature.
CHAPTER 2: LITERATURE REVIEW - INSTITUTIONAL INVESTMENT

2.1 Introduction

In this chapter we consider the evolution of institutional investment. We conduct a high level literature review to better understand the influence of institutional investors on corporate governance issues facing their investee firms and the association between these two parties. We follow with an assessment of the influence that the relationship between institutional investors and the investee firm has on the performance of the investee firm. We end with a review of previous studies conducted which found divergent results on the association between the institutional investors and firm performance.

2.2 The development of increasing institutional ownership

Increasing curiosity and investment by institutional investors in organisations was observed in the late 1990’s. This brought upon core issues relating the rights of shareholders and the protection of minorities in the investment environment. The increase in investment, predominantly in the United States of America (USA), saw large interest in corporate governance and firm performance by institutional investors (Brancato, 1997).

The exceptional growth in institutional ownership captured international equities too and was not only restricted to the markets in the USA and United Kingdom (UK) (Cadbury, 1999). On average, 75% of British equities are owned by institutional investors, counting one third owned by pension funds. This percentage can possibly rise as a result of the aging global population and the associated rise in pension fund investment. Additionally, a corresponding increase in the proportion of funds invested in equities is anticipated in order to improve their returns.

Improved communication technology has given rise to global integration. This provides the expectation for increased investment in international equities as well as growth in cross country transactions and the development of international capital markets. The most important driver for future corporate governance in the market is the large and increasing presence of institutional investors globally (Cadbury, 1999).

Greater institutional ownership is associated with an expectation of increased shareholder activism and engagement aimed to monitor and manage corporations in the evolving and legislated markets. Due to the difficulties of disposing of investments and abiding to mandate limits, institutional investors have adopted a hands-on role in the corporate management and business of their investee
corporations to safeguard their interests. South African Pension Funds have further investment limits and restrictions as set out in Regulation 28 of the Pension Funds Act (Act 24 of 1956), “PFA” as discussed in Chapter 3. Regulation 28 limits the extent to which retirement funds may invest in particular assets or in particular asset classes. These restrictions were previously only imposed at an overall fund level. However, consequent industry developments and the advancement of financial products required the outdated legislation to be reviewed to allow investment in these investment alternatives and to provide the investor with greater protection.

It is argued that placing power in the hands of concentrated investor groups (i.e. institutional investors) and involving investor activism aids in mitigating the separation of ownership and control especially in large corporations causing agency problems (Biem, 2001) (Financial Economists, 1999). Voting rights spread over many shareholders is not seen as an efficient monitoring mechanism. Having voting rights via diffused share ownership aids management in creating opportunities to pursue ulterior profit motives and not acting in the best interests of shareholders. However, placing these rights in the hands of institutional investors is anticipated to decrease management’s opportunistic behavior within the corporation (Smith, 1996.) (Rajgopal, 1997).

2.3 The role of institutional investors in Corporate Governance

“The primary objective of Institutional participation in corporate governance should be to maximize economic value for the institutional shareholders and beneficiaries”. (Financial Economists, 1999) Institutional investors must practise governance initiatives that will enhance the market value of their underlying client portfolios. They should not pursue initiatives intended to advance the interests of other corporate stakeholders, such as suppliers, customers or employees, to the disadvantage of shareholders. In some instances, institutional investors pursue non-economic objectives and don’t pursue profit maximization of portfolios. The beneficiaries might seek religious, social or environmental improvement and want to see their funds invested in promoting these goals (Financial Economists, 1999), this is globally termed “Socially Responsible Investing”. Increased institutional investor ownership has the ability to better monitor and improve the overall effectiveness of corporate governance (Coffee, 1991.) (Silverstein, 1994).

The following points provide a brief review of why institutional investors are likely to pursue an active role in corporate governance oversight and effectiveness:

- Large shareholding in corporations held by institutional investors gives these investors the ability to exercise power to intervene in the operations and lay demands on management by
engagement and activism via events such as public announcements, shareholder proposals and proxy contests (Daily, 1996).

- Implicit powers: actions such as a large presence of votes which are hostile to management and could lead to a takeover threat.
- Explicit powers: actions which vote in favour or against the board committee in the annual general meeting. The larger the shareholding held by the institution, the greater its incentive to pursue active monitoring over management to benefit the shareholders and other beneficial stakeholders (Daily, 1996).

- The exit strategy of any investment is crucial as it supplies a longer term plan to investors as to how they can withdraw their funds from invested companies and obtain a healthy return (McLeod, 2004). The ability for institutional investors to exit is low. For this reason, (Hirschmann, 1970) recommends via his “Exit versus Voice” model, that institutional investors would have large incentive to exercise “voice” (hold the shares and raise their dissatisfaction) as their alternate “exit” (sell their shares) option is low given their large shareholdings. The existence of robust incentives and overt influence gives institutional investors the capability to have better involvement in monitoring managerial actions and thus the ability to achieve effective corporate governance (Demsetz, 1983) (Shleifer, 1997).

- (Roe, 1990) Posits that not only the separation of ownership and control give rise to the agency problem between shareholders and managers, but it is rather the diffused nature of ownership made up of a large number of small shareholders. With this diffused ownership structure, incentive is lacked to monitor corporate management given the small shareholding by the individual owner. The cost of monitoring is higher for the individual owner. Roe suggests that the degree and nature of agency problems is associated to the ownership structures. As envisioned by (Berle, 1932), ownership structures dominated by large shareholders experience lower levels of agency problems. Authors have posited that one of the crucial roles of large shareholders is to at best eradicate agency problems by constant monitoring of management or otherwise taking a controlling role in the corporation (Admati, 1994) (Maug, 1998) (Huddart, 1993) (Noe, 1997). Because diffused ownership results in all shareholders benefiting from the actions of a monitoring shareholder at no costs, the authors

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3 The ability to exit is low as with such large shareholding, it is difficult to find alternate investments matching the risk profiles. Also immediate withdrawal of large funds from the market could create volatility in the share price.
further argued that large shareholders have large incentive to monitor. This view is supported as it was found that company performance improves after an activist investor purchased a block of shares (Bethel, 1998). The existence of large shareholders in a firm is coupled with higher management turnover which suggests that a monitoring function is occurring by these shareholders (Kang, 1995).

- An additional outlook on the large shareholder arises when that shareholder is a lending institution. Prior research shows the lenders occupy a unique position in the firm’s corporate governance with their monitoring capabilities. Banks, especially in their lending capacity have a comparative cost advantage to monitor firms given their access to inside information. The bank lenders’ admittance to greater information, compare to the information available to bondholders, reduces potential agency costs of debt financing (Fama, 1985).

- There is also support when viewing lenders which take positions as equity holders in firms in which they lend to. This is verified when viewing the US and Japan. In the US, for most of the twentieth century, banks were not allowed by law to hold equity in firms. However, in Japan, banks were allowed to take equity positions in firms, including firms to which they made loans to. It was concluded by (Prowse, 1990) that agency problems in Japan were minimized by the Japanese lenders’ holdings. These differences in restrictions concludes that if lending institutions who are equity holders are more effective monitors, then the agency problems in Japan could be less than in the US, everything else equal.

The value to institutional investors from the monitoring function is reviewed in the next section through extensive literature. The studies have been classified into three sets:

1. Institutional investors role as active participants in corporate governance;
2. Institutional investors role as passive participants in corporate governance; and
3. Associations between institutional investors and firm performance.

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4 Large investor have more incentive to monitor corporate activities as it is more likely that gains on their investment as a result of monitoring would be sufficient to cover the monitoring costs.
2.3.1 Active Participants in Corporate Governance

The below studies reviewed support the fact that institutional investors fulfill an active role in the corporate governance matters of their investee corporations.

The studies below illustrate how institutional investor activism leads to the implementation of long term improvement methods and structures within the investee companies, accompanied by increased investment in research and development (R&D):

- (Hansen, 1991) studied 129 US firms (over the period 1977 – 1987) and reviewed the link between institutional investor ownership and R&D expenditure. The study revealed greater levels of institutional ownership was associated to larger R&D expenditure.
- Between 1983 and 1994, (Bushee, 1998) conducted analysis on 13,994 firm observations. It was noted that that managers were less inclined to reduce R&D expenditure to turn around a decline in earnings when institutional ownership was larger. The high institutional ownership suggests institutional investors could monitor and discipline managers, ensuring long run success and value maximization of the firm.
- (Wahal, 2000) studied over 2500 US firms’ (for the period 1988 to 1994) corporate expenditures for property, plant and equipment (PPE) and R&D. PPE and R&D expenditure was noted to be positively associated to institutional ownership. This affirms that institutional investors fulfill an active role to create long term value for the firm.
- (Baysinger, 1991) studied 176 Fortune 500 firms and confirmed that larger equity holding among institutional investors as a group correlated to higher R&D spending.

The studies below further illustrate how firms with larger institutional ownership would approve shareholder proposals with the aim to create long term shareholder value:

- (John, 1995) proposed that shareholder proposals\(^5\) possibly induce managers to improve the firm’s operations it was seen as “… shareholder participation which is not dominated by management”. (Dobrzynski, 1990) recommended that shareholder proposals position management to be more alert and focused on long term value generation. Successful hostile takeover bids can increase long term value for stakeholders if the new management implements changes in policy. For example, shareholder proposals have been accepted in

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\(^5\) A proposal submitted by a shareholder for action at a forthcoming annual meeting. If the holder gives timely notice of their intentions, the firm’s management must include the proposal in the proxy statement and must give the other shareholders a chance to vote for or against the proposal.
various companies, including Avon Products, Inc., Gillette Co., Lockheed Corporation, and USX, Inc., to support hostile takeover bids and possibly increase shareholder value.

- (Gillan, 2000) examined the results of sponsored proposals by public pension funds, coordinated groups of investors, and individual investors in the US (covering 2042 shareholder proposals\(^6\), submitted in 452 companies over the period 1987-1994). It was noted that sponsored proposals by institutions obtained positive votes compared to those by independent individuals or religious organisations. The voting result was associated with sponsor identity and the share of institutional ownership. Results reveal that institutional investors are favorably matched to have a better monitoring role over investee firms. The study also revealed that most of proposals made by the institutional investors were corporate governance related (relating to antitakeover measures, change in voting rights and escalating director independence on the board).

- (Nesbitt, 1994) studied companies targeted by CalPERS\(^7\) and their long term share price performance for the period 1987 – 1992. The assessment focused on whether shareholder value was created by institutional investor intervention such as, the formation of a shareholder advisory committee, executive compensation committee change, a push for additional independent non-executive directors. Results showed that with CalPERS activism, these targeted companies outperformed the S&P 500 index in the subsequent 5 years by 41%.

- (Smith, 1996) studied company characteristics that would initiate engagement by CalPERS, and explored if shareholder activism is a beneficial means to monitor investee firms. Utilising a sample of 51 firms from the 78 targeting proceedings of CalPERS (for the period 1987 - 1993) it was observed if activism measures succeeded to change and or enhance the target firm’s governance framework and improve shareholder value. It was concluded that CalPERS targeted large firms with poor stock performance, lower market to book ratios and greater industry diversification. Improvements in the governance framework were noticed in 72% of the sample over the period. These results show a positive effect of shareholder engagement by CalPERS.

The below studies examined show that institutional investors not only have an interest to participate as monitors of corporate governance, but are also effective monitors of governance in their investee firms:

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\(^6\) The shareholder proposals reviewed in the study included voting issues (i.e. confidential and cumulative voting), board and committee independence issues (i.e. as director ownership increase board independence, director compensation) and matters related to revoking anti-takeover devices (such as repealing classified board, eliminating poison pills, fair price provisions).

\(^7\) California Public Employees' Retirement System (CalPERS) is one of the largest US institutional investors and is a known institutional advocate for corporate governance in the US.
(Hartzell, 2000) studied the relationship between mechanisms of corporate governance, namely between the level of director remuneration and the concentration of institutional investor ownership. Utilising data from 1500 US firms (for the period 1991-1997); a negative relationship was noted between the level of compensation and the percentage of institutional ownership. However a strong positive association between the performance payment sensitivity of executive compensation and both the level and concentration of institutional ownership. This advocates that institutional investor ownership is an efficient corporate governance mechanism to monitor incentive compensation.

(Rajgopal, 1997) examined data from 1541 US firms (for the period 1989-1995). It was established that “communication and informativeness” of data from accounting earnings heightened with increased institutional ownership. The amount of institutional ownership was noted to be inversely associated to absolute discretionary accruals and income increasing discretionary accruals suggesting that earnings management is reduced with higher levels of institutional ownership. This justifies the view that institutional investors serve an effective monitoring role.

(Pozen, 1994) suggested that while shareholder activism might be difficult to link to improved financial return, it can be advantageous to the shareholders and clients. Furthermore, shareholder proposals possibly bring about decisions that are more beneficial to a company’s shareholders.

(Bethel, 1993) analyzed 388 Fortune 500 sample firms in 1981. It was noted that institutional investor ownership was a significant element of total firm downsizing (reduced diversification and decline in average annual PPE expenditure). This evidence supports the supposition that institutional investors fulfill a vital role in monitoring and relaying corporate strategy to managers to prevent over expansion and over diversification.

(Jensen, 1993) argued that there was significant support for the suggestion that the internal control governance mechanism headed by the board of directors of publicly held corporations have been ineffective to result in managers maximizing efficiency and value (Bhide, 1993; Roe, 1990; 1991). Jensen studied 432 US companies and noted that firms with excess capacity have boards which did not bring about timely exit or downsizing. It was furthermore suggested by Jensen (1993) that active investors (including institutional investors) should play a vital role in monitoring for an effective governance system to remedy the situation. The rationale was that these investors have financial interests and also independence to view the company and its overall processes. Thus, the greater amount of active investors onboard the monitoring function, the better firm performance is expected.

(Black, 1992.) argued that when institutional investors evoke shareholder activism (including a demand for more independent directors, discouraging business diversification, evaluating
the suitability of CEO compensation), the ultimate value of the investee companies will increase.

- (Aggarwal, 1990) studied the institutional ownership of 372 US firms and established that the presence of large shareholders initiate improved monitoring of managers within the investee firm. These institutional owners comprised pension funds, banks and trust companies, endowments, mutual funds, and investment advisory firms.

- (Hill, 1988) argued whereas a manager favors policies to enhance self-interest, a shareholder favors policies to maximize wealth. Thus, shareholder involvement in management decisions prefer innovation plans compared to diversification; as innovation is linked with better firm profitability. The hypothesis was confirmed by reviewing 94 Fortune 500 firms and this exposed that a greater shareholder ownership was positively linked to R&D spend; suggesting that innovation over diversification is preferred as it is more profitable.

The following section reviews studies which have found no relationship between higher institutional ownership and heightened firm monitoring and improved governance. Certain studies have highlighted the fact that institutional investors could weaken the governance mechanisms and in the long term dampen shareholder value maximization.

### 2.3.2 Passive Participants in Corporate Governance

- (Davis, 1991) studied 440 US Fortune 500 firms over the period 1984 to 1989. The study revealed that ownership interests held by institutional investors were affiliated to the approval of take over defenses. This is confirms the view that institutional investors supported management’s takeover defenses. This may a negative impact on the long term value for shareholders.

- (Palmer, 1987.) examined 147 US Fortune 500 firms in 1964. A negative correlation was found between ownership held by institutional investors and corporate diversification; signifying a focus on short term instead of long term profitability.

- (Graves, 1988) studied 112 US firms for the period 1976 to 1985. A negative relationship was discovered between institutional investor ownership and corporate innovation. R&D expenditure by the firm concurrently declined with institutional ownership. This supported the view that institutional investors encouraged narrow-minded investment conduct of management.

- (Bushee, 2001) examined 10380 firms observational data for the period 1980 to 1992 and revealed institutional investors favored investee companies with greater short term earnings. This advocates that institutional investors possibly encouraged narrow-minded investment
behavior. However, there is no indication that institutional investors withheld any R&D expenditure (which is a spectacle of long term earnings).

- (Lipton, 1991) suggests that even shareholder proposals with optimistic outlooks could distract managers from their core tasks, resulting in inefficient management. This indicates that monitoring by institutional investors can divert management from enhancing firm value.

- (Saxton, 1994) & (Romano, 1993) noted that institutional investors who were faced with political control and regulation would possibly pursue objectives other than value creation. Public institutions are probable to use corporate governance proposals to influence target firms’ decisions and motivate toward non value politically driven investments. Corporate governance proposals submitted by public institutional investors may decrease overall firm value.

The foundation for the argument that there is no link between institutional ownership and corporate governance stems from the view that these investors are interested in short term volatility and current earnings. (Graves, 1990) argues that institutional investors are noted as “traders” rather than “owners”. Thus, in periods where there is an absence for expected current profits, these investors “sell off” instead of challenging management to implement long term value policies. This has led to a fear of “selling off” where managers act one minded to pursue current profits at the expense of pursuing long term value increasing strategies for the firm. (Jacobs, 1991) (Laverty, 1996)

2.4 Firm performance and institutional investors

In this section, studies linking institutional investors and firm performance are reviewed as it is still uncertain whether institutional investors playing active roles in corporate governance will improve firm performance:

- (Aggarwal, 1990) studied 1200 US firms. The outcome noted a negative association between the level of institutional holdings and the standard deviation of the stock. Thus, a higher level of institutional holding signifies a lower risk for a particular stock according to the author.

- (McConnell, 1990) examined 1173 US firms in 1976 followed by 1093 US firms in 1986. A positive correlation was found amidst institutional ownership and corporate performance, i.e. the greater level of institutional holding the better firm performance. The study suggested that a higher level of institutional holding translates into lower risk investments and better performance.

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8 Specific risk of a certain stock
• (Linn, 1983) studied 398 firms listed on the New York Stock Exchange over the period 1960 to 1980. The study revealed that the average abnormal returns were immaterially different from zero subsequent to statements of contract revisions such as supermajority voting rules.

• (Daily, 1996) tested two hypotheses using a random sample 200 Fortune 500 corporations for the period 1990 to 1993. The hypotheses tested: 1) “the number of governance related shareholder proposals (proxy for shareholder activism) is positively associated with firm performance”; and 2) “institutional investor holdings are positively associated with firm performance”. No evidence was found that supports either hypothesis. This advocates that institutional shareholding and shareholder activism are unrelated firm performance.

There are several recognized explanations for the contradictory outcomes on the effectiveness of institutional investor holdings on corporate performance.

2.5 Explanations for conflicting Results

In some cases, institutional groups have followed the route “free riding” on the engagement of others and reaping the benefit i.e. advances on their portfolios. Institutional investors may lack the incentive to monitor investee activities and for this reason are not seen as active shareholders. (Daily, 1996)

2.5.1 Institutional Investors’ enthusiasm and ability to pursue Activism

The following studies illustrate the lack of incentive towards active monitoring:

• Even though institutional investors have adequate information to make investment decisions, they may not have the correct information to monitor investee firm operations (Kochhar, 1996)

• A certain level of ownership is required by institutional investors prior to obtaining inside confidential information. By maintaining such a high level of ownership in the investee firm, the investor could jeopardize their freedom to maintain liquidity (Bhide, 1993)

• Institutional investors don’t have the capability, knowledge and experience to directly monitor a corporation’s managers (Prowse, 1991) (Taylor, 1990)

• Institutional investors don’t have incentive to actively monitor due to “free riding” among another in monitoring managers of investee firms. There is a cost to actively monitor and the

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9 Supermajority voting rules: it is required to have about 80% of shareholders to vote in favor of any amendments
rewards from engagement will not only benefit the active institutions clients, but rather all shareholders. It is near impractical for the engaging and active institutional investors to induce or force all benefiting shareholders to assist in monitoring. (Black, 1990) (Admati, 1994) (Pozen, 1994)

- Institutional investors seek to out-perform within their industry and the overall market via methods such as institutional investors monitoring. However, out-performance would be unlikely if the market notes investors are in disagreement to the management or the implemented strategies of investee firms. This creates impediments for institutions to engage and be involved in the corporate affairs of investee companies (Morse, 1997).

- Rules and regulations are sometimes deliberately planned to keep institutional investment holdings small (Kochhar, 1996) (Black, 1990) (Roe, 1990). An example which illustrates this would be section 13(d) of the Securities Exchange Act of 1934 and related Securities Exchange Commission Rules which requires any person or ‘group’ which owns more than 5% of a public company’s stock to file a Schedule 13D “beneficial ownership report” disclosing the details of the person or group, its stock ownership, its plans with respect to the company, and numerous other matters. This forms a legal risk for the institutional investors as it places an obligation for disclosure. These types of legislative requirements could discourage the institutional investor from acquiring a large portion in the investee company in order to have a majority governing role.
2.5.2 Costs and Risks of Active Monitoring

Institutional investors have good grounding and judgment prior to participating in the corporate governance affairs pertaining to investee firms. There are costs and risks coupled with activism which institutional investors need to take into account. (Macey, 1998) Identifies some of these costs and risks:

- Institutional investors face the free rider problem, as any gains achieved through activism are not for their sole benefit. These benefits are shared openly to all investors and even rival investors. This is discouraging as the costs of the activism are borne alone by the activists.
- There is no defined definition of the skills match between being a good fund manager and being good in operational advice. Human capital skills needed to be a good fund manager may not be the same skills needed to provide sound operational advice to the investee firm.
- Institutional investors don’t want to lose liquidity in order to gain greater voice in investee firms. Board membership in companies brings upon many responsibilities.
- Constructing diversified portfolios which eliminate firm specific risk and maintain a low cost base is crucial for institutional investors as they operate in a competitive environment. Neither of these tactics is in line with engagement and monitoring by the institutional investors as monitoring involves costs, expertise, time and skill.

Given all shareholders have the equivalent legal rights; institutional investors however may have varying goals and objectives to other holders. This could be short term earnings attention rather than long term value generation and voting strategies.

The presence of diverse institutional investors may have varying effects on their inclination to pursue monitoring and ultimately have altered effects on corporate governance activities. (Johnson, 1999) describes two different institutional investors namely: “pension fund equity” and “mutual and investment bank funds”.

It was hypothesized that, “Pension Fund ownership has a positive correlation with corporate social performance, while investment bank ownership should have a negative correlation”. Pension Fund manager remuneration is not linked to the underlying investment performance and their holdings are fairly long-term (Gilson, 1991). This created a willingness for Pension Fund managers to be hands on in corporate governance matters and an understanding that social gains are realized with a long term horizon (Hoskisson, 1996). Contrary to this, investment bank managers have their remuneration linked to underlying short term performance, and tended to hold stocks for a shorter time period, thus being less involved in corporate governance (Gilson, 1991).
It must be noted that any measurement on the effectiveness of institutional investors’ monitoring role and engagement in corporate governance must account for the current governance mechanisms in place and agency problems within the company. Family ownership can influence the willingness and incentives for the institutional investor which could have a substantial effect on the association between institutional ownership and corporate performance. Though it is anticipated that the effects of institutional monitoring are realized in operating and stock performance, academics have been unsuccessful to note any strong correlation between institutional ownership and corporate performance (McConnell, 1990) (Chaganti, 1991.)

In contrast, following the above literature review, a noteworthy relationship between institutional investors and corporate performance exists. To advance the corporate governance structure of any company, the likely monitoring role of institutional investors cannot be ignored. Institutional investors’ have their own understanding of the monitoring role and this may impact their investment decisions. If institutional investors have a short term view of their investment, corporate governance may have little to no integration in investment analysis and decision making. However, if institutional investors pursued activism and believe their actions and voice can impact on the long-term growth of the company, then the current governance structure in place may impact their investment decisions. The crucial factor is to determine if there is adequate incentive for institutional investors to satisfy this monitoring role.

The lack of willingness to monitor can be affiliated to “free-riding”, shortage of human intellectual capital and experience to directly monitor the investee firm, current governance structures in place and agency problems which exist. Additionally it must be remembered that institutional investors differ: some institutional investors (i.e. pension fund managers) seek long-term value and feel their current efforts in corporate governance will need a longer time horizon to be realized. Contrary to this, others (i.e. investment bankers) aim at remuneration based on their short term performance. Given their short term horizon, they have a lack of incentive to engage and to be hands on in the corporate affairs of investee corporations. (Ferdinand, 2003)
2.6 Summary

Global cross border investment integration and technological advancement have aided the growth of institutional investment globally. South African institutional investors with cross border investments need supplementary information to monitor global firms and their internal firm specific and country specific factors which are not static. Even though literature such as the Cadbury report 1999 makes reference to institutional investments large ownership of equities; the recent financial crises since 2008 has shown that it is imperative for investors to understand liquidity and exit strategies of the broader asset classes as switching becomes instantaneous.

Two main reasons explain why the relationship among institutional investors’ and corporate management has undergone change, namely:

- Exit strategies become inappropriate as shareholding on investee firms increase and become larger; and
- The difficulty of disposing of shares of investee companies, especially poor performing companies and the inadequate investment opportunities which exist in the market.

The change in institutional investor’s attitudes toward investee companies’ corporate governance matters, from a passive to active approach is expected to provide an additional monitoring function. This would at best prevent management opportunistic behavior.

Support of previous studies highlight that greater institutional ownership promotes and enhances good corporate governance practices in investee firms and is associated to:

- Lower executive remuneration;
- Better monitoring of incentive remuneration;
- Greater inclination to vote against takeover defenses which decrease value;
- Higher information on accounting earnings; and
- More emphasis on long-term shareholders’ value. (Ferdinand, 2003)

On the contrary there are studies that do not maintain the view that institutional investors’ are beneficial in monitoring management’s opportunistic actions. Empirical evidence illustrates that institutional investors supported management takeover defenses possibly at the cost of long term shareholders’ interests.
Based on the evidence in the literature review on there exists uncertainty on the relationship between institutional investor ownership and the firm’s financial performance. Firstly this uncertainty could be explained by the diverse institutional investor groups, their various characteristics and different objectives and investment time horizons. Studies failing to consider the variances will possibly have inconclusive or negative outcomes. Secondly, the role of institutional investors in the corporate governance structures of investee companies must be reviewed with the current backdrop (i.e. current governance structure in place and any existent agency issues etc.).
CHAPTER 3 ANALYTICAL FRAMEWORK

3.1 Introduction

The literature analysis in the previous chapter presented the different monitoring roles played by various institutional investor groups.

- Active monitoring was noted as being directly involved in the management and decision making of firms operations.
- Passive monitoring methods on the contrary displayed lack of interest whereby investors would sell out invested portions and rather try to match returns from a lowest possible fee or involvement.

Given these two monitoring roles, it can be said that varying institutional investor goals and objectives would possibly lead to varying contribution levels in the corporate governance of the investee firms.

In order to correctly observe the association between institutional investors and firm performance, both the different types of institutional investors and the current corporate governance mechanisms must be considered. This chapter compares the various levels of institutional investor participation in context to the corporate governance environment.

The existence and complexity of the institutional investor was reviewed in prior studies, with reference to ownership and control issues stemming from organisational structures. This chapter further reviews the existence of institutional investors in South Africa and the guiding principles which exists in the industry.

3.2 Brancato’s Framework

(Brancato, 1997) classified and grouped institutional shareholders by their investment objectives and corporate governance behaviour along a specific spectrum. “Investors” are defined as having an interest in the continuity and succession of the corporation, whilst “traders” are focused on arbitrage and returns over a specific time period. In this spectrum, institutional shareholders are classified as “investors” at one end and as “traders” at the other.

Table 3.1: using examples from the United States, the various levels of shareholder contribution is portrayed. The table shows the different objectives and the role institutional investors fulfil relative to corporate management.
Level 1 (depicted in table 3.1) Active investors in both “financial and voting terms” are positively engaged in monitoring the corporate governance structures and mechanisms of investee firms. These investors observe and assess investments in terms of shareholder wealth maximisation (Brancato, 1997).

Level 4 (depicted in table 3.1) Traders, in both “financial terms and passive in voting” are less likely to participate in corporate governance matters despite their large shareholding (providing leverage to influence management). In addition, traders seek fast returns, thus having a short term view and won’t be invested for long periods in order to participate and fully engage in governance affairs.

The influence Level 1 investors can make on corporate governance and ultimately impact performance of the company depends on current governance mechanisms in place and the degree of agency issues which exists. Example: Level 1 Investors are less incentivised to positively engage where strong governance mechanisms and structures are in place, and where agency issues are minimal.

<table>
<thead>
<tr>
<th>Level</th>
<th>Participation</th>
<th>Examples</th>
<th>Spectrum</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Active investor in financial and voting terms</td>
<td>Warren Buffett, LENS, Inc. &amp; other actively managed public pension funds</td>
<td>Investors</td>
</tr>
<tr>
<td>2.</td>
<td>Passive investor in financial terms but active in voting</td>
<td>CalPERS, New York State Common Retirement Fund &amp; other funds which index stock but vote proxies</td>
<td></td>
</tr>
<tr>
<td>3.</td>
<td>Active investor in financial terms but passive in voting</td>
<td>Trustee accounts at many banks &amp; many corporate pension funds</td>
<td></td>
</tr>
<tr>
<td>4.</td>
<td>Trader in financial terms and passive in voting</td>
<td>Most money managers, program traders</td>
<td>Traders</td>
</tr>
</tbody>
</table>

Source: adapted from Brancato (1997)
3.3 Existence and complexity of the institutional investor

3.3.1 Ownership and agency issues

Factors influencing the level of corporate governance, exposure of agency risk and investor involvement cannot be measured on a standalone basis. These issues need to be viewed in accordance with the depth of institutional existence present in various countries. (Claessens, 2000) analysed ownership and control of 2,980 listed entities for the period 1996. “Nine East Asian economies, namely: Hong Kong, Indonesia, Japan, South Korea, Singapore, Malaysia, the Philippines, Taiwan and Thailand were analysed”. Using ownership organizational data for this period (Claessens, 2000) found a wide spectrum of companies are subsidiaries of a head entity.

Hong Kong has more than 60% of companies which are affiliated to a head group as a subsidiary. The corporate groups here are noted to have complex web ownership links. Thus, you have a base corporation being owner by a group, whereby this head group is the subsidiary to another group. The ultimate head corporate or owner was classified as either of the following:

- Family owned
- State owned
- “Widely held” financial institution
- “Widely held” corporation.

The research concluded that all countries, excluding Japan, had a high concentration of family owned firms. (Claessens, 2000)

(Claessens, 2000) made conclusions which can be further analysed by reviewing ownership structures in Hong Kong. The ownership structures in Hong Kong differ significantly to developed markets such as the United States and the United Kingdom. Family control is a dominant feature in corporate listed companies in Hong Kong, whereby 66% is family owned (Hong Kong Society of Accountants, 1997). The common scenario would be where a large family would own a dominant portion of a listed company shares, with nominee family member’s part of the senior management of the company/ (Tsui, 2001)

(Post, 2000) studied the top fifteen families in Hong Kong with large shareholdings of listed companies. It was not uncommon whereby the Chief Executive Officer (CEO) and the Chairman were...

---

10 Widely held is described where no beneficial owners controlled at least 20% of the shares in any one subsidiary within the organisational structure.
positions occupied by the same person who represented the controlling family shareholder. Given such small shareholding structures, the agency issues stemming from the separation of ownership and control are not critical.

Family ownership is debated to be a mechanism of corporate governance as well (Post, 2000). Agency issues stemming from the separation of ownership and control (between shareholders and management) are less in this ownership structure. Family owners who are activists and engage in management are likely to implement long term value creation policies for the firm.

(Vishny, 1997) has noted that common agency problems could occur as a result of concentrated ownership structures. The controlling shareholder could misuse funds from smaller shareholders. This could be done through in various ways, however a common being the pyramidal organization\textsuperscript{11}. This provides support to show that institutional shareholders in these countries with low shareholdings are unlikely to influence corporate governance over the large family shareholdings. Thus, in Hong Kong especially their role as monitors in governance is highly constrained. In these circumstances, institutional investors tend to follow passive methods.

Widely held companies present in these countries may be more likely to house institutional shareholders which play a more active role and have voting power. (Brancato, 1997) showed that the majority of international investors invested in developing market countries play an active role in corporate governance even though the institutional shareholding is not that large in these markets. Active US based institutional investors investing in Hong Kong equities have an expected level of corporate governance for investee firms. In 1994, the 25 largest US public and private pension funds owned a total of US$85 billion in international equities. This represents on average about 30% of all international equity investments owned by US investors. A substantial increase is noted over the period from US$18 billion in 1989 to US$85 billion in 1994 (Brancato, 1997). Thus supporting the view that institutional investors in the foreign equity market are willing to fulfill an active role in the corporate governance of investee firms where local institutional existence is low.

\textsuperscript{11}Pyramidal organization structure: where a private holding company is at the top, with a second tier firm owning the most valuable assets and the listed company at the third tier of the overall structure.
3.3.2 The South African retirement landscape

The retirement industry in South Africa (excluding for the State and Public Pension Funds) is established and regulated by the Pension Funds Act, 1956 (PFA), as amended and the Income Tax Act, 1962 (ITA), as amended. All retirement structures in South Africa, with a few exclusions (mainly in the public and state entity segments), are regulated under these two acts. All retirement funds (whether group, individual, single or multiemployer) are structured as separate legal entities from their sponsors and contributing employers. Table 3.2 lists the types of funds; these differ in two important respects (Treasury, 2013):

1. Firstly, the tax treatment of contributions, investment income and benefits, and annuitisation requirements depend on whether the fund is classified as a pension fund, a provident fund, or a retirement annuity fund for the purposes of the ITA. A process is currently underway to harmonise the tax treatment of the three types of fund in the ITA to significantly reduce the complexity of the retirement system.

2. Secondly, the degree of employer involvement varies between the different types of the three structures. This affects the management and operation of the fund – such as the marketing initiatives, the funds implicit profit objectives, and its governance. This division is essentially classified in the PFA.

Table 3.2: Main types of South African Retirement funds:

<table>
<thead>
<tr>
<th>Compulsory membership group arrangements</th>
<th>Voluntary membership individual arrangements</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Non-commercial funds</strong></td>
<td><strong>Commercial funds</strong></td>
</tr>
<tr>
<td>Pension funds</td>
<td>Pension preservation fund</td>
</tr>
<tr>
<td>Standalone employer pension fund,</td>
<td>Umbrella fund</td>
</tr>
<tr>
<td>bargaining council fund, industry fund,</td>
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<tr>
<td>union fund</td>
<td></td>
</tr>
<tr>
<td>Provident funds</td>
<td>Provident preservation fund</td>
</tr>
<tr>
<td>Standalone employer provident fund,</td>
<td>Umbrella fund</td>
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<tr>
<td>bargaining council fund, industry fund,</td>
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<tr>
<td>union fund</td>
<td></td>
</tr>
<tr>
<td>Retirement annuity funds</td>
<td>‘Group’ retirement annuity funds</td>
</tr>
<tr>
<td>'Group’ retirement annuity funds</td>
<td>Individual retirement annuity funds</td>
</tr>
</tbody>
</table>

* Marketed to individuals, and thus called voluntary membership individual arrangements; however members primarily join a single large fund with numerous members (Treasury, 2013).
Private retirement provisions in South Africa can be classified into three main areas:

1. Private individual retirement provisions;
2. Private employer sponsored retirement schemes;

The above listed provisions are all funded provisions, such that assets are accumulated over a period of time with the intention to fund future liabilities.

The largest scheme in South Africa is the Government Employees Pension Fund (GEPF). The GEPF is a defined benefit pension fund with more than 1.2 million members (all government employees) and assets over R1trillion. (GEPF, 2014)

Apart from government retirement schemes, there is a large presence in the private pension scheme industry. Provisions to the private pensions industry and individual retirement annuities are promoted by the state via tax incentives.

Retirement funds must apply to the Registrar of Pension Funds for registration under the Pension Funds Act. Upon registration a fund becomes a legal person. In order to qualify for various tax concessions for the fund and its members the fund must also be approved by the Commissioner for the South African Revenue Service (SARS).

There are three types of retirement funds mainly used in South Africa:

- **Pension Funds**;
- **Provident Funds**; and
- **Retirement Annuities**.

Pension and Provident Funds are those types funds that are established based on an employer/employee relationship and require that relationship to exist and their primary purpose is to provide retirement benefits to employees when they retire. The purpose of pension preservation and provident preservation funds are to keep until retirement the accumulated pension fund or provident fund money of an employee who leaves the employment of his employer before retirement. The membership terms and conditions of the two funds are the same; however, each carries its own tax implications.
One of the main differences between a Pension and Provident Fund is the method of pay-out: One third of the Pension Fund in the form of a lump sum is paid out at retirement and the remaining portion is paid out over the lifespan of the receiver. A lump sum of the total benefits is paid out in regard to a Provident Fund at date of retirement.

Retirement annuities are funds/policies taken out in a personal capacity and not linked to an employer/employee relationship.

All funds regulated by the Financial Services Board of South Africa ("FSB") are subject to common governance measures. They have a fixed rules, a board of management whereby fifty per cent (50%) are selected by the members, and present (where required) audited accounts, actuarial valuations and reports to its members. The requirement per section 7A of the PFA necessitates that each fund shall have a board of at least four board members, 50 per cent (50%) must be elected by members of the fund.

Large funds such as government funds are frequently self-administered and managed. These funds either perform in house functions or apply the services of specialised fund administrators and investment managers, which are registered and authorised by the FSB. The PFA requires boards of management to seek advice from investment consultants should they lack adequate expertise. Consultants are qualified and provide advice and guidance to trustees. They support and guide on the asset allocation decision and investment management process. Part of this process is the due diligence process where the asset managers business undergoes extensive review prior to receiving a funds assets.(Treasury, 2013)

3.3.3 Background on South African main institutional investors

The South African institutional investment industry can be viewed as been mainly focused on providing investment management (management of investment assets) and consulting services (asset allocation and investment manager allocation) to the retirement and life insurance industries.

The investment, retirement and life industries in South Africa are all under the supervision of the FSB. The FSB is a unique independent institution established by statute to oversee the South African non-banking financial services industry in the public interest. The FSB’s mission is to promote sound and efficient financial institutions and services together with mechanisms for investor protection in the markets supervised. The FSB regulates insurers, intermediaries, retirement funds, unit trust schemes, management companies and the general financial market. (Board, 2012)
There are approximately 7 dominant organisations in the South African retirement fund landscape. These firms include the asset management arms of Old Mutual, Sanlam, Liberty Life and Momentum. The other managers are independent asset management firms such as Allan Gray, Coronation Fund Managers, and Investec.

The main business and offerings of these managers is to provide a comprehensive range of investment products for differing client needs, for both the institutional and retail investor (individual direct investor). Among the offered products, the distinct manager’s investment philosophy is usually applied across all offered products.

In South Africa the main institutional investors comprise of pension and provident funds and insurers (long-term and short-term). The size and importance of institutional investors has grown over the years and these group of investors make up about 60- 80% of assets managers books in South Africa. The below graph shows growth in assets under management (AUM) for South African asset managers for the period ending December 2004 to June 2013 (most recent available data).

**Total value of Assets managed over period 31 December 2004 – 30 June 2013:**

![Graph showing growth in assets under management (AUM) for South African asset managers for the period ending December 2004 to June 2013.](image)

Figure a. Source: (Forbes, 2013)

Since the beginning of the 1990s, institutional investors globally have shown increased interest in alternative asset classes. However, in South Africa there has not been a large shift in asset allocation away from traditional asset classes. (Nonhlanhla N, 2010)
(Nonhlanhla N, 2010) further analysed the relationship of asset allocation to total assets. The data showed that South African institutional investors largely followed equity orientated investment strategies. Figure b.

Figure b: Institutional investor asset allocation relative to total assets (Nonhlanhla N, 2010)

This is justified as institutions studied all have long-term investment horizons and this therefore allows them to tolerate additional risk in exchange for greater yield from equities relative to bonds and cash. It is further justified that equity exposure is a better hedge of wage growth risks and lower expected plan contributions for the same level of benefits on the part of pension funds.

Asset allocation trends as observed have also been largely (directly and indirectly) influenced by regulatory policy reforms.

The pension fund investment regulation (Regulation 28 to the PFA) governs the investment behaviour of the pension funds sector by empowering the Minister of Finance to define the asset spreading requirement for pension funds. The regulations have historically and to date impacted the asset allocation by this sector. Through setting the prudential limits on the asset allocations by pension funds, historically, Regulation 28 has restricted investments in unlisted equity and excluded allocations into derivatives (except to the extent that they fall within the 2.5 per cent for unclassified assets), structured products and foreign investments into which there is no control on the part of the trustees in terms of the sectors in which foreign investment managers invest.

The regulations allowed up to 100 per cent to be invested in fixed interest stock, not more than 75 per cent in equities and a uniform approach towards fund managers. These have resulted in the dominance of asset classes such as equities, fixed interest securities and government stock. Exposure and risks to government stock have been justified on the basis that they carry a guarantee whereas for other fixed interest securities relative to equities the risks are more or less similar. Moreover, the regulations make the matching of liabilities and inflation hedging difficult. (Nonhlanhla N, 2010)
3.4 Sustainable and Responsible Investment Management Principles

The following guiding principles have become distinctly significant and accepted in the asset management industry. These principles are taken into consideration when investors conduct due diligences on investment management firms.

3.4.1 United Nations Principles for Responsible Investment (‘UNPRI’)

The United Nations-backed Principles for Responsible Investment Initiative (‘UNPRI’) is a grid of international investors functioning as a group to put the six Principles for Responsible Investment into exercise.

The United Nations Secretary-General invited large global institutional investors (20 institutional investors from 12 countries) to partake in developing the Principles for Responsible. Debate and discussion occurred in meetings over the period from April 2005 to January 2006 and The Principles for Responsible Investment was developed as the outcome. (Bruin, 2012)

The Principles were formulated by the investment community and reveal that environmental, social and corporate governance (‘ESG’) matters can affect the performance of investment portfolios; thus these issues are priority for investors to fulfil their fiduciary duty. (Association, 2012)

Responsible Investment is a set of investment and ownership practices that intentionally integrates any factor that may materially affect the sustainable performance of a fund’s assets, including factors of an environmental, social and governance character.

Responsible investment and ownership practices:

- build wealth in a sustainable manner and thereby preserve long-term value for the ultimate beneficiaries;
- help to align investor’s objectives with stakeholders and the broader developmental needs of society;
- apply individually and collectively in the South African, African and global context;
- enhance delivery of long-term returns while reducing down-side risk;
- provide transparency to stakeholders regarding the manner in which ESG factors are integrated into investment and ownership practices.

Responsible Investment and ownership practices are informed by investment philosophy or specific client mandate requirements (ASISA)
3.4.2 King Report

The King Committee on Corporate Governance was formulated in South Africa in 1992 as a new democratic society was evolving. Looking at international standards and thinking at the time, corporate governance from a South African perspective was considered.

The committee issued a report as a result in 1994, known as the King Report which marked the establishment of corporate governance in South Africa. It planned to promote corporate governance in South Africa and established recommended standards of conduct for boards and directors of listed and state entities, financial institutions, with focus for these organisations to have responsibility and accountability for the societies in which they function.

King I endorsed an integrated approach to good governance. This took into account for stakeholder interests and encouraged good financial, social, ethical and environmental practice.

King II, 2002 the second Kind Report had an additional focus on integrated sustainability reporting. King II moves away from looking at profit for shareholders, or a single bottom line approach. The focus would now be on a triple bottom line approach, reporting on economic, social and environmental performance.

King III was released on 1 September 2009. King III requires the need for an annual “integrated report” with the combine focus on the required statutory financial information and sustainability (economic, environmental and social) information. This “integrated report” must encompass reasonable information for the period to note how the company has positively and or negatively impacted the sphere it operates in. Furthermore the report requires a forward looking aspect as to how the board believes they can enhance these aspects in the future.

The King report is voluntary, however the Johannesburg Securities Exchange has a prerequisite for companies on the exchange to comply with the King Report recommendations. Where they do not comply, degree and reasons for non-compliance must be provided. (SAICA, 2010)

3.4.3 The Code for Responsible Investing in South Africa (‘CRISA’)

The investor community has the ability to influence and encourage investee firms to enforce thorough governance principles and to maintain the environment and domain it functions within.

The Code for Responsible Investing in South Africa (‘CRISA’) was confirmed in July 2011 with an effective reporting date of 1 February 2012. The introduction of CRISA noted South Africa to become
the second country after the United Kingdom to formally introduce institutional investors to chain ESG matters into the investment analysis process.

CRISA principles attempt to provide institutional investors with guidance on how to, in line with the United Nations-backed Principles for Responsible Investment (PRI), give effect to the King Report on Corporate Governance in South Africa (King III).

CRISA applies to:

1) Institutional investors who own assets such as pension, provident funds and insurance companies.

2) Service providers acting on behalf of institutional investors such the investment managers and investment consultants.

King III and CRISA jointly offer a structure which covers the role of all key players in the governance system.

The code has been welcomed and well accepted by a broad spectrum of industry bodies in South Africa, with the following making public declaration of acceptance: Principal Officers Association (POA), Johannesburg Stock Exchange (JSE), Financial Services Board (FSB), Institute of Directors in Southern Africa (IODSA) and the Association for Savings and Investment South Africa (ASISA). (Bruin, 2012)

3.4.4 Environmental, Social and Governance (‘ESG’)

Investors are challenged by sustainability issues as well. These issues vary from events of the recent financial crisis which left many financial institutions in debt and many pension schemes underfunded globally, to socio-economic challenges and environmental influence which scares our own presence as human society.

ESG defines the three core areas of concern. These have become the fundamental factors to measure a company in terms of sustainable and ethical issues. Institutional investors have the accountability to make sure investments are made to encourage long-term sustainability. (IOD, 2011)

3.5 Summary

The investment of the assets of a fund is one of the most critical of all the management functions carried out by the trustees of a fund. Particularly now that most members belong to defined contribution funds in which the investment risk is carried by members, most members will experience, directly, any losses suffered, or lower than average returns earned, by the fund.
The varying methods of measuring retirement funds in South Africa is by way of either the size of assets, type of fund (style and strategy), number of members, and by the financial sophistication of trustees and their advisors.

A preamble to the revised Regulation 28 (effective 1 July 2011) highlights the fiduciary responsibility of retirement fund trustees to invest retirement fund assets in a way that promotes the long-term sustainability of the asset values, taking into account sustainable and responsible investment management principles.

Many trustees are newly appointed and are not adequately trained on their duties and role as a trustee. A strong argument can therefore be made that such trustees should be guided in the investment of funds and due diligence to be carried out on investment managers prior to this. The revised Regulation 28 requires the trustees to establish an investment strategy, select investment managers, monitor performance and periodically review the strategy.

Many trustees only have base level financial and legal knowledge, and are not experts. They are consequently essentially reliant on professional assistance for the administration and management of their funds and the investment of assets.

A shift of pressures is apparent in the retirement fund industry. The first is investment choice that decentralises control of investment choice from the trustee to the member. The member is however in a weaker situation as they aren’t in a position to conduct due diligence and measure the services of the investment manager.

The second is the recommendation to appoint a professional independent trustee. This may have benefits but would weaken the position of the untrained trustee in board meetings. Should trustees seek independent guidance they should contract with expert advisors to deliver it, rather than surrender some of their powers.

The reference to the term “institutional investor”, in this paper, predominantly refers to the untrained/trained trustee, the external investment professional or both where collaborative decisions are made. Where members monitor investee firms would only impact their view and risk, rather than the entire fund or collective group of members.

Brancato’s framework is a driver for the methodology used in this study. Given the increase of institutional investors in South Africa, this justifies the potential for improved and increased activism by these investors.
In the formulation of the interview and web based questionnaire, it was essential to classify the corporate information requirements for institutional investors. A comprehensive literature review examining the corporate information needs of institutional investors was completed to identify and obtain this information, which is illustrated in the following chapter.
CHAPTER 4: LITERATURE REVIEW ON THE CORPORATE INFORMATION REQUIREMENTS FOR INSTITUTIONAL INVESTORS

4.1 Factors affecting Institutional Investor decision making

The below reviews the preceding research conducted on firm specific factors which affect institutional investor decision making. These are further broken down into qualitative and quantitative factors.

4.2. Quantitative Factors

4.2.1. Financial performance

- (PricewaterhouseCoopers, 2000) recognised earnings per share as a frequent valuation metric used by analysts and fund managers in reviewing company performance.
- (PricewaterhouseCoopers, 2000) A survey conducted in 1999 on 47 corporate investors from a segment of the financial services industry. This included “securities dealers, brokers, asset management firms, banks and insurance companies”. Findings showed that key drivers to invest for institutional investors were the financial results of the corporation.
- (Falkenstein, 1996) reviewed the preferences of US open ended mutual funds. Using NYSE and AMEX listed stocks for the period 1991 to 1992, numerous stock characteristics were reviewed. Results shows that mutual funds showed preference to higher priced rather than lower priced stocks. Concluding that stock price is a pivotal factor looked at by institutional investors when basing decisions.
- (Badrinath, 1989) conducted tests on a sample of 2,250 firms consisting of all NYSE and AMEX listed companies as at 31 December 1985. The test was piloted with an outlook to analyse the investment behaviour of institutional portfolio managers in the context of their fiduciary duty to clients in managing their assets. It was found that firms with sound history of performance had greater levels of institutional ownership.
- (Gompers, 1997) (Gompers, 1998) ranked all US stocks by their institutional ownership and studied bivariate and multivariate relationships among institutional ownership and firm characteristics. No support was found for the dependence on past performance. They also studied how large institutions varied from other investors. When compared to other investors, results revealed that large institutional investors preferred stocks with lower returns in the prior year.
(Hendry, 1999) conducted interviews on the topic of “people management disclosure” with 68 UK based institutional investors and various corporate managers including fund managers, broker analysts, and human resource managers. When questioned on the information companies and investors required relating to company performance, there was a common overlap for the following required (in order of importance): “financial information data, corporate and business strategy, quality of management and people management”.

The above research supports the notion that the company performance and the relevant financial data is a significant factor in investment analysis and decision making for institutional investors. Even though the above literature shows that financial performance and the annual financial statements are of importance, it is vital for institutional investors to view the level of disclosure in accordance to the underlying differences in measurement. The importance of the quality of financial disclosure is discussed in section 4.3.1.

4.2.2. Future cash flows

The results of the Price Waterhouse survey (1998) found on average 94% of UK institutional investors and 100% in Australia who utilized cash flow modeling in investment analysis (PricewaterhouseCoopers, 2000). Global accounting practices and accounting policies used by management don’t impact cash flow as they may affect earnings, it is for this reason that cash flow is a valuable measure and utilized in analysis.

4.2.3 Dividend yield

Investing in stocks which pay no dividends may be viewed as imprudent and thoughtless by some portfolio managers (Badrinath, 1989). To avoid conflict and negative views, a majority of portfolio managers have a propensity to invest in stocks which have prosperous dividend yield or which have the potential to increase. This was confirmed in a recent study by the author who studied the factors which drive investment choices of insurance companies (Badrinath, 1996).

(Gompers, 1998) ranked all US stocks by their institutional ownership and studied bivariate and multivariate relationships among institutional ownership and firm characteristics, including dividend yield. Results showed that dividend yield was positively associated with institutional ownership, signifying that institutional investors desire stocks with higher dividend yield.
The above empirical evidence advocates that dividend yield is a key driver for institutional investors’ investment decisions.

4.2. Stock liquidity

(Badrinath, 1989) (Badrinath, 1996) established that trading liquidity of a stock was positively associated with institutional ownership. The association was projected for two reasons:

i. High trading liquidity (Badrinath, 1996) is generally associated with large firms 12; and

ii. To reduce transaction costs (including administrative and research costs), ceteris paribus, institutions would tend to avoid over diversification. Therefore, given that the dollar amount that institutions invested in any one stock may be substantial, block trades by institutions may exert significant price pressure if the stock’s trading liquidity is low. To avoid this price risk, institutions would prefer stocks with higher trading liquidity.

(Gompers, 1998) concluded similar large positions held by institutions might necessitate them to invest in active trading stocks. If institutions turned over their portfolios and traded more often than individual investors, they might also be more sensitive to the transaction costs caused by large percentage of bid-ask spreads for illiquid or low priced stocks. This study used the following liquidity variables, namely firm size, S&P 500 membership, share price, and share turnover as proxies for liquidity. The results concluded that all the above liquidity variables have consistent positive signs throughout the sample, and many of these variables were statistically significant in most of the quarters examined.

(Dahlquist, 2001) found stock liquidity to be one of the factors influencing foreign investors in their investment decisions. Using 352 listed Swedish firms for the period 1991 to 1997, they studied the determinants of foreign ownership in Swedish firms and identified various firm attributes that are common to foreign ownership. They found that foreign investors characteristically were mutual funds and the firm characteristics demanded these foreign investors were common to those requested by institutional investors. It was found that foreign investors and institutional investors had a similar preference for market liquidity.

An opposing argument was put forth by (Bhide, 1993) (Roe, 1994). They argued that increases in market liquidity reduced the motivation of institutional investors to purchase large blocks and hence

12 The study hypothesized that large investors had preference to invest in larger firms.
reduced trading liquidity. Greater liquidity means that institutions have less ability to benefit from better information because other investors can conclude their private information from their trades (Bhide, 1993). Consequently investors would be more likely to passively invest (i.e., accumulate small percentage of shares) rather than accumulate large blocks of shares.

4.2. 5 Market risk

(Badrinath, 1989) argued that whilst market risk (beta) should be included as a factor influencing institutional investors' investment decisions, the association between beta and institutional ownership is unclear. This is explained by the following points:

- Investing in a high beta stock could increase the expected return of the stock (risk return relationship). This would transform into above benchmark portfolio performance suggesting a positive relationship between beta and institutional ownership;
- Investing in a high beta stock may also have a negative return due to post return legal costs incurred. These legal costs may occur if a manager is compensated using a symmetric performance incentive remuneration scheme with market return as the performance index. If a portfolio has outperformed the market, the manager would earn a “bonus”, and in the case of sub-market performance the manager incurs a “loss”. Given no potential legal costs, the manager would be indifferent to the beta of the portfolio as the expected performance incentive payment would be zero; and
- In another example, given legal costs which may have to be borne by the manager excluding the losses from the symmetric incentive remuneration scheme, the total costs to the manager for under-performing the market is relatively higher than the benefit of outperforming it. In this instance a manager would be biased to holding low beta stocks.

Based on the above points, it is difficult to envisage a positive relationship between beta and institutional ownership. However in all cases it shows that market risk must be included in investment choices by institutional investors.

4.2. 6 Firm size

Prior studies proved that firm size is a factor which influences institutional investors in their investment decisions. The below reviewed studies support the hypothesis that institutional investors prefer to invest in large firms:

- (Badrinath, 1989) (Badrinath, 1996) argued that institutional investors direct investment activity to firm stocks with higher market values. Individual investors would direct their
investments to the stocks of firms with lower market values. A positive relationship between institutional ownership and firm size (measured by total assets) was found.

- (Gompers, 1997) (1998) (2001) used market equity to proxy for firm size in these studies. It was found that size was consistently related to institutional ownership.
- (Dahlquist, 2001) found foreign institutional investment increased with the size of the firm (measured by the market capitalization of the firm at the year-end).

4.2. 7 Firm age

Using firm age as a proxy for “prudence”, (Gompers, 1998) studied the importance of “prudence” in investment making decisions. Specifically they studied if institutions were more affected by considerations of “prudence” than individual investors, it was expected that institutional ownership should be positively related to firm age. The results showed that institutional investors favour to invest majority of capital in firms with a longer history.

4.2. 8 Years listed in Stock Exchanges

The below studies reveal that the years of stock exchange listing is one of the factors that could affect institutional investors’ investment decisions;

- (Badrinath, 1989) study revealed that institutional investors display preference to invest in stocks with a longer history of stock exchange listing (either NYSE or AMEX in this study). This is explained by the concept of “deemed prudence”: i.e., the longer the stock is listed on the stock exchange, the more “prudent” it seems to be, and hence inducing more institutional investment.
- (Falkenstein, 1996), in an empirical study found that mutual funds preferred stocks with a longer history of listing on an exchange. Mutual funds showed an aversion to firms that were newly listed as this involves greater uncertainty in assessing risk.
4.2.9 Cross-listing

(Dahlquist, 2001) argued that institutional foreign investors preferred investing in firms that were well recognised (better known). This recognition was proxied by whether the firms were listed on other stock exchanges. Firms with cross-listings are more likely to be better known and hence are more likely to be preferred by institutional investors. Thus, lower search costs for those better-known firms can be expected. Results showed that institutions certainly preferred such firms, which is consistent with the hypothesis that institutional investors preferred to invest in companies with less information asymmetry.

Cross listing is a factor that could affect institutional investors’ investment decisions.

4.2.10 Book-to-market ratio

(Gompers, 1998) found that stocks with high book-to-market ratios have higher historical returns than other stocks, and for this reason can attract more institutional investment. This study measured the book-to-market ratio by using book value for the fiscal year ended before the most recent June 30 divided by size (market equity) as of June 30. Empirical results supported their hypothesis that large institutions, when compared with other investors, preferred stocks that have higher book-to-market ratios.

However, other studies documented that the above relationship was not clear. (Falkenstein, 1996) pointed out that (Lakonishok, 1994) study documented that institutions seemed to prefer “glamour stocks”, which were comparable to growth stocks that have low book-to-market ratios. They hypothesized that previous success of the stocks helped institutions to justify their portfolios to investors, and also trend following can bias institutions towards these types of stocks.

This holding preference is similar to (Fama, 1992) finding that high book-to-market ratio stocks appeared to produce high risk adjusted returns (using a two factor model that includes size and the firm’s market beta). On the other hand, the high demand for low book-to-market ratio stocks caused them to be overpriced which induced lower returns in the future.

The above evidence is mixed and is difficult to formulate any exact relationship between the book-to-market ratio and institutional investment. However this prior research does show that the book to market ratio is a factor to be considered by institutional investors.
4.2.11 Transactions costs

(Keim, 1997) studied size and source of transaction costs for a sample of institutional investors which had full information on the equity transactions of 21 institutions in NYSE from 1991 to 1993. Trading costs incorporated explicit and implicit costs. Explicit costs such as broker commission costs were fairly easy to measure, while implicit costs consisted of the price impact of a trade (others included taxes, clearance and settlement fees, but they were deemed relatively insensitive to the choice of trading strategy). The price impact of the trade referred to the deviation of the transaction price from the “unperturbed” price that would prevail had the trade not occurred (the price impact of a trade can be negative if a trader bought at a price below the “unperturbed” price and liquidity providers would enjoy negative costs while liquidity demanders would face positive costs). It was found that total transactions costs were economically significant and were systematically related to trade difficulty and market liquidity. This result confirmed the importance of understanding transaction costs in formulating and assessing an investment strategy (Chan, 1993) (1995).

(Gompers, 1998) also highlighted the importance of transactions costs in institutional investors’ investment decisions. They hypothesized that institutional investors would focus on liquidity and transaction costs in their investment choices. If institutions turned over their portfolios and traded more often than individuals, then they may be more sensitive to the transactions costs caused by large-percentage bid-ask spreads for illiquid or low-priced stocks. It was also argued that some institutions, particularly pension funds and endowments, often have longer investment horizons than most individuals, and many such institutional investors may only need to pay out their principal at a distant future date or not at all, making them more disposed to hold less liquid stocks if there was a premium return in equilibrium. Their study used firm size (market equity), S&P 500 membership, share price, and share turnover (volume divided by shares outstanding) as proxies for liquidity to see whether transactions costs would impact institutional investment choices. It was found that institutions showed a greater preference for liquidity and investments in large companies. This signifies that transaction costs, though an important factor was not as important as liquidity and size.

It can be concluded that transaction costs is a factor considered by institutional investors in their investment decisions.

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13 The data was regarded as representative as the trading activity of the 21 institutions was substantial during the period (a total of 62,333 orders with a market value of approximately $83 billion)
4.3 Qualitative Factors

4.3.1 Quality and disclosure of financial statements

(Bushee, 1999) grouped empirical evidence on the importance of disclosure quality and its impact on the institutional investor’s investment decision making. The affiliation between disclosure quality and the quantity of the firm’s institutional investor base was studied. It was hypothesised that institutional investors are possibly sensitive to disclosure quality for the following:

- Improved disclosure will decrease information irregularity between the firm and investor. Institutional investors possibly have preference to firms with heightened disclosure if the price impacts of trades are reduced (Healy, 1999). Prior studies established that institutions made further investment into firms with a higher average trading volume. This is on par with institutions favouring firms where trades have a lower price effect (Falkenstein, 1996) (Gompers, 1998). Heightened disclosure reduces the spread (bid-ask) spreads and the amount of information possibly revealed by large trades, (Bushee, 1999) thus reducing the potential price effects of (Healy, 1999) a trade (Diamond, 1991) (La Porta, 1998)

- Quality of disclosure can potentially impact profitable investment opportunities. Should disclosures offer a substitute for private information collection or should it reveal proprietary information into the market, the long term value of the firm will be impacted. (Kim, 1994) debated that the skill of intelligent investors to profit, follows on their ability and knowledge to foresee the impact of public signals. The impact of disclosure quality on profiteering all depends on information collection and the processing ability of the information by the investors.

(Bushee, 1999) revealed different results for various institutional investors. However it was resolved that the quality of disclosure is a significant factor in investment analysis of companies. The following results were obtained:

- Short term investment institutions (displaying high portfolio turnover and diversification in portfolios) utilised short term news to make investment decisions and preferably invested in firms with heightened disclosure. Additionally, portfolio holdings were altered according to disclosure quality.

- Institutions utilising index strategies (hold large diversified portfolios and trade rarely), also invested more in firms with heightened disclosure. These institutions traded out of positions

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14 Quality of disclosure was measured by the annual ranking of a firm’s disclosure (published by the Association for Investment and Management Research (AIMR)) using 4,314 firm-observations that included all firms rated by AIMR between 1982 and 1996.
where firms displayed low disclosure, however didn’t instantaneously increase holdings in firms with improved disclosure. This perhaps suggests that these institutions depend on on public disclosures as a low-cost mechanism for observing performance of positions in their portfolios.

- Dedicated institutions (considered as a firm with large holdings in a small number of firms and low portfolio turnover) were not sensitive to disclosure quality levels or changes. This suggests that these institutions focus on sources of information other than public information.

The findings of this study also supported that different institutional investors have varying objectives and hence behaviour.

(La Porta, 1998) analysed the regulatory framework and investor protection standards in more than 49 countries (“including common and civil law jurisdictions”). Results showed that improved disclosure should reduce irregular information at the firm level; and remove any opportunity for expropriation. It was also revealed that accounting standards are vital in corporate governance as they provide better understanding of potential investee firms and further provide improved contractual grounding between parties.

The above literature provides sufficient evidence that quality of disclosure is a key factor for institutional investors to consider in decision making processes.

4.3.2 Availability of information

(Falkenstein, 1996) found that “proxies for information” (including firm age and news stories\(^{15}\)) were positively related with mutual fund ownership. Firms with low exposure possibly required greater search costs to identify desirable investments. They possibly too have higher risk. Results signified that funds preferred to invest in stocks with greater exposure in news coverage, as well as stocks which were listed for longer.

This suggests that the accessibility of information is a factor accounted in institutional investment.

4.3.3 Corporate strategy

(Hendry, 1999) interviewed 86 UK “fund managers, broker analysts, corporate managers and human resource directors” in 1999. Corporate strategy was a factor taking into consideration by institutional investors in their analysis and decision making. Fund managers preferred firms with basic strategy and cautioned against intricate strategies (not well understood), as history has shown simple strategy better to achieve objectives. Fund managers as well as analysts valued constancy and cautioned against businesses which moved away from core activity. Interviewees commonly favoured commitment to their stated strategies. Corporate strategy is a factor considered by institutional investors.

4.3.4 Quality of management

(Hendry, 1999) stated in his interview study, that whilst profit of a company is resultant from “market and productivity factors”, high standards of people management can improve firm performance. Hendry, 1999 defined people management factors to include:

- “management contribution in making decisions and creating ideas;
- flat and open management style;
- high levels of training for management;
- continuity preparation from the top level;
- an equilibrium and balance between current staff and new recruits;
- and top management incentives”.

Interviewed fund managers overall showed more enthusiasm to invest in firms with a higher quality of management.

4.3.5 Audit quality

The audit quality has a key impact on the confidence institutional investors place on investee firms. (Gul, 1998) (Gul, 1999) defines audit quality as, the possibility that an auditor would find measurable errors, and post discovering this will report on these findings. “Big Five auditors” are identified as higher quality auditors in the literature. In a study of 468 Australian companies, (Gul, 2001) showed that the market found the earnings of firms audited by the Big Five to be more informative. (Teoh, 1993) conducted a study in the US and discovered the market responded well to Big Five audited firms.
We can establish that institutional investors favour firms affiliated with Big Five auditors. It can also be said that audit quality is a factor that these investors account for in the investment analysis and decision making process.

4.3.6 Information disclosures on social responsibility or human resource

Institutional investors’ decisions can be affected by information of social responsibility or human resources. (Milne, 1999) conducted a questionnaire study on investment analysts in the UK to understand the value of social disclosures in annual reports and its impact on investment decisions. Results showed that social disclosure was irrelevant until the 1980s. Early assessments only found little to no focus on social disclosures and its impact on institutional investment analysis and decision making (Benjamin, 1977) (Buzby, 1979). Recent studies proposed that social and especially environmental information was important in decisions (Epstein, 1992) (Deegan, 1997).

Information on human resource (in the annual reports or as a supplement) was important for investor decisions (Acland, 1976) (Schwan, 1976). (Milne, 1999) revealed that social disclosure in annual reports didn’t lead to more than 15% of investors to switch holdings (given factors such as “financial performance, risk, size and industry constant”).

It can be concluded that social and or human resource disclosure is measured by the institutional investors in analysis to make investment decisions.

4.3.7 Level of corporate governance

Prior studies reviewed have concluded that firms with higher levels of corporate governance were seen to attract more institutional investment.

(McKinsey & Company, 2000) Investor Opinion Survey highlighted the significance of corporate governance in investment analysis and decision of institutions. The report was made up of the findings from three surveys conducted by McKinsey & Company (in partnership with the “World Bank and Institutional Investor’s regional institutes in 1999 – 2000”). They reviewed the value of corporate governance to investors in both developed and emerging markets. Responses were grouped from an average of 200 institutional investors, (“20% from USA, 40% from Latin America and 40% from Asia”) with large international holdings, with an average of US$3.25 trillion in assets under management. Findings revealed:

- Three-quarters of investors say board practices are at least as important to them as financial performance when they are evaluating companies for investment.
In Latin America, almost half the respondents consider board practices to be more important than financial performance.

Over 80 percent of investors say they would pay more for the shares of a well-governed company than for those of a poorly governed company with similar financial performance. The actual premium investors say they would be willing to pay for a well-governed company differs by country. For example, investors say they would pay 18 percent more for the shares of a well-governed UK company than for the shares of a company with similar financial performance but poorer governance practices. They would be willing to pay a 22 percent premium for a well-governed Italian company, and a 27 percent premium for one in Venezuela or Indonesia.

In Asia and Latin America, where financial reporting is both limited and often of poor quality, investors prefer not to put their trust in figures alone. They believe their investments will be better protected by well-governed companies that respect shareholder rights. In Europe and the U.S., where accounting standards are higher, the relative importance of corporate governance is lower.

In 1999, Price Waterhouse Coopers and the previously known Stock Exchange of Singapore collaborated to conduct a survey to understand the corporate governance structure in Singapore from an investors view. This was done to provide corporations further information on the expectations of their investors. A survey (October 1999) was conducted among 47 corporate investors (representing a “cross-section of the financial services industry, including security dealers and brokers, asset management firms, banks and insurance companies”).(PricewaterhouseCoopers and Singapore Exchange., 2000)

In summary the results revealed that investors considered corporate governance to be important. The results also showed that investors seek better corporate governance mechanisms and standards. The survey revealed:

- Singapore’s corporate governance standard is rated marginally higher than Hong Kong and Japan, however considerably better than Korea, Taiwan and Malaysia which are secondary capital markets.

- Whilst the overall corporate governance and business ethics standards improved (at the date of survey, on average 60% agreed to improvement), the disclosure contained in annual reports of listed firms were still insufficient (on average 74% seek further disclosure).

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16 For the purpose of the surveys, a well-governed company is defined as having a majority of outside directors on the board with no management ties; holding formal evaluations of directors; and being responsive to investor requests for information on governance issues. In addition, directors hold significant stockholdings in the company, and a large proportion of directors’ pay is in the form of stock options.
On average 93% of respondents will invest given unsatisfactory factors relating to independent non-executive directors (i.e. quality, qualifications and industry experience).

88% of the respondents were indifferent on the number of independent non-executive directors.

Improvements can be effected to the following:
- Heightened disclosure of directors’ dealings with interrelated parties;
- Chairman and the CEO to be separate roles;
- More frequent company reporting;
- Distinct separation between owners and manager of a corporation;
- Defining roles of the directors.

(Solomon, 2000a) (2000b) reported survey findings on institutional investors view on corporate governance reform in the UK. Questionnaires were sent to a random sample of 522 fund managers in 1999 (drawn from four groups of institutional investors – “pension funds 44%, investment trusts 15%, unit trusts 11% and insurance companies 25%”). Results agreed for improved corporate governance reform in investee firms. Investor relations reform was noted as a higher priority as this can decrease agency costs.

Several papers published by (La Porta, 1997) (1998) (1999) (2000) studied the impact of corporate governance to a corporations external financing. Utilising over 49 countries, the study revealed that heightened investor protection, specifically legal, led to higher investor confidence -with institutional investors being a subset. It was further stressed that this “protection” inspires the growth of the overall financial market. Corporate governance was revealed to be a vital driver to the growth of financial markets and the value of the firm.

(Vafeas, 1999) studied institutional investment choice and the bearing effect when exposed to certain corporate governance mechanisms. The link between the regularity of board meetings and the value of the firm was investigated. Analysing 307 US firms over the period 1990 to 1994, revealed that frequency of meetings was positively associated to firm value especially for firms with prior poor performance. Following a period of irregular meetings, operating performance was improved. However improvement was notable especially for firms with prior years of poor performance, and too for firms unengaged in “corporate control transactions”. Results show that good board activity (noted by the regularity of meeting) is imperative to board operations and firm performance.
(Wirthlin Worldwide, 1997) piloted a survey for “Russell Reynolds Associates” on 2 groups of institutional investors in the United States, specifically institutional shareholders (i.e. public and private pension funds, endowments, investment management wing of corporates) and portfolio managers (managing investments of institutional shareholders i.e. asset management firms, banks and mutual fund management companies).

Some of the key findings and factors accounted for when conducting investment analysis:

- Quality of directors is accountable when conducting analysis and making decisions. A quarter of respondents noting this factor as vital.
- Investors noted they lacked base information to measure board effectiveness i.e. Information such as prior industry experience and contributions to previous boards. This shows that basic personal information of directors was reviewed to assess the impact on an individual basis and as a board.
- Board composition was significant. Board compliment was reviewed, and the make up in terms of mix of internal and external directors and the skillset and industry experience.
- Investors had strong preference that boards should be more forceful in extracting non performing directors.
- Succession planning must be a pivotal concern for the CEO and board of directors.
- Institutional investors as a group demonstrate activism in their investee firms, and expressed opinions. This shows they fulfil a monitoring role in corporate governance matters.

This literature review reveals that corporate governance is imperative to institutional investors when conducting investment analysis and making investment decisions.
4.4. Summary

By means of the literature review, this chapter aims to recognise the diverse “quantitative and qualitative” information which institutional investors want when analysing both current and potential corporate investee firms and investment managers (portfolio managers). The literature review was directed to ascertain these factors.

The below quantitative and qualitative factors are noted to be of relevance which institutional investors account for:

Quantitative

- Financial performance;
- Future cash flows;
- Dividend yield;
- Stock liquidity;
- Market risk;
- Firm size;
- Firm age;
- Years listed in stock exchanges;
- Book-to-market ratio;
- Transaction costs.

Qualitative

- Quality and disclosure of financial statements;
- Availability of information;
- Corporate strategy (Falkenstein, 1996);
- Quality of management;
- Audit quality;
- Social or human resources information disclosure;
- Level of corporate governance.

The qualitative and quantitative factors mentioned above should not only be reviewed on short listing investee firms, however institutional investors should draw up a focus list (screening tool), using these factors as risk indicators against an entry benchmark and monitor this on a continual basis. Institutional investors should actively monitor performance of investee firms, communicate the
outcomes clearly and periodically review the monitoring process and risk benchmarks for effectiveness. Monitoring performance would include reviewing annual reports and accounts against qualitative factors. The process should also ensure that independent directors provide adequate oversight and maintain a clear audit trail of their meetings and of votes cast on company resolutions, in particular for contentious issues. In particular, institutional investors should satisfy themselves that the investee company committees are structured effectively.

A recommendation based on time constraints would be for institutional investors to challenge and intervene when there are concerns about issues such as disclosure, corporate strategy and operational performance.

This would form an essential part of a risk management tool and is vital to the success of companies in which they invest as guardians of saving entrusted to them.

The Solvency Assessment and Management (SAM) regime is due to be effected in 2014 in South Africa and will be grounded on the principles of the Solvency II Directive of the European Parliament and Council (Solvency II). Solvency II is developed around three pillars: Pillar 1 - Quantitative Requirements, Pillar 2 - Risk Management and Governance and Pillar 3 - Reporting and Disclosure Requirements.

Heightened transparency in the financial services arena has been a priority on the international agenda. Furthermore, companies’ disclosure to the market has been a big topic and faces increased scrutiny. Solvency II seeks to enforce further critical requirements on risk and capital management disclosures, and further requires insurers to prepare distinct reports.

The extensive qualitative and quantitative disclosure requirements will require disclosure on:

- A summary of the insurer’s business and external environment, objectives, strategies and performance from underwriting activity.
- Systems of governance in place, fit and proper process and procedure, as well as responsibilities of the Board, key committees and senior management (internal control).
- Risk exposure of the insurer, concentration risk and further information on risk management and internal control.
- Valuation bases for assets and liabilities, together with an explanation of any major differences in the valuation methods utilised.
- Own funds structure and capital management, including the minimum and solvency capital requirements.
- Any non-compliance with minimum and solvency capital requirements.
Insurers must understand the requirements to comply as there is a large volume of information required to collate and provide. Where there is more than one business or subsidiary, this would be for each line of business.

It is imperative to evaluate whether the information is presently available, in what way it will be composed and how it will influence both financial reporting under International Financial Reporting Standards (IFRS), as well as regulatory reporting under the SAM regime, without triggering repetition of efforts. (ASISA, 2011)

Majority of the above qualitative and quantitative factors covered in the literature review have at best been incorporated in both the web based and interview surveys. It is important to see how these factors are initially screened by South African Institutional investors, and as well if they are actively monitored against the entry benchmark as a risk management tool whilst invested.
Chapter 5: Methodology

In this chapter the approach and methodology used to collect information for the study is outlined.

5.1 Approach

The primary objective of this study is to survey South African institutional investors and their current attitudes and suggested reforms toward corporate governance standards in South Africa. Web base questionnaires and in depth interviews were considered the most suitable methods to gather this information. Specifically, these two collection mediums were utilized to collect information from institutional investors on the following:

- Identification of the corporate information requirements which impact their investment choices;
- Establish their outlook on the suitable level of corporate governance standards for South Africa;
- Establish their expected level of standards and the type of corporate governance principles.

Two steps were carried out prior to scheduling interviews and disseminating the web-based questionnaires. These steps are outlined further in sections 5.1.1 and 5.1.2 below.

The study was conducted from March 2012 to June 2012 via web based questionnaires and interviews. The interviews were conducted in July 2012 as this was the availability of interviewees post quarter end; these were revised in June 2013 to maintain the integrity of the study. The web based study was aimed to primarily capture the views of the greater asset management industry in South Africa and obtain an initial view on current governance trends and issues. The first goal of the interviews was to explore practices and codes viewed by asset consultants and adopted by large institutional managers. The second goal was to collect the respondent’s opinions on the current level of governance in the South African investment industry, and in particular the institutional arena. The follow up interview in June 2013 was conducted to view if views of the respondents had changed significantly.

5.1.1 Identification of the Institutional Investors

Institutional investors are organizations with large sums of money that invest these monies in investment assets. They can also be seen as operating companies which invest internal investment vehicles into investable assets. Types of institutional investors which were identified through South
African asset consultants\footnote{Institutional investors often employ advisers, sometimes referred to as asset consultants or investment consultants to guide them through the process of selecting assets and service providers.} were pension funds, mutual funds, investment banks, insurance companies. Through discussions with these asset consultants and market research, a common overlap of the largest institutional investors in South Africa was identified. Based on these consultations and research conducted, target interviewees were identified for the detailed interviews, and the audience for the web based questionnaire.

*The detailed (in depth) interviews* were seen as a beneficial technique to collection information as it allowed for more detailed information. It allows the interviewer to follow on from a base question with additional enquiry into various aspects to gain supplementary information on the topic. Apart from this, the interviewer has more control over the information collected. *The online (web-based) questionnaires* allow us to view a more common outlook of attitudes as it is distributed to a larger sample of institutional investors. It is time and cost efficient. This medium also allows for the technical conclusions to be drawn using the sample of statistical information.
5.1.2 Comprehensive Literature Review

An extensive literature review on academic studies and prior investors’ surveys reviewed:

- The role which institutional investors fulfill and the impact of this on the corporation’s performance (Chapter 2). Based on this literature review, an analytical framework for institutional investors was established to understand their roles in the South African market (Chapter 3).
- The information requirements and relevance of specific information when institutional investors conduct investment analysis and make investment decisions. This was the basis from which the interview questionnaire and online questionnaires was developed (Chapter 4).

5.1.2.1 titles the key academic journals and 5.1.2.2 the institutional investor surveys piloted by professional groups.

5.1.2.1 Academic journals

- Journal of Law & Economics
- Journal of Accounting & Economics
- Journal of Accounting Research
- Journal of Finance
- Journal of Applied Corporate Finance
- Journal of Financial Economics
- Journal of Financial & Quantitative Analysis
- Contemporary Accounting Research
- Columbia Law Review
- Stanford Law Review
- Academy of Management Journal

5.1.2.2 Institutional investors’ opinion surveys

- Corporate Governance 1999 Survey of Institutional Investors partnered with PricewaterhouseCoopers and the Singapore Exchange
5.2 In-depth Interviews

The interview list was compiled of institutional investors. The list was made up of the largest independent asset managers in South Africa (Based on Assets under Management in South Africa). Added to this list were portfolio managers for large South African corporate pension funds (identified with the input of a large asset consulting agency based in Cape Town). After further research on these investors, a final list was compiled and narrowed down to Eight (8) interviewees selected to interview. These represented four key players in institutional asset management, two internal portfolio managers for a corporate pension fund, and two asset consultants hired with advisory capacity for a listed corporate entirety on the Johannesburg stock exchange (the consultant managing the pension funds’ assets of the listed corporation).

The interview questionnaire was based on the extensive literature review. The content and setup of the interview questionnaire was reviewed by the Head of Research at the University of Cape Town, a senior legal advisor to an asset management firm (with an in-depth knowledge of South African corporate governance), and the University of Cape Town Ethics Committee. A trial interview was conducted to time assess the reaction, test ambiguity, and the time taken for the interview prior to being finalized. The interview guideline was semi-structured. This meant that some questions were closed questions, whereas other questions were designed to let the interviewees develop their own thinking on a specific point and provide feedback.

5.3 Online (web based) Questionnaires

The online questionnaire was the main data collection technique and established for the following reasons:

- Respondents are corporate institutional investors and advisors; it is not unusual for them to have internet and email access. This method was also feasible from as the respondent could complete this at their own leisure (after hours) and it assists in an improved response rate.
- Accurate data capturing can be warranted with substantial time saving on data input and collation as data can be directly entered into the database from respondents.
Following the above literature review, the online questionnaire was developed. The questionnaire was further “fine-tuned” to ensure that important questions were included and the average completion time did not exceed 15 minutes. The questionnaire was trialed by the head of Research at the University of Cape Town, and a senior asset consultant, in order to determine initial feedback on the content, readability, and presentation of the questionnaire and completion time. Amendments were made following feedback to further develop the questionnaire.

The web based survey was sent to the respondent via an email link with open access to the survey. The survey platform was suggested by the University of Cape Town, namely “Select Survey”.

Sample respondents are defined as institutional investors investing in South African assets. A total of 20 respondents were chosen from the discussions with South African asset consultants. The respondents were made up of South African listed entities, asset consultants, asset managers, multimanager\(^{18}\), pension funds, and provident funds. The sample size of respondents is small and valid given the small nature of the asset management industry in South Africa.

5.4 Data Analyses

Chapter 6 contains a summary of the outcome from the detailed interviews. Statistical tools were employed to analyze the responses from the online web-based questionnaires. The next chapter discusses the findings from both the interview questionnaires and web-based questionnaires.

5.5 Summary

The primary method of data collection was the web based questionnaire. The literature review conducted (which included the corporate information requirements) formed the basis for questions raised with interviewees. The interview questionnaire was used to collect additional information, and also to identify variances in the South African market.

Both research techniques were anticipated to provide insight on the attitudes and views of respondent’s to corporate governance in South Africa, especially in the institutional investment framework.

\(^{18}\) Multi managers do not invest in market securities, but in other managers, aiming to provide better performance through their skill in selecting those managers that have a greater likelihood of outperformance against peers, and the lowest risk via allocation across managers.
CHAPTER 6: FINDINGS

6.1 Introduction

The two primary methods to collect and analyse information was via direct interview questions and a web based online questionnaire. This chapter outlines the findings and links findings back to the literature review conducted.

The first section provides a description on the interviewees. A summary of the salient findings, supported where applicable with the literature review is followed. Detailed quotes from the interviewees are included with a summary and discussion of the general findings where appropriate.

The second section provides a description of the online respondents, followed by a discussion on the findings.

6.2 In-depth Interviews

An interview guideline was used to provide consistency and direction.

Although the profiles of each interviewee may seem different, they do fulfil similar functions in the industry. Each interviewee is entrusted with the stewardship and responsibility of assets and has a certain degree of decision making responsibility. Each interview lasted on average 40 minutes. Anonymity was granted to all respondents, as this was the condition on which they agreed to do the interview. This meant that verbatim quotes used, would not be linked to their names and would merely be recognised as i.e. Respondent 1.

Further questions were asked in the interview as to how managers would implement the new Code of Responsible investing.

The below section summarises the in depth interview section by reviewing overlapping and unique quotes from the Respondents in the interviews conducted. These quotes are then further discussed and analysed in the context of this paper and the current South African investment management arena.
Findings:

- “South Africa has a well-developed financial market with governance standards that are on par and comparable to many developed economies”

All respondents strongly agreed on the above statement put forth to them.

South Africa’s voluntary governance system founded by the King Code has already set the international benchmark in terms of corporate governance and best practice. Looking forward to the effective date of the CRISA Code, South Africa becomes the second market after the UK (Stewardship Code) to have a defined set of principles clarifying the role of the institutional investor (being the custodian of assets) in promoting a responsible investment approach. CRISA is a voluntary framework, however both this and the Stewardship code in UK aim to toughen the overall governance system and the governance of the company.

Asset Managers acknowledge CRISA to ensure that sound governance is practiced. CRISA looks largely at issues similar to the ones addressed within the United Nations Principles of Responsible Investing (UNPRI). Responsible investing is a growing and a rapidly changing field. Broadly defined, it integrates an active consideration of environmental, social and corporate governance (ESG) factors within investment decision making and ownership.
To what extent do you feel your clients’ wishes will be instrumental in your decision to adopt CRISA?

- “Clients wishes are not instrumental in our adoption to CRISA”

One respondent, a pension fund consultant disagreed with the above statement. The respondent felt that as consultants they would be key role-players to ensure that large asset managers adopted the codes of CRISA. Investment consultants will continuously ask (once effected) about the managers incorporation and adoption to CRISA. “The more we ask, the more managers will feel threatened that they could lose our allocation of assets should they not comply”.

The balance of respondents felt clients’ wishes were not instrumental in the decision to adopt CRISA. CRISA is voluntary is a guideline on how to execute investment activities and endorse thorough governance that will result in the long-term value of companies. Clients will be the ultimate beneficiaries and deserves the confidence of a sound investment decision making process (in this instance by incorporating the CRISA codes).

- “We would regretfully decline an appointment as the asset manager when the investment restrictions are too onerous on the manager and where additional mandated performance benchmark is specified.”

This statement follows from a question where asset managers were asked at what point they will terminate appointment following the client (fund / investment consultant) becoming too prescriptive regarding socially responsible investing.

Both asset managers confirmed they do offer segregated (separate) portfolios with minimum investment amounts, where the client would be able to negotiate a benchmark and mandate restrictions. These restrictions will be discussed by the asset manager with the client as it must conform to the asset manager’s investment philosophy.

**Firm specific factors which are important to investment analysis and decisions:**

**Quality of management**

Majority of respondents categorised quality of management as a crucial factor in investment decisions and transparency was observed as an important constituent for quality.

It was stated that the corporate governance mechanisms set up by any investee company will be effective if a there is a high quality of management in place. Poor management is unreliable and any
realisation of corporate governance mechanisms would purely exist in form and be ineffective in substance.

One respondent mentioned that poor management could be a source of value and that a turnaround strategy could be deemed profitable in the company and beneficial to shareholders.

None of the respondents factored in a set corporate governance structure into their valuation criteria.

Example of quote:

“The quality of management is vital when assessing the prospect to invest. The manager’s track record and especially their obligation to shareholders are important, and whether the shareholders best interests have always been met.”

Financial results, business strategy and other financial planning

All respondents believed that past financial performance is important, as well as the current disclosures made in financial statements. These disclosures entail the current performance period, as well as disclosures on applicable growth rate and business dynamics which would impact future cash flows and ultimately future financial performance – being the key driver to investment decisions.

Six respondents believed that corporate strategy plays an important role in investment decision making and hence holds an important weighting. These respondents additionally felt that good corporate performance stems from good corporate governance and strategy.

Examples of quotes from this finding:

“Strong forecasted future performance is what is important (in our investment decisions). To obtain this we need to review past performance and transparent disclosures”.

“It is deemed that good performance stems from good corporate governance. However we possibly hold two stocks which had good governance (comparable international standard) when we invested and produced strong results. To date the results have improved, however the governance standards have deteriorated.”

At what point will you divest from a company if the company disregards sustainability considerations?

Both asset managers and consultants favoured long term investment horizons. Both managers follow an investment process where a long-term normalised margin to value a company is used. The company’s behaviour will then affect the assessment of margins and sustainability. The valuation will
it will then divest should there not be a significant upside to fair value.

It is important for valuations to be focused on the sustainability of earnings. Going forward, ignoring ESG factors will result in valuations that are not cognisant of all risks, given the adoption of ESG in the market. It is crucial that socially responsible investing is functional to the investment process, and the process of analysing investment in companies. Exceeding the clients’ alpha expectations within the prescribed mandated limits is the core driver to meet portfolio and client objectives.

All valuations should ideally incorporate the key elements of sustainable development and incorporate the following:

- ESG issues should be incorporated and documented in analysing and calculating the long term value of a company. Producing comprehensive and rigorous quantitative and qualitative analysis of all substantial exposure to ESG issues should be encompassed in the investment case. The substantial ESG issues should then be evaluated and approved, thereafter openly engage with segregated clients by formal notification to determine if their mandates or policies require specific screens or exclusions e.g. gaming shares, tobacco and or alcohol shares and adjust the mandate, benchmark and how the fund is managed.
- Proxy voting – notify clients, vote, record, provide disclosure when required and record voting actions.
- Annual review of sustainable development policy, related techniques and procedures.
- Internal monitoring of adherence and compliance with UNPRI.
- Review any conflicting concerns raised with regards to the policy, and ensure steps taken to maintain future compliance within the policy.
- Disclose to clients when requested: the policy, conflict of interest policy, the proxy voting policy and records.

June 2013: Managers noted a significant shift of importance from asset consultants and institutional investors on ESG. There has also been communication among industry peers and all seek to introduce ESG reporting when conducting report back presentations to clients. This would include not only industry and stock specific ESG issues, but also the managers evolving approach to ESG in a fast changing environment.
Describe your company’s corporate governance policy. How important is corporate governance in the assessment of underlying stocks?

“We are committed to the principles of good corporate governance and have a fiduciary duty to our clients (institutional investors) to ensure, as far as possible, that the companies in which we invest on behalf of its clients are also committed to adhering to these same principles”.

In ensuring that the interest of its clients would be best served, both managers noted they avoided positions in companies that are considered to be poorly governed, or they would become more actively involved in the company through discussions with management, making its views public, exercising its proxy voting right or through any other means in order to enhance shareholder value.

“It is not our intention to become involved in the management of the company’s operations or to be involved on a long-term basis.” These statements are from one manager who also believed in the independence of their investment team and therefore did not encourage representation on the boards of other companies but may do so under exceptional circumstances. The second manager supported independence of the board of the investee firm, however they believed that constant monitoring of the board representation and management activities has recently been crucial and will in years to come. This constant monitoring sparked not only from the financial crisis, but also from many corporate scandals locally in South Africa and globally as well. Good corporate governance of investee firms is a form of investor protection, it is proactive. There is a better chance that when such governance prevails for problems to be identified and resolved swiftly before escalating to a crisis level.

Two of the asset managers continue to encourage empowerment and employment equity with the emphasis being on shareholders, board composition, executive and senior management and procurement. They fully subscribe to the spirit of the King Code of Conduct and best practice with regard to corporate governance. “Our corporate governance policy outlines our views on the key issues and indeed governs the way we vote on all resolutions.”

Independent non-executive directors (IND)

Majority of the interviewees believed the quality of IND’s is crucial in a good governance mechanism.

A board is only as good as its members. In particular the INDs bring great external views and judgment on which the board’s oversight function is predicated. A good board includes IND’s who provide broad strategic input whilst also bringing their specific knowledge and experience to tackle boardroom issues.

Example of a quote:
“The role of IND’s is to question management, and to question the direction of the company. They also should play pivotal roles in all corporate governance issues.”

Firm performance and corporate governance

All institutional investors believed corporate governance will enhance overall firm performance. In addition a good corporate governance regime is central to the efficient use of capital. It promotes market confidence, lowers the cost of capital and ensures accountability for the ultimate beneficiaries.

The respondents were prepared to pay a premium for firms with good corporate governance as they feel this translates into better long term performance.

All respondents felt that about 75% of the stocks they invested had an internationally comparable corporate governance standard. Other stocks had good governance, not comparable to international standards – however these companies had returns which were sufficiently high to compensate for the risk differential.

The overall perception is that the Corporate Governance standards in South Africa are on par with international standards.

Describe your firm’s internal proxy voting policy or principles. How do you manage conflicts with clients (investors) on how specific proxy voting decisions should be made?

“Proxy voting is very important to us, and is fully documented. We are committed to the principles of good corporate governance, and have a fiduciary duty to our clients to ensure that all companies we invest in are also committed to adhering to these principles”.

The asset managers interviewed had a formal, clearly articulated Corporate Governance Policy document which clearly defined the policy with regards to voting at AGMs and this was used in conjunction with the King report on principles of good governance.

“Our approach is not a confrontational, high publicized approach but rather a more tactful approach of pro-actively engaging management on issues we do not agree with or feel that management should be addressing to enhance shareholder value”.

The above statement is important. Should a manager act out in a boastful manner, and is unsuccessful, the manager may well lose credibility from the current client and prospective clients in the market. The managers explained: in the event of not being able to resolve the issue, we will rather vote with our feet than get actively involved in the management of the business. In addition, should any action deemed to destroy shareholder value without allowing minority shareholders the opportunity to influence the decisions, we will not hesitate to follow the legal route.
It is important for custodians of investable assets to have a clear distinct proxy voting guideline, and have this circulated to all members of the firm, including current clients. The framework will serve as a base to which the manager is required to consider all the issues and vote accordingly at AGM’s. The key issues of Board composition, share capital, corporate actions, remuneration, election of directors and environmental issues should be included.

The policy will act as framework for the entire investment team on how to vote at special and annual general meetings. At client report backs, the sales consultant should report on how the manager voted for its clients at AGMs held in the period. For clients that would like to vote differently on certain issues or who would like to include even more stringent criteria, these should be accommodated for.

**Active or passive participants in corporate governance**

Following the above discussion of proxy voting, it is evident that investors passively monitor investee companies, and only play an active role when issues arise (this would be where the investors hold large shareholding in the firm).

Most respondents expressed that they preferred not to have a constant active role in all investee companies. They would only pursue active roles and have dedicated analysts to monitoring roles where the shareholding was large (i.e. more than 20%). In most instances they lacked the powers to pursue activism given the size of their shareholding in the investee firm.

Passive monitoring includes attending the annual general meetings, monitoring management quality, reviewing corporate strategy and affiliated company transactions.

Example of a quote:

“We typically play a passive monitoring role in investee firms, and a decision to take any action is done once we consider whether the applicable investment is part of our “fundamental holdings” with a long term view.”

**Corporate governance reform**

All respondents supported corporate governance reform, and all noted the most crucial drivers are management and IND’s.

Management’s integrity and willingness to progress corporate governance is imperative. Should management perceive corporate governance to be advantageous to the firm and ultimately enhance shareholder value, then any development of corporate governance mechanisms would add value.
IND’s also play an important role as they can exercise independent judgment, have the right experience and external (independent) view to ask the right questions.

Example of quote:

“Not only should management and IND’s play a pivotal role in reform – the board sub committees are vital as well in the corporate governance of investee firms.”

How do you deal with red flag investments (investments which don’t meet your responsible investing criteria in your investment process)?

Two asset managers noted that despite mandate limits, some investments simply fall immediately foul of their responsible investing criteria by failing to meet the ethical expectations. It is expected by the portfolio managers to red flag these investments and to apply a look-through view. In other words, asset managers do flag both direct and indirect exposure to any entity that does not meet ethical requirements with a view to excluding it.

The asset consultant provided a view on entities which are expected to be excluded and commonly exist in stringent mandate limits. Such entities include those involved in anti-personnel mines, biological or chemical weapons or nuclear weapons, cluster bombs, gross violation of human rights, funding of terrorist activities and blood diamonds. This list may be added to in future.

Almost all pension funds avoid direct investment in individuals, and entities or countries on the sanctions list of South Africa. Where indirect investments are made (for example where a company’s principal business activities are not in a sanctioned country, but some equity is exposed to a country on the sanctions list) we ensure the asset manager exercises consideration for ESG risks.”

What controls do you have in place to ensure effective and continuous compliance with existing and new legislation in South Africa and globally where applicable?

All asset managers and consultants have an both an internal compliance officer and legal advisor who monitor and assess the impact of legislative and regulatory rules, supervisory requirements and industry codes on a daily basis thereby ensuring full compliance and awareness with current and pending legislation. The compliance officer and legal advisor have various sources of information as well as maintaining good relations with the various regulatory and self-regulatory bodies (Compliance Institute of South Africa, FSB, ASISA, JSE, Reserve Bank and Accounting Firms) ensuring that changes to legislation and the promulgation of new legislation is communicated to the business immediately.

The compliance and legal department are responsible for assessing new legislation, implementing the requirements thereof and ensuring that all legislative and client mandate requirements are reviewed
and monitored. A legislative and regulatory matrix should be kept by compliance and monitored and reviewed by management to ensure accuracy and completeness.

If you are engaging with investee organisations, are you doing so on your own, or as part of a group?

The above question was directed to the asset managers:

“We believe that engagement with our investee companies is required to the point to which it is necessary to ensure the delivery of preferred outcomes on any issues enhancing their enduring sustainability and valuation in the best interests of our clients”. The extent of engagement varied among managers depending on a number of factors which include: the requirements as specified in client mandates, issues that arose as part of due diligence or analytical process with respect to ESG and financial factors, and the extent to which issues identified have an impact on company valuation and sustainability.

“If the achievement of our objective to improve the sustainability of our investments looks difficult or impossible in isolation, we then actively seek to engage with like-minded investors to effect the required change.” The extent of this engagement was not purely identified, however it would be determined by the extent to which collaboration is required or possible in each specific circumstance.

“We don’t commit specific resource to ESG research”.

The above statement was confirmed by all interviewees.

Asset managers ensure that ESG research is applied in the investment process and monitoring done on the investment feedback loop process. In addition, it is purely the investment team and analyst team which has majority of training on ESG matters as these are the key persons who engage with investee firms on all major issues. Investment analysts also rely on subscribed ESG research.

Portfolio managers at pension funds and asset consultants for pension funds ensure they are aware of industry ESG matters. It is rather important that these two parties make exceptional effort to gain knowledge on ESG matter as they would need to ask the correct questions to asset managers when conducting due diligence and receiving report back presentations. Trustees have base level knowledge and are mainly educated via industry bodies and workshops held.

Given the developing stage of ESG growth in South Africa (compared to international standards) – the interviewees have no dedicated ESG personnel, and rely on subscribed research to a certain degree which controls cost at this stage. In the medium to long term, the asset managers forecast dedicated in house ESG units. Given South Africa’s emerging market status and the growing portion of
international pension funds invested with local managers – international ESG standards are slowly pressuring local managers to fully comply.

Kindly could you provide an overview of your proxy voting process, and are you able to exercise voting rights in accordance with trustee instructions?

This question was purely directed to the asset managers who manage investments on behalf of institutional clients in segregated vehicles. The below describes the salient findings of how the managers manage the proxy voting process:

Where clients own shares in companies, all proxies are voted on. The investment analyst / analysts will recommend a course of action for each proxy vote after discussion with the Chief Investment Officer and or Head of Research. Where a mandate is in place to vote, the recommendation will be effected. Should permission be required by the client, the manager would provide their view on the vote, and thereafter vote per the client’s instruction. Management of the company or the correct company liaison is contacted to clarify items where issues are unclear or appear misstated. All effected votes are recorded and are reported back to the client. Further voting information is also available upon request to the client.

It was interesting to note that one manager confirmed their internal proxy voting guideline was last reviewed two years earlier - “We review our policy on the outcome of new legislation”. The second manager conducted an annual review, and felt that doing this biannually would incur cost as this function was outsourced to a legal consultant.

This poses an issue as the voting guidelines would thus note fully capsize all industry issues and ESG issues timely.

The proxy voting policy is merely a guideline. The managers noted that clients are the main priority and each proxy is analysed contextually. In some instances, strict obedience to these guidelines was not applied if it impedes the prevailing mandate of enhancing risk adjusted performance in the long run. All voting records were maintained and available for review upon request from the client.

A list was compiled from all interviewees on how proxy votes were directed and suggested to be utilised, this was specific to South African listed entities:

Composition of the Board:

Votes were ensured to cover the following:
• A board includes an acute mix of skills and experience (high importance of experience in the same business or supply chain), and sufficient size for the essential committee functions to be performed;
• The board encompasses primarily of non-executive directors (large portion being independent from management) and has balance of power – so that there is no group domination, or room for this in the decision making processes;
• The number of directors should be related to the size and sophistication of the business;
• The diversity and demographics of the board are important – especially in South Africa;
• Non-executive directors display dedication to the company, and also have time and the capacity to display this. It is also vital to monitor attendance of meetings of this group of directors – this shows the commitment in line with remuneration;
• The number of Board positions held by an individual is important as too many positions could compromise on their responsibilities to the company. It is also important to review the types of companies (size, industry, conflicts of interest) where the board positions are held. “Where an individual holds more than four board positions, further analysis would be required by the analyst”;
• The Audit committee, as well as the Remuneration and Nomination committees should comprise a majority of independent non-executive directors.

**Chairperson of the Board**

The below proposed voting guidelines are concerning the chairperson:

• The Chairperson and the Chief Executive Officer (CEO) should be independent roles. The chairperson of a company is the head of its board of directors. The board is selected by shareholders and is responsible for protecting investors' interests, such as the company's profitability and stability. The CEO will typically delegate many of the tactical responsibilities to other managers, focusing instead on strategic issues, such as which markets to enter, how to take on the competition, and which companies to form partnerships with (Slate Group, 2000);
• The Chairperson shouldn’t be a member of the Audit committee and should preferably be an independent non-executive director;
• The Chairperson’s aptitude and performance should be evaluated against the firm’s goals and expectations to date.

**Selection of Board members**

The below resolutions are preferred when voting on director appointments:
• Annual re-election of one third of the board of non-executive directors;
• Directors should be voted on independently by a single resolution;
• Requirement for balanced board: review current skill set, industry experience and diversity of the board;
• Prior to nomination for the re-appointment of a director – a thorough analysis and evaluation of the director performance must be conducted. The evaluation should include factors such as attendance, and also be reviewed against meeting the expectations in context of the firms goals for the period.

Remuneration / Compensation

Although an overlap exists amid companies’ remuneration policies, every policy must be reviewed independently. The following resolutions would be voted against:

• Director remuneration is disproportionate and higher in contrast to rival companies (account for size, industry, stage of growth);
• Management performance objectives are not affiliated to value creation in the long term for shareholders;
• A poor performance management process is obvious;
• Remuneration policy which appears convoluted and not understandable (non-transparent);
• Non-executive director’s remuneration is advocated to be funded largely in cash.

In addition to the list above, it will be very alarming if the committee assembled less than twice a year. This would designate a committee which assembled purely to approve remuneration without much debate.

Share options

Should the following be applicable, the issuing of share options will be voted on:

• Participation is broad based. “There have been many instances in South Africa where participation has not been broad based”;
• Options must be based on performance objectives that are clearly articulated and transparent, challenging and it is imperative that approval is obtained from both remuneration committee and the shareholders;
• The vesting period should be over a medium to long term, i.e. 5 to 10 years.
**Share issues**

Share issues to be viewed and voted on in accordance with various factors. There must be a concrete and fully reviewed proposal for the share issue. As well, the history of share issues need to be reviewed – in terms of how much value has been destroyed.

**Share repurchases**

The interviewees were generally comfortable with a share repurchase limit of between 8% - 12% of outstanding issued share capital. In addition to this range, the following terms were a requirement to comply with:

- The cash reserves and resources must be adequate;
- The current market share price should be below what the analyst calculate the intrinsic value to be;
- The liquidity of the share must not be affected;
- There must not be a drastic shift in the capital structure of the entity.

**Resolution of conflicts**

Situations occur where the company is opposed to the analyst’s view (who represents a large institutional base). In occurrences where there is no resolution regarding substantial risks, an extraordinary general meeting (EGM) can be called. At this meeting, the issues can be surfaced and the suggested changes can be placed to vote by shareholders. It must be noted that an EGM is a far-reaching occurrence – should this meeting be called, the asset manager would communicate with all investors they represent prior to this.

**Summary of Major Findings from Interviews**

Eight institutional investors were interviewed, and a summary of the main findings are as follows:

- South Africa has a well-developed financial market. Most importantly the corporate governance standards seem to be on par with international standards.
- Quality of management is ranked as one of the most important drivers in the investment decision making process.
• The following factors are important and impact investment decisions: Financial performance (historic and forward looking), forward looking cash flows, disclosure quality in financial statements and business strategy.

• An experienced group of Independent non-executive directors is crucial to have a well-functioning and balanced board.

• Good corporate governance not only sets the platform for business growth and performance in the long run, it also builds credibility and will lower the cost of capital. Investors are willing to pay more for well governed businesses.

• Majority of respondents do not fulfil an active role when monitoring their investee companies. A passive monitoring role is the norm with majority if investors. Active monitoring is difficult as a small shareholder, and is only acted upon with large shareholdings.

• The most important mechanisms for good corporate governance are the quality of management, experience and existence of IND’s and the boards sub committees.

• Investors were still prepared to hold positions in firms where the corporate governance has deteriorated over time; however the returns are sufficiently high.

• South Africa is becoming increasingly aware of responsible investment and ESG and the standards required to attract and maintain International investors. ESG is still growing in South Africa, and dedicated resource has not been allocated to this area at firms as yet.

• Responsible investment has been built into the investment processes of many of the respondents.

• Proxy voting is important, and must be viewed independently. A summary of the most important resolutions were covered earlier.
6.3 Web based Questionnaire
The web based survey was sent out to a diverse mix of key players in the South African asset management area. The survey was sent out to 20 individuals. A response rate of 60% was obtained (12 respondents’ information received and analysed).

6.3.1 Profile description
1. Categories of Business:
   - Respondents were all located in South Africa
   - Respondents represented a diverse range of asset management business.

<table>
<thead>
<tr>
<th>Asset Management company</th>
<th>Hedge Fund</th>
<th>Institutional asset manager</th>
<th>Investment Management Firm (Retirement funds and Unit trusts)</th>
<th>Multimanager</th>
<th>Private Equity Fund</th>
<th>Private Wealth Manager</th>
<th>Provident Fund</th>
<th>Asset consultant pension fund</th>
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<td>2</td>
<td>1</td>
<td>1</td>
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</table>

2. Average length of portfolio investment horizon in South Africa:
   - This varied across respondents. The shortest average length is 2 to 6 months, and the longest over 10 years.
   - The graph below also groups the respondents by classification. Majority of respondents have a preferred investment horizon of 2 to 5 years.
3. **Approximate value of institutions assets under management:**

   Majority of the respondents have assets under management of greater than R10billion.

4. **Percentage of short and long term investment to total portfolio:**

   Respondents have less than 10% of their allocated investment portfolios as short term investment.

<table>
<thead>
<tr>
<th>Value of assets under management in R</th>
<th>&lt;10</th>
<th>10-20</th>
<th>20-30</th>
<th>30-40</th>
<th>40-50</th>
<th>50-60</th>
<th>60-70</th>
<th>70-80</th>
<th>80-90</th>
<th>90-100</th>
<th>Total Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>&gt;R10billion</td>
<td>94%</td>
<td>0%</td>
<td>0%</td>
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<td>0%</td>
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<td>0%</td>
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<tr>
<td>R5-10billion</td>
<td>5%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
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<td>0%</td>
<td>0%</td>
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<td>&lt;R1billion</td>
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<td>0%</td>
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<td>0%</td>
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</table>

   Majority of respondents invested more than 50% of their portfolios on average with a long term horizon view.

   Short term investments may comprise of derivative instruments, cash funds, money market investments all with a short term outlook. All investors would have some percentage invested in short term instruments for liquidity purposes.

**6.3.2 Company specific factors:**

Respondents from the online questionnaires were requested to indicate the significance of each of the following company specific factors, from “most important” (score 5) to “not important” (score 1) in their investment decisions. Below is a summary:
Most important:

- Legal framework in place
- Content of financial statements, disclosures and transparency
- Quality of management
- Future financial stability and cash flow
- Level of communication between Institutional investor and Investee Company
- Future cash flow
- Auditor’s reports
- Directors share ownership
- Existence of audit committee
- Chairman of the board cannot occupy a position as CEO or managing director
- Code of ethics and statement of best practice to be drawn up by board

Important:

- Trading liquidity
- Degree of leverage
- Timeliness of annual reports
- Audit Quality (audited by big 5)
- Share price volatility
- Market Risk i.e. Beta
- Past financial performance
- Independence of IND’s
- Family ownership and influence
- A statement of responsibility issued by directors relating to the content of the annual report
- Past financial performance
- Dividend yield
- Board composition: balanced board, existence of sub committees, experienced board members and representation of IND’s
- Existence of remuneration committee
Neutral:

- Existence of nomination committee
- CEO domination in the firm
- Institutional investors should have nominee directors on boards of investee companies

Unimportant:

- None

Very unimportant:

- None

6.3.3 Corporate governance mechanisms

The below summarises the important factors contributing to good corporate governance:

6.3.3.1 Board ownership and practices

Respondents noted a balanced board and the existence of sub committees (audit, remuneration and nomination committees) to be a contributing factor. The existence of IND’s contributes to a balanced board and good governance, and the quality of management was regarded as important as they are the enforcement of most mechanisms.

6.3.3.2 Quality of independent non-executive directors (IND’s)

Overall respondents considered the independence of IND’s to be an important factor contributing to good corporate governance. They also considered that IND’s should have knowledge in finance and accounting. A transparent system of nominating and full disclosure on tenure of IND’s was also considered as important for good corporate governance. Respondents also noted for IND’s to have more than 10years of industry experience as important to their role.
6.3.3.3 Board structure and practices

Respondents generally considered it important that the Chairman of the board not be the Managing director or the CEO.

Respondents were of the view that family ownership, and the influence of this on the board is an important consideration and factor on the corporate governance. Thus there should be restrictions placed on the number of family members on the board and majority of the board should be independent non-executive directors. Respondents noted that emphasis should be placed on the recruitment and quality of directors and the IND’s.

When assessing the experience of board members, this experience should draw to address the challenges of the firm. It is noted globally that regulators, politicians and shareholders are increasing pressure on companies for greater board diversity to improve good governance and efficiency, forcing boards to rethink their composition. Apart from diversity and experience, there should be a clear division of responsibility across the board and this should be transparent.

The balance between IND’s and executive directors has become increasingly important. One step further would be to ensure that board committees are chaired by non-executive directors whom have no service contracts with the company and who receive no remuneration linked to firm performance.

The position of chairman and chief executive officer should be separate and a clear line between these roles defined. The chairman provides leadership of the Board and should is primarily responsible for ensuring effective corporate governance. The chief executive officer is responsible for devising, formulating, implementing and maintaining the strategic direction of the company and attends to day-to-day matters of the group while supervising all operations.

It is a requirement for companies on the Johannesburg Stock Exchange (JSE) to have CEO and chairman as separate persons and duality is not allowed, however this is only for main board issuers. ALT-x listing issuers, who are for smaller firms listing on the JSE, are allowed to have the chairman and CEO to be the same person. Given the size of these firms and initial listings, this would be allowed due to capacity. (Johannesburg Stock Exchange, 2012)
6.3.3.4 Annual Report Disclosures

Respondents commented that it was very important for annual financial statements with auditor’s report to be sent to shareholders within a short time frame after the financial year-end date. They welcomed increased financial disclosure, specifically on directors’ dealings with related parties, directors’ benefits derived from exercising share options and/or warrants. In addition, a report on corporate governance in the annual report, a general statement of business risk in the annual report (i.e., foreign exchange exposure) to be important disclosures to improve corporate governance standards.

The strength of an organisation’s corporate governance systems and the quality of public disclosures has become increasingly important to shareholders. As sustainability surfaces as a business issue, stakeholders focus their efforts to what is reported and how. The financial crisis has polished the lens through which corporate governance structures are held to account; as well expectations around transparency raises the standard for more comprehensive and proactive disclosures from organisations, as opposed to the release of corporate governance details or policies in a ‘reactive’ manner in the past. Organisations that see disclosing information on corporate governance as an opportunity to be transparent with stakeholders can potentially use reporting processes to drive improvements to their structures and processes internally.

6.3.3.5 Investor Protection

The following was considered important by respondents as part of good governance:

- Level of communication between the institutional investor and Investee Company
- Equal distribution of information among the analyst and other investors
- Both the “one share one vote” principle and the introduction of representative actions against firms were considered important to healthy corporate governance standards.

It was interesting to note that respondents didn’t find the presence of nominee directors (on behalf of the Institutional investor) on boards of Investee Company as important (scorecard 3.41).

Family shareholding was considered to hinder company performance, as well to affect the suitable management of board functions by respondents.
They generally disagreed that good corporate governance is more important for poor performing companies whilst they strongly agreed that corporate governance requirements are as important for smaller listed companies as for larger companies.

The high level of communication and the equal dissemination of information are considered important primarily for transparency which is vital to good corporate governance.

The Companies Act in South Africa stipulates that, "every member of a company having a share capital shall have a right to vote at meetings of that company in respect of each share held." In addition to this, Johannesburg Stock Exchange listing requirements no longer allow shares with low/no voting rights (referred to as N-shares) to be listed on the exchange.

Institutional investors should have close dated meetings with company management to monitor performance rather than adopt the role of a nominee acting on behalf of investees. The board of the investee company should consist solely of stakeholders in the businesses that are focused on developing, driving and executing strategy.

6.3.3.6 Corporate governance in South Africa

Respondents were not fully satisfied with the current requirements of annual report disclosures (average value was 3.1). Respondents were satisfied with the listing requirements on the Johannesburg stock exchange boards.

50 % of respondents indicated that their investment strategies would not change if there were improvements in corporate governance practices in South African listed companies. 25% of respondents indicated that both their horizons would be lengthened and the proportion invested increased.

Firm performance:

75% of respondents indicated that companies with good corporate governance will outperform poorly governed companies in the long term, rather than the short to medium. This was affirmed with their investment experience, rather than the respondent’s outlook of the industry.

Majority of respondents indicated that the financial service sector has the highest level of corporate governance in South Africa. 58% agreed that premium is paid for well governed
companies relative to industry peers. The aggregated premium was indicated to be less than 2% by respondents. 58% of respondents also noted companies with high levels of governance to be value stocks rather than growth stocks.

Institutional investor activism:

75% of respondents do not have representatives on boards of investee companies. The main cost categories associate with exercising voting rights according to respondents were, analysing proxy statements and the time cost of senior management. Major of respondents meet with senior management of investee companies once a quarter. 3 respondents indicated they met once a year and 4 respondents indicated they never met at all. 6 respondents indicate that they have disinvested significantly on average 3 times. The reasons for this:

- Poor return performance (58% of respondents)
- Achieved significant returns and met targets (42% of respondents)
- Company share price is overvalued (58% of respondents)
- The share price would worsen due to deteriorating corporate governance (42% of respondents)
- Turn around growth, better opportunities in other industries (50% of respondents)
- Poor disclosure practices (42% of respondents)
- Sub optimal board composition (8% of respondents)
6.4 Summary of Findings from Interviews and Online questionnaire survey

Findings obtained from both groups of respondents were notably consistent when the results from the in-depth interviews are compared with those collected from the online web-based questionnaire.

All respondents categorised both management quality and financial statement disclosure and transparency as the most important factors influencing their investment analysis and investment choices. The quality of financial statements is imperative as it not only shows the current financial health of the firm, but serves as input to look at forward earnings and completing technical and fundamnet analysis prior to investing. In addition to financial reports available, web based respondents noted volatility, beta and dividend yield as important factors when investing.

The existence of a balanced board is important to both groups of respondents; however the interviewees placed more emphasis on this. All respondents felt very strongly about the presence of IND’s on a board. The selection and experience of the IND’s was also vital, with the web based respondents noting more than 10 years to be good industry experience for an IND. The interviewees placed emphasis on the role on the IND’s, noting there role as drivers of good governance.

Interview respondents regarded corporate governance as an important factor in their investment decisions, and ensured this was built into model analysis when conducting due diligence. The topic of corporate governance was split into a few questions, which covered corporate governance standards and mechanisms. Respondents were asked to classify the importance of each in terms of influence on their investment decisions. Common overlap among questionnaire respondents showed the following factors to be important in investment choice, namely: “investor communication, IND composition and independence, family ownership and influence.”

The presence of a nomination committee, CEO domination and representation of nominee directors on boards were however viewed as only somewhat important factors.

All respondents felt strongly that the chairman of the board cannot fill a position as CEO or managing director.

A passive approach to activism has been noted between the two groups of respondents. Active roles were only pursued when major issues arose – as noted by the interviewees. 75% of the web-based respondent’s did not have representatives on boards of investee companies.

Both groups noted they would pay a premium for well governed companies, with the web based respondents averaging this around 2%.
Inconsistent results between the two groups of respondents were notable. Interview respondent’s merely placed emphasis on the importance of autonomy in the audit function. The web based respondent’s noted audit reports and the assurance of a good external auditor to be important. Interviewee respondents mentioned positive cost factors in analysing and exercising voting rights. They had fully articulated voting policies and documented all procedures. However web based respondents noted a cost to analyse proxy statements as a negative. Although the two groups of respondents share similar attitudes on the important factors, there was no major contradiction in views and the findings.

The next chapter covers the conclusion for this study based on the detailed findings provided thus far.
CHAPTER 7: Summary and Limitations

7.1 Summary

The primary aim of this study is to examine South African institutional investors and their overall views on corporate governance following a decade encompassing a series of crippling global financial events. In specific, we examine the different roles of institutional investors and their attitudes, and outlook on corporate governance standards in South Africa.

Chapter 1 describes the concept of corporate governance, and highlights its increased importance as a by-product of the extensive development of the modern corporate landscape. Modern corporations today go beyond being described as “large organisations”. With the various levels of reporting lines, processes and procedures, hierarchies and global presence to add - each corporation can be described as a “meta-system” by itself, having different structures and these being complementary to other structures of the system. Without this complementarity, the system would not be efficient.

In the analysis of institutional investors and their role in the modern corporate landscape, “agency and incomplete contracting” problems are highlighted as two significant factors.

Agency problems stem from conflicts of interest which exist between shareholders (principal) and managers (agent). This occurs as there is one party who is expected to act in another’s best interest, and ultimately – the agent’s own best interests may differ from the principals best interests.

Incomplete contracting arises from the difficulty in writing contracts to cover the entire organisation, and also the difficulty to monitor these contracts – to ensure no opportunistic behaviour. The modern corporation with is complementarity consists of a plethora of contracts, all in place to aid the efficient outcome.

Chapter 2 seeks to understand the development of the role between institutional investors and corporate governance. To attain a comprehensive understanding of the association between institutional investors and the level of corporate governance the following analyses was executed in this chapter:

- The development of increased institutional ownership and the role of institutional investors in corporate governance matters;
- The willingness and benefits for institutional investor’s to participate in shareholder activism;
- The differences between an active and passive role of an institutional investor on level of corporate governance;
The costs and risks of shareholder activism.

Chapter 3 provides the analytical framework for this study. This framework was based on the Brancato model and provides an understanding of the various roles, incentives and motivation of institutional investors. Brancato categorised shareholders along a spectrum, with *investors* on the one end and *traders* on the other end of this continuum.

The *investors* on the one end were seen as value or long term investors, and would have incentive to actively engage in corporate governance.

On the other end were *traders* who seek short term profit and thus would pursue only a passive role.

The roles of institutional investors in corporate governance as described by Brancato cannot be viewed in isolation as each investor would also be more or less likely to engage based on the governance mechanisms and regulatory framework in place. Organisational structures and the severity of agency problems within them are influencing factors as well.

The second part of Chapter 3 looks at the complexity and background of the South African institutional investment environment. The primary governance mechanisms and regulatory framework in place in South Africa is also reviewed.

This framework provides a basis to define topical areas and create a framework to direct the interview and online based questionnaires.

Chapter 4 conducts a literature review on the corporate information requirements for institutional investors when making investment choice, from both a qualitative and quantitative perspective. This further provides a base to structure and design the flow of interviews and web based questionnaires.

Chapter 5 reviews the overall methodology used for accomplishing the objective of the study; which was interview a sample of institutional investors and disseminate the online web based questionnaire.

Chapter 6 discusses the results from the interviews conducted and online web questionnaires distributed.

The first section of Chapter 6 reviews the outcomes from the personal interviews conducted. Quality of management and a reliable management team were considered key in making investment decisions by investors. A reliable and experienced management team will adopt the establishment of a good governance mechanism, corporate strategy and turnaround strategy (where required), rather than posing as a hurdle in the implementation process. Additional factors such as: financial reports, future
cash flow and forward earnings, disclosure quality (in financial statements) and corporate strategy were regarded as vital in investment analysis and decision making.

Whilst corporate governance was noted as an important factor in the assessment of underlying stocks and in ultimately making an investment decision; there was no formal metric or measurement conducted on governance as part of investment analysis. This finding may evidence that improved governance and implementation mechanisms are only required where a poor management team seems to exist. Contrary to this, a good governance structure can only exist with a strong management team. A management team with the correct skill set and industry experience will be more inclined to implement policies and thereafter pursue full transparency and good corporate governance in the best interest of shareholders in all areas.

In addition to the quality of management, another vital driver to good corporate governance was the existence of “quality” IND’s. The interviewees stressed the importance of good recruitment of these directors, and ensuring these individuals were backed by sufficient industry experience. To be effective, an IND requires an acute understanding of the specific company they are advising, and the entire supply chain process of the trade. With industry experience, these IND’s can truly provide valuable sufficient strategic input to the board. However to enforce good governance and uphold policies, these IND’s must continuously question management and challenge them. Time commitment from the IND is vital. In a modern world the total time commitment and overall responsibility of an IND role has increased. Attending the board meetings should now only be considered the bare minimum. IND’s must be fully engaged to get to know the business, and build relationships with management and shareholders. In addition to building relationships with management, IND’s must also seek to be challenge, support and educate continuously.

There was an affirmative view from investors that corporate governance improves firm performance and or would decrease the cost of capital over time. With regard to the corporate governance standard in South Africa, it was noted that majority of investee firms had corporate governance mechanisms and policies on par with international standards.

Investors noted they avoid positions where good governance is poor or not displayed. There were exceptions:

- They would invest in a firm that has good governance, but this may not be highly on par with international standards;
- They continue to hold positions where the investment decision occurs in a firm with good governance, however they do not dis invest when governance has deteriorated over time as returns have increased and dividend yield is high.
The overall view is that South Africa has good governance standards which are internationally comparable. Institutional asset managers however noted ESG to be a growing with rising interest from institutional pension funds and other investors. The local industry has not fully perfected this arena as it is a growing trend; however ESG factors are taken into consideration by the analyst and portfolio manager in the analysis process rather than having dedicated personnel performing the research. The international arena has developed and adopted ESG such that majority of managers have dedicated resource to ESG research and responsible investing.

It was revealed that institutional investors don’t actively monitor their investee companies:
- Active monitoring would occur when shareholding was large. With a relatively small shareholding they would lack the power to influence;
- An active role is take from the beginning of an investment where they see fundamental value and seek to increase their investment size in the long term;
- An active role is taken when fundamental issues arise – this is in the best interest of shareholders.

Despite the passive role, proxies from all investee firms were continuously monitored, well reviewed and voted on accordingly.

Largely, interviewees supported corporate governance reform.

The second portion of Chapter 6 reviews the findings of the online based questionnaire. The above outcomes from interviews with institutional investors were largely consistent with results from the online questionnaire.

The less consistent results related to proxies and procedures around this. Interview respondents placed lots of emphasis on analysing proxies, having procedures in place for this and correct record keeping of voting records. Web based respondent’s flagged proxy voting as a negative and felt this was a costing procedure, and drew time away from senior management who were required to analyse proxies at times.

Further findings on the topic of corporate governance issues were obtained from the online questionnaires. The following findings were obtained and ranked as important corporate governance issues:
• Investor communication: Level of communication between Institutional investor and Investee Company
• Director share ownership
• Family ownership and influence
• Existence of structure for director’s performance appraisal.

Overall, no noticeably deviating or opposing views were noted.

Role as owners - The most common situations when institutional investors prompt change are:
• Underperformance
• Special situations, crisis mode
• Corporate finance issues

Monitoring: There is potential for institutional investors to improve their role in corporate governance in South African listed entities. Additionally, there is room for institutional investors as pension funds to ensure asset managers investing on their behalf, are pursuing active roles on sizeable house view positions.

In order to improve their influence in corporate governance institutional investors need to be prepared to pursue an escalation strategy. This for example encompasses to increase their stake to a meaningful and powerful level, or to collaborate and work systematically with other shareholders to possibly place a nominee on a supervisory board. However, such approaches require an in-house mind-set and long term commitment in the best interests of the shareholders.

Communication: The investor communication function has been deemed important, however was not criticised. Communication is one of the most important measures, and respondents to this study agreed with this. However, other powerful measures have not been fully utilised – such as the use of voting rights and more regular contact with the members of the supervisory board. Pushing to obtain a seat on the supervisory board by obtaining a meaningful stake will only seem possible where the investor views ultimate long term fundamental value in the stock. Collaboration in South Africa has not occurred to a large extent and this could be due to the small environment investors operate in and the competitive nature between the firms.

Independence and expertise: Institutional investors with a high level of expertise can contribute to the broadly discussed improvement of the competence and independence of South African supervisory boards. However, important requirements which do exist would be that no conflicts of interest exist
and sufficient expertise exists. Conflicts of interest may be an issue where an asset manager has a few large positions of firms in the same industry. These issued would need careful addressing.

External forces such as international investment in South Africa are a motivating change, with the bar being raised significantly in terms of expectations around comprehensive risk management and governance practices – for both traditional and alternate asset managers. This was noted in this paper by the interview respondents who have obtained increased pressure on responsible investing and ESG monitoring from both local and international investors.

An increasingly complex regulatory environment has heightened demand for transparency and accountability with majority of the onerous being on the asset manager. Also investors have heightened expectations and expect institutional quality governance, processes and controls from their asset managers and too seek transparency and disclosures on monitoring and risk management practices from the asset manager.

Though the South African industry is perceived to be on par with international governance standards, the industry should rethink traditional organisational and governance models, with greater involvement and oversight. More formal committee structures need to be formed with increased pressure for transparency and disclosures, as controls should not function autonomously, but rather working hand in hand with strong governance and oversight.

7.2 Limitations

As in all research studies, limitations are existent which possibly impact the measurement of results.

- A 100% response rate was the goal from the web based questionnaire. 80% response was achieved. Although identities were assured to remain confidential – individuals may have been over cautious given the close knit institutional area in South Africa.

- The web based questionnaire was run over a period of 2 months. Due to time availability of interview respondent’s – the interviews were conducted a few months after the initial web based questionnaire send. The limitation here was that issues which were described in the interviews could not be rebuilt into the web based questionnaire. An example would be the increasing responsible investment and ESG arena which was developing at this stage.

- The portfolio holding mix of the interview questionnaires was undisclosed by the respondents as this was confidential.
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[Accessed 24 09 2013].


Tsui, J. a. S. L., 2001. *Family control, CEO dominance and firm performance in Hong Kong.*, s.l.: Working paper, City University of Hong Kong..


Institutional Investor Governance in South Africa

1. Which of the following categories describes your institution?*
   - Pension Fund
   - Mutual Fund
   - Investment Bank
   - Insurance Company
   - Provident Fund
   - Private Equity Fund
   - Unit Trust Company
   - Other, please specify

2. What is the average length of your portfolio investment horizon in the South African market?*
   -- Please Select --

3. Please indicate an approximation of your institution's current investment holding mix:*
   - <10%
   - 10-20%
   - 20-30%
   - 30-40%
   - 40-50%
   - 50-60%
   - 60-70%
   - 70-80%
   - 80-90%
   - 90-100%
   - Short term %
   - Long term %

4. What is the approximate value of your institution's assets under management?*
   -- Please Select --

5. Financial Fundamentals*
   Please indicate the importance of the following factors in your investment decisions
   - Very Important
   - Important
   - Neutral
   - Unimportant
   - Very Unimportant
   - Future cash flow
   - Share price volatility
   - Market Risk i.e. Beta
   - Trading Liquidity
   - Future Financial performance
6. Board Structure, Ownership and Practices*

Please indicate the importance of the following factors in your investment decisions:

<table>
<thead>
<tr>
<th>Factor</th>
<th>Very Important</th>
<th>Important</th>
<th>Neutral</th>
<th>Unimportant</th>
<th>Very Unimportant</th>
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</thead>
<tbody>
<tr>
<td>Existence of nomination committee</td>
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<td>Board composition i.e. Percentage of independent no executive directors on the Board</td>
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<td>Experience of Board members</td>
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<td>Quality of Management</td>
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<tr>
<td>Directors share ownership</td>
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<td>Independence of independent non executive directors</td>
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<tr>
<td>Existence of Remuneration committee</td>
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<tr>
<td>CEO domination in the firm</td>
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<tr>
<td>Controlling Shareholder</td>
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<tr>
<td>Existence of audit committee</td>
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<tr>
<td>Family ownership and influence</td>
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</tbody>
</table>

7. In your opinion, has King 3 improved corporate governance in South African firms? *

- Yes
- No

8. Rank the importance of macro factors prior to investing: *

<table>
<thead>
<tr>
<th>Factor</th>
<th>Very Important</th>
<th>Important</th>
<th>Neutral</th>
<th>Unimportant</th>
<th>Very Unimportant</th>
</tr>
</thead>
<tbody>
<tr>
<td>Political Stability</td>
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<td>Legal Framework in place</td>
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<td>Investor protection and regulation</td>
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<td>Inflation and interest rate outlook</td>
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<td>Availability of independent research</td>
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</table>

9. Quality of Independent Non – Executive Directors *

How important are the following factors in contributing to good corporate governance?

<table>
<thead>
<tr>
<th>Factor</th>
<th>Very Important</th>
<th>Important</th>
<th>Neutral</th>
<th>Unimportant</th>
<th>Very Unimportant</th>
</tr>
</thead>
</table>
### 10. Board structure and practices*

How important are the following factors in contributing to good corporate governance?

<table>
<thead>
<tr>
<th>Factor</th>
<th>Very Important</th>
<th>Important</th>
<th>Neutral</th>
<th>Unimportant</th>
<th>Very Unimportant</th>
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</thead>
<tbody>
<tr>
<td>Chairman of the board cannot occupy a position as CEO or managing director</td>
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<td>Restrictions should be placed on the number of family members who can sit on the board</td>
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<tr>
<td>Chairman of the board to be an independent non executive director</td>
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<tr>
<td>Majority of the board to be independent non executive directors</td>
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<td>A code of ethics or statement of business practice must be drawn up by the board</td>
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<tr>
<td>Emphasis on the recruitment of quality of directors, especially independent non executive directors</td>
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### 11. Annual report disclosures (a)*

Please indicate the importance of the following factors on your investment decisions

<table>
<thead>
<tr>
<th>Factor</th>
<th>Very Important</th>
<th>Important</th>
<th>Neutral</th>
<th>Unimportant</th>
<th>Very Unimportant</th>
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<tbody>
<tr>
<td>Content of Financial statements and notes</td>
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<tr>
<td>Timeliness of Annual</td>
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</tbody>
</table>
### 12. Annual report disclosures (b)*

**How important are the following factors in contributing to good corporate governance?**

<table>
<thead>
<tr>
<th>Disclosure of directors' benefits derived from exercising share options and/or warrants</th>
<th>Very Important</th>
<th>Important</th>
<th>Neutral</th>
<th>Unimportant</th>
<th>Very Unimportant</th>
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</thead>
<tbody>
<tr>
<td>Disclosure of directors' dealings with related parties</td>
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<tr>
<td>A corporate governance report in the annual report</td>
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<tr>
<td>Statement of business risk i.e. stating forex exposure</td>
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</table>

### 13. Investor Protection (a)*

**Please indicate the importance of the following factors on your investment decisions**

<table>
<thead>
<tr>
<th>Level of communication between Institutional Investor and Investee Company</th>
<th>Very Important</th>
<th>Important</th>
<th>Neutral</th>
<th>Unimportant</th>
<th>Very Unimportant</th>
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</thead>
<tbody>
<tr>
<td>Equal dissemination of information among analysts and other investors</td>
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</table>

### 14. Investor Protection (b)*

**How important are the following factors in contributing to good corporate governance?**

<table>
<thead>
<tr>
<th>Class actions against companies</th>
<th>Very Important</th>
<th>Important</th>
<th>Neutral</th>
<th>Unimportant</th>
<th>Very Unimportant</th>
</tr>
</thead>
<tbody>
<tr>
<td>One share one vote principle</td>
<td></td>
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<tr>
<td>Institutional investors should have nominee directors on boards of investee companies</td>
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</table>

### 15. Corporate governance in South Africa*

**State your level of agreement with the following statements**

<table>
<thead>
<tr>
<th>Family shareholding affects Company financial performance</th>
<th>Strongly Agree</th>
<th>Agree</th>
<th>Neutral</th>
<th>Disagree</th>
<th>Strongly Disagree</th>
</tr>
</thead>
</table>
Family shareholding affects proper management of board functions
Current requirements of annual report disclosure are adequate
Good corporate governance is more important for poor performing companies
High standards of corporate governance is as important for smaller listed companies as for larger companies
The present listing requirements on the JSE boards are adequate

16. If you note improvements in corporate governance practices in South African listed companies, will your investment strategies change?*
   -- Please Select --

17. Do you think companies with good corporate governance strongly outperform companies with poor governance in stock performance, over the:
   Long Term  Medium Term  Short Term

18. From your investment experience, do stocks with high corporate governance outperform stocks peers with lower corporate governance?*
   Yes  No

19. What are the sources of information from which you evaluate corporate governance level of a company?
   In house  Public reports  Professional reports

20. In your view, Which business sector in South Africa has the highest level of corporate governance?*

21. a) Does the market pay premium for well governed companies relative to industry peers, given all other factors constant?*
   Yes  No

22. b) What is this aggregate premium:
   -- Please Select --

23. Do you notice companies with high levels of governance to be either a:
   Growth Stock  Value Stock

24. Board Representation- Representatives of your institution:
   i. Does your institution have a policy to nominate directors to the boards of companies in which you hold equity above a
25. Board Representation - Representatives of your institution:*  
ii. If yes, what is your typical threshold for a portfolio company (your holding as a percentage of the company’s total equity)?  
-- Please Select --  
   Yes  No  

26. What are cost categories associated with exercising of your voting rights? (select applicable)*  
Select at least 1 response and no more than 5 responses.  
- Analysing proxy statements  
- Sending to oversight boards for evaluation  
- Hiring external advisor  
- Legal fees  
- Time cost of senior management  

27. How often does your institution meet with the senior management of the companies you invest in?*  
-- Please Select --  

28. In how many cases have you decided to disinvest (significantly) in a portfolio company?*  
-- Please Select --  

29. What are the principal factors that may lead you to disinvest (significantly) your stakes in a portfolio company? Tick*  
Select at least 1 response and no more than 7 responses.  
- Poor return performance  
- Have achieved benchmark returns significantly  
- Belief that the company’s share price is overvalued  
- Belief that company share price will worsen due to deteriorating corporate governance  
- Turn around growth in other industries – better opportunity  
- Unsatisfactory disclosure practices  
- Sub optimal board composition
Annexure 1 b._Web based survey response analysis

Survey Results -- Overview

Institutional Investor Governance in South Africa

<table>
<thead>
<tr>
<th>Respondents:</th>
<th>12 displayed, 12 total</th>
<th>Status:</th>
<th>Open</th>
</tr>
</thead>
<tbody>
<tr>
<td>Launched Date:</td>
<td>25/03/2012</td>
<td>Closed Date:</td>
<td>N/A</td>
</tr>
<tr>
<td>Display:</td>
<td>Display all pages and questions</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

1. Which of the following categories describes your institution?

<table>
<thead>
<tr>
<th>Category</th>
<th>Response Total</th>
<th>Response Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pension Fund</td>
<td>0</td>
<td>0%</td>
</tr>
<tr>
<td>Mutual Fund</td>
<td>0</td>
<td>0%</td>
</tr>
<tr>
<td>Investment Bank</td>
<td>0</td>
<td>0%</td>
</tr>
<tr>
<td>Insurance Company</td>
<td>0</td>
<td>0%</td>
</tr>
<tr>
<td>Provident Fund</td>
<td>1</td>
<td>8%</td>
</tr>
<tr>
<td>Private Equity Fund</td>
<td>2</td>
<td>17%</td>
</tr>
<tr>
<td>Unit Trust Company</td>
<td>0</td>
<td>0%</td>
</tr>
<tr>
<td>Other, please specify</td>
<td>9</td>
<td>75%</td>
</tr>
</tbody>
</table>

Total Respondents: 12

2. What is the average length of your portfolio investment horizon in the South African market?

<table>
<thead>
<tr>
<th>Horizon</th>
<th>Response Total</th>
<th>Response Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>2-6 months</td>
<td>1</td>
<td>8%</td>
</tr>
<tr>
<td>6-12 months</td>
<td>1</td>
<td>8%</td>
</tr>
<tr>
<td>1-2 years</td>
<td>0</td>
<td>0%</td>
</tr>
<tr>
<td>2-5 years</td>
<td>5</td>
<td>42%</td>
</tr>
<tr>
<td>5-10 years</td>
<td>3</td>
<td>25%</td>
</tr>
<tr>
<td>Over 10 years</td>
<td>2</td>
<td>17%</td>
</tr>
</tbody>
</table>

Total Respondents: 12

3. Please indicate an approximation of your institution's current investment holding mix:

<table>
<thead>
<tr>
<th>Short term %</th>
<th>Response Total</th>
<th>Long term %</th>
<th>Response Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;10</td>
<td>33% (3)</td>
<td>9% (1)</td>
<td>9 (1)</td>
</tr>
<tr>
<td>10-20</td>
<td>11% (1)</td>
<td>0% (0)</td>
<td>0% (0)</td>
</tr>
<tr>
<td>20-30</td>
<td>22% (2)</td>
<td>0% (0)</td>
<td>0% (0)</td>
</tr>
<tr>
<td>30-40</td>
<td>11% (1)</td>
<td>9% (1)</td>
<td>9% (1)</td>
</tr>
<tr>
<td>40-50</td>
<td>11% (1)</td>
<td>18% (2)</td>
<td>18% (2)</td>
</tr>
<tr>
<td>50-60</td>
<td>11% (1)</td>
<td>9% (1)</td>
<td>9% (1)</td>
</tr>
<tr>
<td>60-70</td>
<td>0% (0)</td>
<td>18% (2)</td>
<td>27% (3)</td>
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<tr>
<td>70-80</td>
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<td>0% (0)</td>
<td>0% (0)</td>
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<tr>
<td>80-90</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>0% (0)</td>
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<td>90-100</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>0% (0)</td>
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</table>

Total Respondents: 12
4. What is the approximate value of your institution's assets under management?

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<thead>
<tr>
<th>Response</th>
<th>Total</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; R1billion</td>
<td>5</td>
<td>42%</td>
</tr>
<tr>
<td>R1 – 5 billion</td>
<td>0</td>
<td>0%</td>
</tr>
<tr>
<td>R5-10 billion</td>
<td>1</td>
<td>8%</td>
</tr>
<tr>
<td>&gt; R10 billion</td>
<td>6</td>
<td>50%</td>
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</table>

Total Respondents 12

5. Financial Fundamentals

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<tr>
<th>Factor</th>
<th>Very Important</th>
<th>Important</th>
<th>Neutral</th>
<th>Unimportant</th>
<th>Very Unimportant</th>
<th>Response Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Future cash flow</td>
<td>67% (8)</td>
<td>17% (2)</td>
<td>17% (2)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
<tr>
<td>Share price volatility</td>
<td>8% (1)</td>
<td>50% (6)</td>
<td>25% (3)</td>
<td>8% (1)</td>
<td>8% (1)</td>
<td>12</td>
</tr>
<tr>
<td>Market Risk i.e. Beta</td>
<td>25% (3)</td>
<td>42% (5)</td>
<td>17% (2)</td>
<td>8% (1)</td>
<td>8% (1)</td>
<td>12</td>
</tr>
<tr>
<td>Trading Liquidity</td>
<td>25% (3)</td>
<td>67% (8)</td>
<td>8% (1)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
<tr>
<td>Future Financial performance</td>
<td>50% (6)</td>
<td>50% (6)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
<tr>
<td>Degree of leverage</td>
<td>17% (2)</td>
<td>50% (6)</td>
<td>33% (4)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
<tr>
<td>Dividend yield</td>
<td>0% (0)</td>
<td>67% (8)</td>
<td>33% (4)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
<tr>
<td>Past financial performance</td>
<td>8% (1)</td>
<td>75% (9)</td>
<td>8% (1)</td>
<td>8% (1)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
<tr>
<td>Audit Quality (audited by big 5, or not)</td>
<td>8% (1)</td>
<td>58% (7)</td>
<td>33% (4)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
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</table>

Total Respondents 108

6. Board Structure, Ownership and Practices

<table>
<thead>
<tr>
<th>Factor</th>
<th>Very Important</th>
<th>Important</th>
<th>Neutral</th>
<th>Unimportant</th>
<th>Very Unimportant</th>
<th>Response Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Existence of nomination committee</td>
<td>8% (1)</td>
<td>42% (5)</td>
<td>42% (5)</td>
<td>8% (1)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
<tr>
<td>Board composition i.e. Percentage of independent no executive directors on the Boars</td>
<td>25% (3)</td>
<td>58% (7)</td>
<td>17% (2)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
<tr>
<td>Experience of Board members</td>
<td>67% (8)</td>
<td>25% (3)</td>
<td>8% (1)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
<tr>
<td>Quality of Management</td>
<td>75% (9)</td>
<td>17% (2)</td>
<td>8% (1)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
<tr>
<td>Directors share ownership</td>
<td>50% (6)</td>
<td>17% (2)</td>
<td>33% (4)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
<tr>
<td>Independence of independent non executive directors</td>
<td>25% (3)</td>
<td>58% (7)</td>
<td>17% (2)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
<tr>
<td>Existence of Remuneration committee</td>
<td>25% (3)</td>
<td>50% (6)</td>
<td>17% (2)</td>
<td>8% (1)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
<tr>
<td>CEO domination in the firm</td>
<td>17% (2)</td>
<td>42% (5)</td>
<td>42% (5)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
<tr>
<td>Controlling Shareholder</td>
<td>8% (1)</td>
<td>50% (6)</td>
<td>33% (4)</td>
<td>8% (1)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
<tr>
<td>Existence of audit committee</td>
<td>50% (6)</td>
<td>17% (2)</td>
<td>33% (4)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
<tr>
<td>Family ownership and influence</td>
<td>8% (1)</td>
<td>42% (5)</td>
<td>50% (6)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
</tbody>
</table>

Total Respondents 132

7. In your opinion, has King 3 improved corporate governance in South African firms?

<table>
<thead>
<tr>
<th>Response</th>
<th>Total</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>7</td>
<td>58%</td>
</tr>
<tr>
<td>No</td>
<td>5</td>
<td>42%</td>
</tr>
</tbody>
</table>
8. Rank the importance of macro factors prior to investing:

<table>
<thead>
<tr>
<th>Factor</th>
<th>Very Important</th>
<th>Important</th>
<th>Neutral</th>
<th>Unimportant</th>
<th>Very Unimportant</th>
<th>Response Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Political Stability</td>
<td>33% (4)</td>
<td>42% (5)</td>
<td>25% (3)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
<tr>
<td>Legal Framework in place</td>
<td>50% (6)</td>
<td>42% (5)</td>
<td>8% (1)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
<tr>
<td>Investor protection and regulation</td>
<td>75% (9)</td>
<td>8% (1)</td>
<td>8% (1)</td>
<td>0% (0)</td>
<td>8% (1)</td>
<td>12</td>
</tr>
<tr>
<td>Inflation and interest rate outlook</td>
<td>42% (5)</td>
<td>50% (6)</td>
<td>8% (1)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
<tr>
<td>Availability of independent research</td>
<td>33% (4)</td>
<td>33% (4)</td>
<td>17% (2)</td>
<td>17% (2)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
</tbody>
</table>

9. Quality of Independent Non – Executive Directors

<table>
<thead>
<tr>
<th>Requirement</th>
<th>Very Important</th>
<th>Important</th>
<th>Neutral</th>
<th>Unimportant</th>
<th>Very Unimportant</th>
<th>Response Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independence of independent non executive directors</td>
<td>42% (5)</td>
<td>58% (7)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
<tr>
<td>Majority of independent non executive directors should have an understanding of finance and accounting</td>
<td>42% (5)</td>
<td>25% (3)</td>
<td>33% (4)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
<tr>
<td>Majority of independent non executive directors should have experience in the industry of more than 10 years</td>
<td>33% (4)</td>
<td>50% (6)</td>
<td>17% (2)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
<tr>
<td>Independent non executives to be appointed by the nomination committee</td>
<td>33% (4)</td>
<td>33% (4)</td>
<td>25% (3)</td>
<td>8% (1)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
<tr>
<td>Reasons for resignation of independent non executives should be disclosed</td>
<td>33% (4)</td>
<td>33% (4)</td>
<td>25% (3)</td>
<td>8% (1)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
</tbody>
</table>

10. Board structure and practices

<table>
<thead>
<tr>
<th>Requirement</th>
<th>Very Important</th>
<th>Important</th>
<th>Neutral</th>
<th>Unimportant</th>
<th>Very Unimportant</th>
<th>Response Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chairman of the board cannot occupy a position as CEO or managing director</td>
<td>50% (6)</td>
<td>50% (6)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
<tr>
<td>Restrictions should be placed on the number of family members who can sit on the board</td>
<td>25% (3)</td>
<td>42% (5)</td>
<td>25% (3)</td>
<td>8% (1)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
<tr>
<td>Chairman of the board to be an independent non executive director</td>
<td>50% (6)</td>
<td>50% (6)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
<tr>
<td>Majority of the board to be independent non executive directors</td>
<td>25% (3)</td>
<td>58% (7)</td>
<td>17% (2)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
<tr>
<td>A code of ethics or statement of business practice must be drawn up by the board</td>
<td>58% (7)</td>
<td>25% (3)</td>
<td>17% (2)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
<tr>
<td>Emphasis on the recruitment of quality of directors, especially independent non executive directors</td>
<td>42% (5)</td>
<td>33% (4)</td>
<td>25% (3)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>12</td>
</tr>
</tbody>
</table>

11. Annual report disclosures (a)
### Survey Results -- Overview

<table>
<thead>
<tr>
<th>Section</th>
<th>Content of Financial statements and notes</th>
<th>Timeliness of Annual Reports</th>
<th>Auditors Report</th>
<th>A statement of responsibility issued by directors relating to the content of the annual report</th>
<th>Very Important</th>
<th>Important</th>
<th>Neutral</th>
<th>Unimportant</th>
<th>Very Unimportant</th>
<th>Response Total</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>67% (8)</td>
<td>42% (5)</td>
<td>58% (7)</td>
<td>33% (4)</td>
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<td></td>
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<td>12</td>
</tr>
<tr>
<td></td>
<td>25% (3)</td>
<td>50% (6)</td>
<td>42% (5)</td>
<td>50% (6)</td>
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<tr>
<td></td>
<td>8% (1)</td>
<td>8% (1)</td>
<td>0% (0)</td>
<td>17% (2)</td>
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<td></td>
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<td>12</td>
</tr>
<tr>
<td></td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>0% (0)</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td>12</td>
</tr>
<tr>
<td></td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td></td>
<td></td>
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<td></td>
<td>12</td>
</tr>
<tr>
<td></td>
<td><strong>Total Respondents</strong></td>
<td></td>
<td></td>
<td></td>
<td>48</td>
<td></td>
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</tbody>
</table>

12. **Annual report disclosures (b)**

<table>
<thead>
<tr>
<th>Disclosure of directors’ benefits derived from exercising share options and/or warrants</th>
<th>Very Important</th>
<th>Important</th>
<th>Neutral</th>
<th>Unimportant</th>
<th>Very Unimportant</th>
<th>Response Total</th>
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</thead>
<tbody>
<tr>
<td>50% (6)</td>
<td>42% (5)</td>
<td>8% (1)</td>
<td>0% (0)</td>
<td>0% (0)</td>
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<td>12</td>
</tr>
<tr>
<td><strong>Total Respondents</strong></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td>48</td>
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</table>

13. **Investor Protection (a)**

<table>
<thead>
<tr>
<th>Level of communication between Institutional Investor and Investee Company</th>
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<th>Important</th>
<th>Neutral</th>
<th>Unimportant</th>
<th>Very Unimportant</th>
<th>Response Total</th>
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</thead>
<tbody>
<tr>
<td>83% (10)</td>
<td>17% (2)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td>0% (0)</td>
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<td>12</td>
</tr>
<tr>
<td><strong>Total Respondents</strong></td>
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<td></td>
<td></td>
<td></td>
<td>24</td>
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</tbody>
</table>

14. **Investor Protection (b)**

<table>
<thead>
<tr>
<th>Class actions against companies</th>
<th>Very Important</th>
<th>Important</th>
<th>Neutral</th>
<th>Unimportant</th>
<th>Very Unimportant</th>
<th>Response Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>25% (3)</td>
<td>58% (7)</td>
<td>17% (2)</td>
<td>0% (0)</td>
<td>0% (0)</td>
<td></td>
<td>12</td>
</tr>
<tr>
<td>One share one vote principle</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Institutional investors should have nominee directors on boards of</td>
<td>25% (3)</td>
<td>58% (7)</td>
<td>17% (2)</td>
<td>0% (0)</td>
<td></td>
<td>12</td>
</tr>
<tr>
<td>investee companies</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Respondents</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>36</td>
</tr>
</tbody>
</table>

15. **Corporate governance in South Africa**

<table>
<thead>
<tr>
<th>Family shareholding affects Company financial performance</th>
<th>Strongly Agree</th>
<th>Agree</th>
<th>Neutral</th>
<th>Disagree</th>
<th>Strongly Disagree</th>
<th>Response Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>17% (2)</td>
<td>25% (3)</td>
<td>50% (6)</td>
<td>8% (1)</td>
<td>0% (0)</td>
<td></td>
<td>12</td>
</tr>
<tr>
<td>Family shareholding affects Proper management of board functions</td>
<td>17% (2)</td>
<td>42% (5)</td>
<td>25% (3)</td>
<td>8% (1)</td>
<td></td>
<td>12</td>
</tr>
<tr>
<td>Current requirements of annual report</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
16. If you note improvements in corporate governance practices in South African listed companies, will your investment strategies change?

<table>
<thead>
<tr>
<th>Response</th>
<th>Total</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) No</td>
<td>6</td>
<td>50%</td>
</tr>
<tr>
<td>b) Yes, the horizon will be lengthened</td>
<td>2</td>
<td>17%</td>
</tr>
<tr>
<td>c) Yes, the proportion invested will increase</td>
<td>1</td>
<td>8%</td>
</tr>
<tr>
<td>d) Both B &amp; C</td>
<td>3</td>
<td>25%</td>
</tr>
</tbody>
</table>

Total Respondents 12

17. Do you think companies with good corporate governance strongly outperform companies with poor governance in stock performance, over the:

<table>
<thead>
<tr>
<th>Duration</th>
<th>Total</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long Term</td>
<td>9</td>
<td>75%</td>
</tr>
<tr>
<td>Medium Term</td>
<td>2</td>
<td>17%</td>
</tr>
<tr>
<td>Short Term</td>
<td>1</td>
<td>8%</td>
</tr>
</tbody>
</table>

Total Respondents 12

18. From your investment experience, do stocks with high corporate governance outperform stocks peers with lower corporate governance?

<table>
<thead>
<tr>
<th>Response</th>
<th>Total</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>7</td>
<td>58%</td>
</tr>
<tr>
<td>No</td>
<td>5</td>
<td>42%</td>
</tr>
</tbody>
</table>

Total Respondents 12

19. What are the sources of information from which you evaluate corporate governance level of a company?

<table>
<thead>
<tr>
<th>Source</th>
<th>Total</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>In house</td>
<td>2</td>
<td>17%</td>
</tr>
<tr>
<td>Public reports</td>
<td>1</td>
<td>8%</td>
</tr>
<tr>
<td>Professional reports</td>
<td>9</td>
<td>75%</td>
</tr>
</tbody>
</table>

Total Respondents 12

20. In your view, Which business sector in South Africa has the highest level of corporate governance?

View responses to this question

Total Respondents 12
21. a) Does the market pay premium for well governed companies relative to industry peers, given all other factors constant?

<table>
<thead>
<tr>
<th>Response</th>
<th>Total</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>7</td>
<td>58%</td>
</tr>
<tr>
<td>No</td>
<td>5</td>
<td>42%</td>
</tr>
</tbody>
</table>

Total Respondents: 12

22. b) What is this aggregate premium:

<table>
<thead>
<tr>
<th>Response</th>
<th>Total</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;2%</td>
<td>6</td>
<td>50%</td>
</tr>
<tr>
<td>2-5%</td>
<td>3</td>
<td>25%</td>
</tr>
<tr>
<td>5-10%</td>
<td>2</td>
<td>17%</td>
</tr>
<tr>
<td>&gt;10%</td>
<td>1</td>
<td>8%</td>
</tr>
</tbody>
</table>

Total Respondents: 12

23. Do you notice companies with high levels of governance to be either a:

<table>
<thead>
<tr>
<th>Response</th>
<th>Total</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Growth Stock</td>
<td>5</td>
<td>42%</td>
</tr>
<tr>
<td>Value Stock</td>
<td>7</td>
<td>58%</td>
</tr>
</tbody>
</table>

Total Respondents: 12

24. Board Representation- Representatives of your institution:

<table>
<thead>
<tr>
<th>Response</th>
<th>Total</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>3</td>
<td>25%</td>
</tr>
<tr>
<td>No</td>
<td>9</td>
<td>75%</td>
</tr>
</tbody>
</table>

Total Respondents: 12

25. Board Representation- Representatives of your institution:

<table>
<thead>
<tr>
<th>Response</th>
<th>Total</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;5%</td>
<td>9</td>
<td>75%</td>
</tr>
<tr>
<td>5-10%</td>
<td>1</td>
<td>8%</td>
</tr>
<tr>
<td>10-15%</td>
<td>1</td>
<td>8%</td>
</tr>
<tr>
<td>15-20%</td>
<td>0</td>
<td>0%</td>
</tr>
<tr>
<td>&gt;20%</td>
<td>1</td>
<td>8%</td>
</tr>
</tbody>
</table>

Total Respondents: 12

26. What are cost categories associated with exercising of your voting rights? (select applicable)

<table>
<thead>
<tr>
<th>Response</th>
<th>Total</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Analysing proxy statements</td>
<td>9</td>
<td>75%</td>
</tr>
<tr>
<td>Sending to oversight boards</td>
<td>4</td>
<td>33%</td>
</tr>
</tbody>
</table>
for evaluation

<table>
<thead>
<tr>
<th>Service</th>
<th>Total</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hiring external advisor</td>
<td>3</td>
<td>25%</td>
</tr>
<tr>
<td>Legal fees</td>
<td>3</td>
<td>25%</td>
</tr>
<tr>
<td>Time cost of senior management</td>
<td>7</td>
<td>58%</td>
</tr>
</tbody>
</table>

Total Respondents 12

27. How often does your institution meet with the senior management of the companies you invest in?

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Total</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Once a quarter</td>
<td>5</td>
<td>42%</td>
</tr>
<tr>
<td>Once a year</td>
<td>3</td>
<td>25%</td>
</tr>
<tr>
<td>Once in two years</td>
<td>0</td>
<td>0%</td>
</tr>
<tr>
<td>&lt; once in two years</td>
<td>0</td>
<td>0%</td>
</tr>
<tr>
<td>Not at all</td>
<td>4</td>
<td>33%</td>
</tr>
</tbody>
</table>

Total Respondents 12

28. In how many cases have you decided to disinvest (significantly) in a portfolio company?

<table>
<thead>
<tr>
<th>Number of Cases</th>
<th>Total</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>3</td>
<td>25%</td>
</tr>
<tr>
<td>0-5</td>
<td>6</td>
<td>50%</td>
</tr>
<tr>
<td>5-10</td>
<td>1</td>
<td>8%</td>
</tr>
<tr>
<td>&gt;10</td>
<td>2</td>
<td>17%</td>
</tr>
</tbody>
</table>

Total Respondents 12

29. What are the principal factors that may lead you to disinvest (significantly) your stakes in a portfolio company?

<table>
<thead>
<tr>
<th>Factor</th>
<th>Total</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poor return performance</td>
<td>7</td>
<td>58%</td>
</tr>
<tr>
<td>Have achieved benchmark returns significantly</td>
<td>5</td>
<td>42%</td>
</tr>
<tr>
<td>Belief that the company’s share price is overvalued</td>
<td>7</td>
<td>58%</td>
</tr>
<tr>
<td>Belief that company share price will worsen due to deteriorating corporate governance</td>
<td>5</td>
<td>42%</td>
</tr>
<tr>
<td>Turn around growth in other industries – better opportunity</td>
<td>6</td>
<td>50%</td>
</tr>
<tr>
<td>Unsatisfactory disclosure practices</td>
<td>5</td>
<td>42%</td>
</tr>
<tr>
<td>Sub optimal board composition</td>
<td>1</td>
<td>8%</td>
</tr>
</tbody>
</table>

Total Respondents 12
### Factors

<table>
<thead>
<tr>
<th>Factors</th>
<th>Average Score (5 = very important)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A: Quality of Independent Non Executive Directors</strong></td>
<td></td>
</tr>
<tr>
<td>Independence of IND's</td>
<td>4,41</td>
</tr>
<tr>
<td>Reasons for resignation of independent non executives should be disclosed</td>
<td>3,92</td>
</tr>
<tr>
<td>Majority of independent non executive directors should have an understanding of finance and accounting</td>
<td>4,08</td>
</tr>
<tr>
<td>Independent non executives to be appointed by the nomination committee</td>
<td>3,92</td>
</tr>
<tr>
<td>Majority of independent non executive directors should have experience in the industry of more than 10 years</td>
<td>4,17</td>
</tr>
<tr>
<td><strong>B: Board Structure, Ownership and Practices</strong></td>
<td></td>
</tr>
<tr>
<td>Existence of nomination committee</td>
<td>3,50</td>
</tr>
<tr>
<td>Chairman of the board cannot occupy a position as CEO or managing director</td>
<td>4,50</td>
</tr>
<tr>
<td>Board composition i.e. Percentage of independent non executive directors on the Board</td>
<td>4,08</td>
</tr>
<tr>
<td>Experience of Board members</td>
<td>4,58</td>
</tr>
<tr>
<td>Quality of Management</td>
<td>4,67</td>
</tr>
<tr>
<td>Directors share ownership</td>
<td>4,17</td>
</tr>
<tr>
<td>Independence of independent non executive directors</td>
<td>4,08</td>
</tr>
<tr>
<td>Existence of Remuneration committee</td>
<td>3,92</td>
</tr>
<tr>
<td>CEO domination in the firm</td>
<td>3,75</td>
</tr>
<tr>
<td>Controlling Shareholder</td>
<td>3,58</td>
</tr>
<tr>
<td>Existence of audit committee</td>
<td>4,17</td>
</tr>
<tr>
<td>Family ownership and influence</td>
<td>3,58</td>
</tr>
<tr>
<td><strong>C: Annual report disclosures</strong></td>
<td></td>
</tr>
<tr>
<td>Content of Financial statements and notes</td>
<td>4,58</td>
</tr>
<tr>
<td>Timeliness of Annual Reports</td>
<td>4,33</td>
</tr>
<tr>
<td>Auditors Report</td>
<td>4,58</td>
</tr>
<tr>
<td>A statement of responsibility issued by directors relating to the content of the annual report</td>
<td>4,17</td>
</tr>
<tr>
<td>Disclosure of directors’ benefits derived from exercising share options and/or warrants</td>
<td>4,42</td>
</tr>
<tr>
<td>More disclosure on directors’ dealings with related parties</td>
<td>4,50</td>
</tr>
<tr>
<td>A corporate governance report in the annual report</td>
<td>4,42</td>
</tr>
<tr>
<td>Statement of business risk i.e. stating forex exposure</td>
<td>4,18</td>
</tr>
<tr>
<td><strong>D: Investor Protection</strong></td>
<td></td>
</tr>
<tr>
<td>Level of communication between Institutional Investor and Investee Company</td>
<td>4,83</td>
</tr>
<tr>
<td>Equal dissemination of information among analysts and other investors</td>
<td>4,33</td>
</tr>
<tr>
<td>Class actions against companies</td>
<td>4,08</td>
</tr>
<tr>
<td>One share one vote principle</td>
<td>4,08</td>
</tr>
<tr>
<td>Institutional investors should have nominee directors on boards of investee companies</td>
<td>3,41</td>
</tr>
</tbody>
</table>