Corporate Control and its effect on Company Performance

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CONTENTS

DIAGRAMS AND CHARTS

Abstract

This study investigates the effects that various ownership structures have on company performance. It is assumed that the ownership structure of the firm dictates the manner in which the firm monitors its managers. It is further assumed that the objective of the firm is to maximise shareholder wealth. The study therefore analyses which ownership structure provides shareholders with the greatest returns. Such a system would add the most to an economy's efficiency. It was concluded that of the three systems identified, not one system provided shareholders with a return significantly different from the others.

The study added to the current South African debate as to whether or not the concentration of economic power detracts from the country's economic efficiency.

Statistical evidence proves that companies owned by any of the large South African groupings are no less productive than companies otherwise owned.

Notice

It is to be noted by the reader that the majority of the work on this thesis was concluded in 1996. As the market that it sets out to analyse is dynamic, there may be facts in the thesis that apply to 1996, and are no longer necessarily valid.

Introduction

A number of studies both internationally such as Shome and Singh, 1995, McConnel and Servaes, 1990 and Sheehan and Holderness, 1988, also locally Day and Uliana, 1990 and Cohen and Uliana, 1990, have attempted to prove that the ownership structure of a firm affects the firm's performance. This study strives to take those conclusions a step further. It suggests a reason, while analysing managerial monitoring systems, why the ownership structure of a firm should indeed influence the firm's performance.

The modern corporation has allowed for the evolution of professional managers (Berle and Means, 1932). These managers are said to be self-maximising individuals, who are more often motivated by power and control rather than maximising stockholder investments (Jensen and Meckling, 1976). It is the potential of this managerial class to divert the organisation's resources into sub-optimum investments which necessitates the formation of monitoring systems (Jensen and Meckling, 1976). The monitoring system that is best able to prevent managerial incompetencies, will provide a particular company with its most efficient workings and enhance shareholder wealth to its maximum (Hill and Jones, 1992) (Hart, 1995) (Jensen and Meckling, 1976). Thus, the need for efficient managerial monitoring is paramount; on a micro level for any company to reach its most profitable point and on a macro level for a country as a whole to be efficient.

This study equates different ownership structures with different managerial monitoring systems and attempts to identify the differences between the various systems. The study reviews corporate ownership and identifies the effect various ownership patterns have on company performance. It is assumed that a particular ownership structure dictates the method through which managers are monitored and as such the study attempts to highlight which ownership structure best monitors the agent/principle relationship. The various monitoring systems will be compared against their ability to produce shareholder returns. The return to shareholder measure is therefore used as a yardstick by which to determine the success of a particular system. In order to determine which monitoring system provides the best shareholder returns, the measures will be tested statistically, thus ensuring that hard statistical evidence supports the accompanying financial theory.

Background

The growth of the modern corporation and its resulting separation of ownership and control, has given rise to professional managers who run the organisation on behalf of the owners (Berle and Means, 1932). It was the sheer size of the modern company that made it a very difficult organisation to manage (Berle and Means, 1932). Owners were therefore obliged to hire professionals to assist them in managing their companies (Berle and Means, 1932). An agent-principal relationship developed between the shareholders and managers (Jensen and Meckling, 1976).

The principals (shareholders) who owned the company, engaged the services of agents (professional managers) to perform on their behalf. This relationship facilitated the delegation of certain decision-making authority from the owners to the agent (Jensen and Meckling, 1976) (Fama, 1980). Managers were placed in a position where potential existed for them to maximise their own welfare at the expense of their principals (Ross, 1973). As Jensen and Meckling (1976, pp85) stated :

If both parties to the relationship (share-holder/manager) are utility maximisers there is good reason to believe that the agent will not always act in the best interests of the principal.

In order for any organisation to run effectively, it became paramount that the agent-principal relationship was carefully monitored (Jensen and Meckling, 1976) (Fama and Jensen, 1983b) (Fama and Jensen, 1983a) (Jensen, 1989). However, as companies grew larger and their shareholdings dispersed further, the incentive for shareholders to monitor management diminished (Shleifer and Vishny, 1986). Monitoring is a public good: if one shareholder's improved monitoring leads to improved company performance, all shareholders benefit (Hart, 1995). Therefore, given that monitoring is costly, each shareholder will free-ride in the hope that other shareholders will do the monitoring (Hart, 1995). Unfortunately, most shareholders think the same and the possibility exists that little monitoring will take place (Hart, 1995).

The inability to monitor management effectively leads to a loss of efficiency in a company and a resulting loss in wealth to shareholders (Hill and Jones, 1992). Shareholders expecting to make the maximum return on their investment must ensure that managerial behaviour is kept in check, or else risk losing out to managerial excesses (Hill

and Jones, 1992). It is therefore the shareholders who are charged with this responsibility of monitoring management (Alchian and Demsetz, 1972) (Jensen and Meckling 1976) (Manne, 1965). The challenge for shareholders is to devise monitoring systems that can operate cheaply and effectively while achieving the desired effect of disciplining management and ensuring that wealth losses are kept to a minimum.

The agent/principle characteristic of the modern corporation has allowed modern companies the opportunity of operating at less than their full potential. This is due to the fact that managers (agents) have the potential to redirect company resources into less optimal projects. The problem for shareholders is therefore to develop methods to ensure that their companies are being run at the most efficient level possible. It is this problem and the various methods that have developed to counter-act this problem, which this thesis intends to address.

Over time different shareholding structures have developed, each with its own unique manner of keeping managers in check. Various shareholding structures monitor managers in various ways (Fama and Jensen, 1983a). For example, in companies that are owned by a few significant shareholders,[1] it is to be expected that the shareholders themselves will monitor management. Significant shareholders are expected to take an active interest in monitoring managers. These investors with large investment stakes are not likely to shirk their duty of monitoring management, as the costs associated with the shirking are simply too high (Demsetz and Lehn, 1985). The free-rider[2] problem, which is best evident in a company with a wide dispersion of shareholders and no significant owners, is therefore not as prevalent in companies with a few significant shareholders.

Companies with widely dispersed shareholder structures can not rely on shareholders to monitor managers. These companies are forced to rely on the efficient workings of the capital market to ensure that their managers are monitored (Fama, 1980). Managers are monitored through professional consortiums that attempt to identify poor management and buy out such companies at low prices, in the process replacing poor management teams (Smith and Jensen, 1985). This type of monitoring system was prevalent in the USA in the early eighties, when groups and individuals that later became known as "corporate raiders" bought out poorly managed companies and replaced their management (Pound, 1992) (Jensen, 1987). "Take-over specialists" or "raiders" such as Icahn, Posner, Steinberg and Pickens were at the forefront of the drive to force managers to behave efficiently or else risk losing their jobs (Jensen, 1987).

[1] Investors that have invested large amounts of their own personal wealth into a company and own a substantial percentage of the company

[2] The shirking of managerial monitoring associated with firms of diffuse ownership (Demsetz and Lehn, 1985)

The capital market not only provides the conduit for "raiders" to evaluate companies, through share prices, but also an effective avenue through which to purchase company stock (Fama and Jensen, 1983a) (Manne, 1965). This system of managerial monitoring relies on efficient capital markets and a number of "potential raiders" that are prepared to purchase stock which they believe to be underpriced. The threat of take-overs prevents managers from running companies poorly, as incumbent managers realise mismanagement will result in their dismissals (Jensen and Ruback, 1983)(Jensen, 1987). The system does however allow ordinary minority shareholders to free-ride on the workings of an efficient capital market (Fama and Jensen, 1983a).

A third system of managerial monitoring relies on large groupings, either institutional or corporate, to ensure that the managers are properly monitored. These large groupings rely on an internal system of managerial monitoring to ensure that the managers do not underperform.

Gerson (1992) identified three models through which corporations are controlled by their shareholders and managers. Each model relies on a defined shareholding structure in order to monitor effectively and it is this link between managerial monitoring and shareholding structures that this thesis will explore. The three models closely resemble the three structures defined above and are listed below.

Model 1: A system in which not only the percentage claim to dividends but also the shareholder's voting rights of the corporations are diffusely distributed. This system is effectively built on the premise of one-share-one-vote. In such an environment free-riding among shareholders is likely to be endemic and it is to be expected that this system will demonstrate very low voter participation rates at shareholder meetings. Managers are disciplined in such a system through the threats of hostile take-overs.

Model 2: This system is characterised by the absolute majority of the effective shareholder voting rights being held by a single family (usually the founding entrepreneur's family) or some other stable, identifiable coalition. However, the coalition's percentage claim to dividends in the companies that it controls is not necessarily equivalent to its voting rights. Indeed, this system permits coalitions (via the issue of dual class shares or the formation of pyramid companies) to maintain voting control while giving up control over the dividend flows of the company. Since the coalition has effective control over the company, the threat of hostile take-overs, which was evidenced in Model 1 as a disciplining source for managers, is not available. Senior managers are directly accountable to the owners and have very limited power. The controlling shareholders discipline the managers and ensure that they perform.

Model 3: In this system control of the corporations reside in the hands of large financial or corporate institutions. It is not unusual to witness corporations being controlled by a consortium of institutions. The management of the operating companies is held accountable to the large institutions or groups. It is [illegible] which ensure that the managers are kept in check and that the operating companies perform adequately.

Gerson (1992) stated that although each country has its own unique set of features that characterise its system of corporate governance, these three models represent the broad outline of any governance system. This thesis will deal with each of the stated models and their ability to monitor managers in a South African setting. It is therefore necessary to gain an understanding of the South African (S.A.) economy and the monitoring systems that have evolved in the country.

The South African economy is currently dominated by corporate groupings. These groupings, which are vast and diverse in size, control close to 80% of the market capitalisation of the Johannesburg Stock Exchange (JSE) (Gerson, 1992) (Savage, 1987). Examples of such groupings include the Anglo American Corporation and the Rembrandt group. The question facing South African shareholders is whether these group structures present the most effective manner of monitoring managers or whether an alternative corporate structure provides a better monitor for management.

The African National Congress (ANC) has spoken strongly against the corporate groupings (ANC policy guidelines, 1992). It is their opinion that the groupings have been detrimental to the balanced development of the economy. It is their intention to limit the power of the large South African (S.A.) groups via the implementation of anti-trust and anti-merger regulations. The ANC is under the impression that such policies would lead to greater efficiency in the private sector (ANC policy guidelines, 1992).

The theory of managerialism would tend to support the ANC viewpoint. The theory suggests that managers attempt to maximise asset and company size instead of shareholder wealth (Fox and Hamilton, 1994). Proponents of this theory therefore believe that the corporate groupings are merely manifestations of powerful management and do not actually add wealth to the shareholders (Fox and Hamilton, 1994). Thus it is believed that the groupings are indeed formed out of management's desire to ensure their own job security rather than through the need for effective managerial monitoring.

The objective of this thesis is to analyse the manner in which managers are monitored[3] in the South African context. Specific attention will be paid to the large South African

[3] The term monitoring includes more than just measuring or observing managers. It includes efforts on the part of the shareholders to control the behaviour of the managers.

corporate groupings and the methods that these groupings utilise to monitor their managers. The thesis will attempt to define the monitoring structure which best monitors managers. The findings of this research will contribute towards the debate as to whether or not large South African corporate groupings are efficient in creating shareholder value. It is also intended that the findings should add a South African focus to the agency theory of finance.

This thesis is divided into six sections:

Section 1 places the study in relation to agency theory and the evolution of the agent-principle literature.

Section 2 discusses the various systems available to monitor managers.

Section 3 is a brief account of the evolution of the South African corporate groupings.

Section 4 is an analysis of the methodology of the study.

Section 5 presents the results and conclusion of the study as well as a number of areas for future research.

The overall conclusion of the study is presented in Section 6.

Section I

Development of the firm and the Agency Theory

Introduction

This section first sets out the historical evolution of the firm; it then defines the firm and lastly presents the arguments surrounding the agency theory. The section introduces the essential problem with which this thesis is concerned; namely: that the development of the modern corporation has facilitated a managerial class that, if maximum efficiency is to be obtained, must be properly monitored. It is this necessity to monitor managers and the reasons behind the monitoring that this first section intends to set out.

1.1) The Firm (modern corporation)

The first developments of the corporation can be traced back to the Roman Empire. The idea of the corporation was slow to grow and developed out of public necessity (Kempin & Wiesen, 1983). Associations of individuals of the same trade or crafts developed. These colleges, as they were referred to, had no rights or ownership as a group. Whatever property such a college possessed, was purely private property (Kempin & Wiesen, 1983). It was only by sovereign power, the state, that corporations could be created (Kempin & Wiesen, 1983). These corporations were then allowed to develop their own legal personality, separate from their members. The Governments of the day were restrictive in their granting of corporate charters and it was usually only the very wealthy – those who could afford to bribe state officials - who could expect to gain corporate charters (Kempin & Wiesen, 1983).

The growth of the modern corporation was the result of industrial and manufacturing concerns growing at such a rate that individual fortunes were no longer adequate to finance such enterprises (Solomon, Stevenson and Schwartz, 1987). The industrial revolution of the eighteenth century placed unprecedented levels of demand on capital investment and manpower. The result was the early development of the modern economic organisation known as the firm (Berle and Meane 1932). The firm received further momentum in its development after the Second World War when, once again, vast demands were placed on industry to produce (Jassim, Dexter and Sidhu, 1988).

The modern firm has allowed resource owners the opportunity to increase productivity through co-operative specialisation (Fama and Jensen, 1983b) (Smith and Jensen, 1985). It was this aspect of the firm that allowed owners to hire managers to run their companies for them (Alchain & Demsetz, 1972). The large size of the firm and the demands it made

on an individual's capital, led to ownership patterns developing which encouraged the separation of ownership and control (Berle and Meane, 1932). The modern firm differs therefore from most other business entities in its ability to allow for this risk specialisation. Owners of the firm do not [illegible] while managers do not need to own the firm (Alchian and Demsetz, 1972) (Fama and Jensen, 1983a).

The modern corporation thus evolved from its early form as an ad-hoc organisation that was as much a vehicle for conferring monopoly privileges on a small group as it was a legal form for conducting business, into a distinctive entity, legally available to all (Solomon, Stevenson and Schwartz, 1987). The development of the corporation has marked capitalist society and allowed for an efficient business form to manage the factors of production (Alchain & Demsetz, 1972).

A distinctive set of financial literature has evolved from the development of the firm. This literature, known collectively as the theory of the firm, defines the modern corporation and its objectives. The following section serves as an overview of the developments in this sphere of financial literature.

1.2) Theory of the firm

Early work on the theory of the firm was conducted by Knight (1923) and later advanced by Coase (1937). The firm was viewed as the exception in a system governed overall by the workings of the price mechanism. The main motivation for establishing a firm was that it avoided the costs associated with the use of the price mechanism. The work of both Knight and Coase saw the entrepreneur as the sole risk-taker and controller of the firm. It was, however, Coase who pointed out that a professional management class may exist, and that this class would be responsible for co-ordinating the activities delegated to them.

Berle and Means (1932) highlighted the evolution of the corporation as the reason for owners no longer being in control of their firms. They argued that large companies had come to lack the centre of ownership necessary to ensure control for their owners. Ownership of wealth without appreciable control and control of wealth without appreciable ownership appear to be the logical outcome of corporate development (Berle and Means, 1932, pp 66). Thus the shift of ownership of companies from the individual or entrepreneur to shareholders has led to the emergence of professional managers.

Nearly forty years after the work of Coase (1937), Alchian and Demsetz (1972) advanced the theory of the firm. Alchian and Demsetz (1972) defined the firm as a policing device

utilised when joint team production was present. It was the ability of the firm to monitor and discipline team members that was seen as the main reason for establishing firms. Alchian and Demsetz (1972) objected to the notion that activities within the firm were governed by authority as first defined by Coase (1937). They emphasised the role of contracts as vehicles for voluntary exchange within the context of the firm.
Jensen and Meckling's seminal paper of 1976 was the first exhibition of the modern agency theorem. In their paper (Jensen and Meckling, 1976, pp85) they defined the private corporation as a:

Legal fiction which serves as a nexus for contracting relationships and which is also characterised by the existence of divisible residual claims on the assets and cash flows of the organisation which can generally be sold without permission of the other contracting individuals.

Jensen and Meckling viewed contractual relations as the essence of the firm. It was this multitude of complex relationships (contracts) between the firm and the owners of labour, material, capital inputs and the consumers' output that defined the firm. To enquire whether the firm had a social responsibility or what its objectives were, was totally misleading. Jensen and Meckling believed that the personalization of the firm was wrong. Firms were merely legal fictions that served as a focus for a complex process in which conflicting objectives were brought into equilibrium. In this sense, the behaviour of the firm is similar to that of the market; i.e. the outcome of a complex equilibrium process. (Jensen & Meckling, 1976).

The contractual view of the firm highlights the numerous parties and intricate contracts from which a firm is established. The firm may be viewed as a focal point around which various parties contract to ensure their own position is maximised (Jensen and Meckilng, 1976). Owners contract with managers in order to reap the benefits associated with the dispersion of ownership and control (Jensen and Meckling, 1976) (Fama and Jensen, 1983a). It is implied that the managers have a responsibility to ensure that the welfare of the owners is maximised. If this were not the case, owners would not contract with managers and either run the firm themselves or invest in management teams that would maximise their welfare (Fama & Jensen, 1983a).

1.3) Agency Theory

Agency theory, which is a sub-set of the literature on the theory of the firm, attempts to gain an understanding into the contracts around which the firm is established (Jensen and Meckling, 1976). Agency theory makes specific attempts to understand the workings of the manager-shareholder relationship. It is this agent-principle relationship which is fundamental to this research and from which the related hypotheses are developed.

Narrowly defined, an agency relationship is a contract in which one or more persons (principal(s)) engage another person (agent) to take actions on their (principals) behalf which involves the delegation of some decision making authority to the agent.

(Smith and Jensen, 1985, p96)

The emergence of the modern corporation and with it the evolvement of a professional class of managers, resulted in conflicts developing between owners and managers. In simplistic terms, agency theory suggests that management are likely to act in their own interests rather than in the interests of the shareholders (Uliana, 1989) (Hill and Jones, 1992).

Shareholders delegate authority to professional managers (Barnea, Haligan & Senbert, 1993) (Smith and Jensen, 1985). The delegation of decision-making authority may give rise to conflicts of interest between agents (managers) and principals (shareholders). The central assumption surrounding agency theory is that individuals choose actions that maximise their own personal welfare (Jensen and Meckling, 1976) (Barnea, Haligan & Senbert, 1993). As Adam Smith noted over 200 years ago:

The directors of companies (joint-stock), however, being the managers rather of other people's money than their own it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master's honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company.

Wealth of Nations, 1776, p700

Therefore, unless shareholders can ensure that their welfare is directly linked to the welfare of the managers, one can expect managers to make decisions which would not directly benefit shareholders, but rather themselves (Barnea, Haligan & Senbert, 1993).

The conflict which exists between managers and owners can be ascribed to three main factors (Jensen and Smith, 1985) :

- **Choice of Effort**: An increase of effort on the part of the manager would normally increase the value of the firm. The increased effort represents a cost to the manager in its demand on his human capital. Therefore, shareholders would require the manager to exert as much effort as possible in the performance of his duties, whereas managers would opt to perform their tasks with the bare minimum of effort. The less effort exerted by management, the greater managers can save in respect of their human capital expenses.

- **Differential Risk Exposure**: Managers have a significant investment in the firm in terms of their human capital. Shareholders, on the other hand, usually have diversified portfolios with only a limited portion of their wealth invested in any one firm. Managers are therefore exposed to total risk, whereas shareholders are exposed only to market, or portfolio, risk.

- **Differential Time Horizons**: The manager's interest in the firm is limited to his period with the firm. The shareholders interest is indefinite, since the benefits accruing beyond his time horizon, after he has sold his shares, will be of interest to the acquiring shareholder and so reflected in the price at which the shares are traded.

It is virtually impossible for the principal or the agent, at zero cost, to ensure that the agent makes the optimal decisions from the principal's viewpoint. Jensen and Meckling (1976) defined agency costs of comprising three distinct components :

a) Monitoring expenditures by the principal
b) Bonding expenditure by the agent
c) The residual loss

The sum of these three components is equal to the total agency cost. Agency costs arise because contracts are not costlessly written (Fama and Jensen, 1983a).

It is through close monitoring and the development of appropriate incentive measures that shareholders can attempt to limit divergences from their interest by managers. The costs associated with this monitoring are referred to as monitoring costs (Fama and Jensen, 1983a) (Fama, 1980) (Smith and Jensen, 1985). In addition, in some situations it may be

favourable to managers to expend resources (bonding costs) to guarantee that they will not take certain actions which could harm the shareholders (Fama and Jensen, 1983a). In most agency relationships the principal and the agent will incur positive monitoring and bonding costs and in addition there will be some divergence between the agent's decisions and those decisions which would maximise the shareholders wealth. The loss in welfare experienced by the principal as a result of a divergence in optimal decisions between himself and the agent is referred to as the "residual loss" (Jensen & Meckling, 1976).

The agency cost literature deals with the conflicts between agents and principals. The manager, as a fundamentally self interested corporate stakeholder and one capable of taking actions or exploiting information hidden from shareholders, cannot always be relied upon to act in the best interests of the company's owners (Jensen and Meckling, 1976). Recognising this possibility, rational shareholders are induced to develop appropriate incentives and safeguards to prevent self interested opportunism by managers. The cost of designing and running these systems and the shareholders value lost due to the private consumption of corporate wealth by managers, are the "agency costs" borne by the shareholders (Kester, 1993).

It is these "agency costs" and the methods that have evolved to limit them, that this thesis tends to analyse. The key to understanding the agency problem is the recognition that the parties to a contract bear the agency costs of the relationship (Smith and Jensen 1985).

1.4) Separation of Ownership and Control

If a firm is owned and managed by the same person, the individual will make decisions relating to the firm which maximise his utility. These decisions involve both pecuniary and non-pecuniary benefits. The optimum mix of pecuniary and non-pecuniary benefits is achieved when the marginal utility derived from both benefits is equal. In such a situation both benefits would weigh equally with the owner (Jensen & Meckling, 1976) (Fama, 1980).

If the owner-manager sells equity claims, agency costs will be generated by the divergence between his interests and those of the outside shareholders, since he will bear only a fraction of the costs of any non-pecuniary reward he takes in maximising his own utility (Jensen and Meckling, 1976).

1.4.1) Disadvantages:

The disadvantage [illegible] is the greater incentive for owners to shirk their responsibility. The benefit derived by the owner from shirking is his ability to use his time and ability on other tasks and indulgences. This benefit accrues entirely to him (Demsetz and Lehn, 1985). The cost of his shirking - presumably the poorer performance of the firm - is shared by all the stockholders in proportion to their percentage ownership. The more concentrated the ownership, the greater the degree to which costs and benefits are borne by the same owner, the less it would be favourable for the owner to shirk, as he is now losing potentially more of his own wealth (Demsetz and Lehn, 1985). The shirking associated with diffuse ownership is known as the free-rider problem. An example is given by Cheung (1985) of a large group of workers who owned a river boat in China. The owners agreed to hire a monitor to whip them. The reason was that in this way the owners ensured that none of them would shirk their responsibility. This example illustrates quite dramatically the disadvantages of diffuse ownership. Clearly, in today's modern world we would not expect owners to hire whippers to ensure that they maintained their responsibilities. However, methods have evolved to ensure that even managers in diffusely owned corporations are monitored. These will be discussed in detail later.

Jensen and Meckling (1976) postulated that prospective minority shareholders would realise that the owner-manager interests would diverge from theirs. Efficient capital markets would therefore price companies so as to reflect the monitoring costs and the effect of the divergence between manager interests and those of prospective owners. Following Jensen and Meckling's argument, the market discounts companies with divergent shareholding structures in order to account for the extra costs shareholders must pay to ensure managers perform (Jensen & Meckling 1976). Their argument was further substantiated by a study conducted by Holderness and Sheehan (1988). Holderness and Sheehan (1988) found that stock prices reacted positively with announcements of trades resulting in majority shareholders. They concluded that major shareholding blocks were formed in order to achieve better monitoring over managers and the market rewarded such moves with an increase in the underlying share price (Holderness and Sheehan, 1988).

The previous section on the development of the firm and the intricacies associated with the establishment of shareholder manager contracts, has highlighted the problems for owners (shareholders). Given these inefficiencies, the question may be asked as to the reason for the existence of the modern corporation. Demsetz and Lehn (1985) argued that given a rational world, there must be advantages to counterbalance the disadvantages associated with the firm, or else no firms would exist. Fama and Jensen (1983b) argued that all forms of organisations competed against each other in their ability to deliver products demanded by consumers at the lowest price, while covering costs. Under general conditions, therefore, the type of organisation which survived was efficient in its

utilisation of resources. The firm's survival is therefore testament to its ability, even with its disadvantages, to produce efficiently (Smith and Jensen, 1985) (Fama 1980).

1.4.2) Advantages:

The modern firm and its ability to allow for the separation of decision making from the residual claims (ownership from control), has allowed residual claimants (those who have the right to the net cash flows of the organisation) to take no active role in the organisation (Fama & Jensen, 1983b). The residual claims of firms are said to be free and unrestricted, in the sense that :

1) Stockholders are not required to have any other role in the organisation
2) The residual claims are freely transferable
3) The residual claims are rights in net cash flows for the life of the organisation (Fama and Jensen, 1983b)

This gives rise to certain advantages:

- **Restricted Risk Sharing**

Each shareholder is able to decide the extent to which he wishes to bear risk. Since his shares are freely tradable, he can diversify his risk across a portfolio of organisations. This lowers the risk of the individual shareholder, as instead of investing in only one organisation, he now has a whole spectrum, as large as the market, in which he is able to invest. The lower risk which shareholders face as a result of being able to diversify, lowers the cost of capital for companies. A company's capital is priced only according to its market risk and not its total risk. Therefore the benefits of diversification, felt by the shareholders, is passed on to the firm. Concentrating risk on a specific group of claimants can create efficiencies by substantially reducing the duplication of information costs incurred by other contracting parties.
(Fama & Jensen 1983a) (Smith and Jensen, 1985) (Jensen & Meckling, 1976)

- **Specialisation of Management**

Investors, people with capital willing to bear risk, are not necessarily competent managers, whereas competent managers do not necessarily have the funds available to start and finance their own enterprises . The combination of the two parties are essential in creating a successful firm. Through the separation of ownership and control, skilled managers may be acquired with the necessary talents to co-ordinate and run a

complex organisation. Investors, therefore, have avenues to hire managers, whereas managers have opportunities to engage investors to finance their projects.
(Fama & Jensen, 1983b) (Uliana, 1989) (Demsetz and Lehn, 1985)

- **Economies of Scale**

The capital required to take advantage of economies of scale may be too large for one individual, or small group of individuals. It may be more efficient to have a large number of residual claimants investing in large firms. When the size of the risk to be born is large, it is advantageous to have a number of residual claimants among whom the risk is spread (Smith and Jensen, 1985).

The stated advantages are not exhaustive and a number of other advantages exist in separating ownership and control (Smith and Jensen, 1985) (Uliana, 1989) (Jensen and Meckling, 1976) (Fama and Jensen, 1983a). In order for there to be a truly advantageous shareholder/manager relationship, it is imperative that the advantages associated with the separation of ownership and control outweigh the costs of maintaining the agency relationship (Alchian and Demsetz, 1972).

Conclusion

This historic perspective of the firm and the theory associated with the development of the firm, highlights the advantages of the modern corporation and the reasons for its evolution. The firm was seen as an efficient form of business ownership which allowed owners of limited sources of capital the ability to extend their operations without necessarily increasing their own capital contributions.

Along with its unquestionable advantages, the development of the modern corporation has provided a number of disadvantages. Perhaps the greatest disadvantage and one that directly prevents the corporation, as a business entity, from realising its goal of producing efficiently, is the ability for the managerial class to exploit resources for their own benefit rather than for the corporation's.

It is this very ability of managers to detract from the efficiency of the firm and the methods and structures that have evolved to prevent such exploitation, that this thesis analyses. Managerial excesses manifest themselves in a number of ways: unusually high salary payments, excessive perquisites, incorrect business decisions, such as buying of game parks or the sponsoring of golf days.

The following section deals with the forces that place pressure on managers to perform efficiently and the managerial monitoring systems that have evolved.

Section II

Forces that Monitor Managers.

Introduction

This section identifies the various methods that shareholders have at their disposal to monitor the agency relationship between themselves and their managers. There are occasions when the organisation of the relationship between managers and owners, no matter how well planned, breaks down. It is at these times when the forces that exert pressure on managers come into play. This section focuses on the forces which place pressure on management to perform efficiently and the managerial monitoring systems that have developed as a result of these forces.

The four basic control forces as illustrated by Jensen (1994) are: the legal, political and regulatory system; the product and factor markets; the capital market and the internal control system of the company.

The four forces defined by Jensen (1994) combine to discipline managers and ensure they perform to the best of their capabilities. The threat to managers is the potential that they might lose their jobs (Hill and Jones, 1992). This threat stems from the large amounts of human capital managers invest in an organisation. The greater the amount of human capital invested by management into an organisation, the stronger is the potential threat to the manager of losing his job. Managers are therefore driven to perform in order to maintain their employment. Managers realise that the loss of their job has an effect on their ability to earn in the future (Fama, 1980). Therefore, even if managers were not satisfied with their current positions, the negative effects of dismissal would still ensure that managers perform to the best of their abilities until their work contracts have expired. In the managerial field reputation is very important. Therefore a dismissal and the resulting damage it causes a manager's reputation, can have a devastating effect on a manager's potential to earn in the future (Dickerson, Gibson and Tsakalatos, 1995).

The forces stated by Jensen (1994) exert pressure on managers. The pressure originates from the force's potential to dismiss management from their employment (Fama, 1980). It is the intention of this thesis to discuss methods available to shareholders to monitor managers; as such, each potential force is viewed within the context of its availability to the shareholders.

2.1) Legal, political and regulatory system

In certain instances the state's ability to intervene in managing the corporation acts as a mechanism to ensure that firms run efficiently and managers are kept in check. This legal or state system of monitoring managerial behaviour is particularly strong in state owned enterprises, where mismanagement will lead to laws passed to dismiss managers either directly or through the deregulation of industries. In privately held firms the state can exert its legal force on management where it believes firms have underperformed and thus it can eliminate monopolies and outlaw certain contracts (mergers). The state thus has an influence on firms, especially large monopoly firms, and can at times force managers to perform in order to keep their employment (Roe, 1990) (Oliver, 1995) (Roe, 1991).

The state also plays a large role in firms where it has granted a licence. These firms owe their ability to operate in a limited market to the state. It is believed that in such firms any underutilisation of resources, especially managerial excesses, will be prevented, as the fear exists that the state might grant licenses to other firms. The cellular phone companies in South Africa are examples of opportunities where the state may intervene to stop managerial underperformances. It is feasible that in the event that the companies underperform, more licenses will be granted. This fear of state intervention ensures that managers do not abuse the situation and thus operate efficiently.

There are, however, a number of shortfalls associated with allowing the state to monitor managerial behaviour. The problem with the legal/political regulatory system is that it is far too blunt an instrument to handle the problems of wasteful managerial behaviour effectively (Jensen, 1994). A further limit to legal regulations is that the ordinary shareholder realistically has no quick and easy way of implementing this system to enable him to dismiss management. In the case where a minority grouping is so powerful as to force judicial action, the system is slow and cumbersome (Roe, 1991). Therefore although legal/political regulatory controls do exist, they seem to be out of reach of most shareholders. Management is pressured; however, it is a weak pressure, without any real authority or fear.

A further problem with the legal/political regulatory system is that the legal controls are drawn up by lawmakers and as such represent the interests of the lawmakers. These controls may not necessarily be in what the shareholders believe are their best interests (Roe, 1991). A situation may develop where regulations are put into place to limit managerial behaviour. However, these regulations may have a greater negative impact on shareholder returns than if those regulations were not implemented. An example of such interference was evident in the USA. The Williams Act and other similar anti-takeover legislation was passed in order to prevent take-overs (Roe, 1991). The legislators, in an effort to form a more stable economic environment, made hostile take-overs extremely

difficult to execute. It can be argued that these laws, instead of adding to economic efficiency, detracted from the efficiency of the economy, as managerial monitoring was made harder to implement (Roe, 1991).

Thus although the state has the ability to monitor managers, it is doubtful whether this monitoring force actually increases shareholder wealth, but rather acts as a prevention mechanism to stop managerial excesses.

2.2) Product and Factor Markets

The second source of pressure is the pressure exerted on management from the product and factor markets. If a company is not able to supply a product that customers desire at a competitive price, then that company will not survive. The failure of the company will lead to managers being without employment (Jensen, 1994). Thus factor and product markets exert pressure on management (Scherer, 1988). Unfortunately for shareholders, by the time the factor and product market pressures are beginning to be felt by the firm, the firm is most often in severe financial distress. Therefore it would be unwise for shareholders to rely exclusively on factor and product markets to discipline their management, as although these markets do control mismanagement, they are slow to act. (Jensen, 1994) (Scherer, 1988)

The control of the product and factor market is out of the hands of the shareholders and firmly in the hands of the customers and suppliers of a company. It is imperative that no matter what control shareholders use to discipline management, attention is paid to the signals emitted by the product and factor markets.

2.3) *Capital Market Control and Insider Control*

The last two measures of control, namely capital market control ("outsider control") and insider control, rest firmly in the hands of the shareholders. These two forces form the basis of the managerial monitoring systems and the foundations of the three models listed by Gerson (1992), as defined earlier in this thesis.

The pressure exerted by capital markets is mostly dependent on outside shareholders or minority shareholders within a company (Fama and Jensen, 1983a). These shareholders rely on an efficient capital market to price equities correctly. In such markets poor management will result in the stock price of the firm dropping to attractive levels for outside management teams to purchase the company (Manne, 1965) (Davis and Stout, 1992). Take-over bids are mounted and poor management teams are replaced with better, more efficient teams, which attempt to turn the performance of the company around at a handsome profit (Franks and Mayer, 1990).

The outsider system thus relies on competition amongst management teams, as without a competing team to attempt a take-over, this system is rendered ineffective. The greater the competition between managers, the quicker action can be taken to dismiss poor management, as replacements are easily available (Fama, 1980). If no managerial replacements exist and the firm's managers are running the firm exceptionally poorly, it may be expected that some of the shareholders will fulfil management's role (Fama, 1980).

The internal control system relies heavily on current shareholders to take actions to prevent poor management (Roe, 1990). Unlike the force of the capital markets, where the onus to correct management falls on the market as a whole, the internal system places the onus to discipline management on the shoulders of the current shareholders (Franks and Mayer, 1990).

Shareholders therefore have two alternative options at their disposal to discipline management. The one method is to make use of the capital markets and outside shareholders (outsider system); this method relies on an efficient capital market as well as a competitive market for managers. The alternative is for current owners of a company to discipline their management themselves (insider system); this system relies on the owners, who through the workings of group structures, ensure that managers perform.

The following is a brief definition of each system and illustrates the major differences of various aspects of each system.

2.3.1) The Outsider system

The "outsider" system is characterised by ownership of individual firms being dispersed among a large number of individual and institutional investors. This system relies on the *invisible hand* of the stock market and the market for corporate control to discipline managers (Buzzachi and Colombo, 1996). Shareholders are responsive, flexible and mobile. Faced with a problem, they tend to act quickly (Breeden, 1993).

The United States is perhaps the best proponent of the outsider system (Bhide, 1994). The system is often referred to as an Anglo-Saxon system of financial control, as the USA and UK represent the best examples of the system (Kester, 1993). The USA authorities have devised a number of rules and regulations that protect investors and promote market efficiency and liquidity (Roe, 1991) (Roe, 1990) (Bhide, 1994). These regulations highlight the importance that the capital market holds in such a system. All shareholders receive equal access to information and stringent disclosure and insider trading rules exist in order to protect small shareholders from being exploited by large dominant shareholders (Franks and Mayer, 1990). The entire USA economy has evolved around these regulations. The regulations ensure that the economy is dominated by the outsider system and eliminate any chance of an insider type system developing (Bhide, 1994).

2.3.2) Insider system

The "insider system", in contrast to the outsider system, is characterised by the ownership of individual firms being concentrated in the hands of a small number of other firms, banks and families (Jenkinson and Mayer, 1992). Cross-shareholdings between firms are common place and the controlling shareholdings are retained within the corporate sector. The insider system has a more institutionally-based focus, with shareholders being smaller in number but larger in size than shareholders in the outsider system (Dickerson et al, 1995) (Porter, 1992).

Whereas the outsider system stresses the importance of the efficient market (Manne, 1965) and strongly protects the small shareholder, the insider system favours large shareholders, often at the expense of the efficient market (Prowse, 1990) (Yoshikawa, 1995) (Aoki and Kim, 1995). Large shareholders are encouraged to form close ties with managers. These relationships allow the shareholders to be privy to price sensitive information before the information is released to the markets. Inasmuch as the outsider system favours the small shareholders, the insider system favours the large shareholders.

The striking feature of the insider system is the formation of business groupings. These groupings are economic entities composed of a set of judicially independent firms connected through equity linkages that jointly guarantee common control over all group assets (Buzzachi and Colombo, 1996). The legal existence of such groupings is rarely acknowledged, but they are present in Japan, Continental Europe and South Africa (Buzzachi and Colombo, 1996) (Gerson, 1991). These large corporate groupings manage the agency problems associated with a professional management class. It is the corporate group that ensures managers are kept in check and perform. Whereas the outsider system relies on the markets to ensure that managers execute their tasks optimally, the insider system relies on the workings of a large corporate group to ensure managerial competence.

The rationale for the formation of group structures is generally quite different from the rationale for the acquisition of companies in a conglomerate. Conglomerate structures can be explained as the result of agency problems that arise from attenuated monitoring, rather than as an attempt to resolve those problems. Conglomerates tend to be less successful than group structures and are believed to be manifestations of managerial power. They represent a break down in the outsider system, rather than the effective use of the insider system (Grundfest, 1990). The insider system is developed to limit managerial excesses and prevent managers from misappropriating power, whereas conglomerates are generally formed out of the misappropriation of managerial power.

2.4) Differences between the Insider and Outsider system

The differences between the two systems will be illustrated on a global level with examples from a number of countries being used to emphasise certain characteristics of each system. It must be noted that each system varies from country to country and as such the two systems may be operating differently in South Africa to the manner in which they operate in the USA or Japan. This point does not detract from the analysis, as the essential characteristics of each system are still clearly visible in the South African context.

2.4.1) Contracting

The nature and culture of the people within a country dictates to a large extent the manner in which business contracts are drawn up (Kester, 1993). This factor would therefore play a role in determining whether a country embraced an insider or outsider managerial monitoring system. Countries such as Japan and Korea, which rely on a set of moral codes and place a high premium on trust, tend to rely on the insider system of control. Insider contracts are often no more than "legal boilerplates" which specify parties are entering into a commercial relationship (Kester, 1993) (Internet, 1996); thus the insider system with its informal *handshake agreements* provides the perfect setting for such cultures. Conversely, contractual parties in the outsider system take pains to ensure that contracts are highly discrete and specify precisely the obligations of all concerned. The contract itself defines party obligations and no room is left for any ambiguity between the parties. The high specification set that the system demands is evidence of the scepticism that exists between the parties to an arrangement (Kester, 1993). Therefore countries such as the USA, where the nature of society is less trusting, would tend more towards an outsider system of monitoring.

The extensive reliance of the insider system on implicit contracting ensures that a system of trust must develop not only amongst employees of single companies, but also among the top executives of the industrial groups (Internet, 1996). Trust is engendered in a number of ways: for example, the Japanese employ a system of lifelong employment which relies on the hiring of management straight from university (Internet, 1996). Managers are discouraged from leaving the company by a reward system that makes it attractive to remain with a single company. The insider system focuses on fostering loyalty and trust between managers and the company (Johnson, 1993).

The greater loyalty and trust of the insider system allows its contracts to remain as flexible as possible. This flexibility, mutual trust and shared expectation enables companies to make rapid, informal and highly refined adjustments in order to preserve the spirit and substance of a business agreement, rather than merely the letter of a written contract. The flexibility of implicit contracting promotes the longevity of commercial relationships and enables the industrial groupings to adopt far sighted strategies, rather than focusing on the pure contract agreement (Kester, 1993).

The maintenance of implicit contracts and long term relationships is further enhanced by reciprocal shareholding arrangements. Examples of such relationships are visible in the Japanese, German and the South African economies (Johnson, 1993). The equity ownership of major companies in an industrial group is frequently concentrated in the hands of group members or financial institutions with long standing relationships with the

group. Accompanying many of these holdings is the implicit understanding that group equity holders will not sell shares in the group (Kester, 1993).

unable to mature in an outsider system. The very nature of the outsider system prevents shareholders from forming any close links with managers. Managers and shareholders of firms in the outsider system tend to regard each other with suspicion. This alienation is visible in the lengthy and explicit contracts that dominate the outsider system. These allow all parties to the contract the feeling of security that the stipulated agreements will be performed (Porter, 1992) (Kester, 1993) (Grunfest, 1990).

Perhaps the reason for this mistrust in the outsider system is to be found in the use of take-overs as a method to displace underperforming management. Take-overs undermine contractual relations between investors, managers and employees (Grundfest, 1990). It seems that the very mechanism on which the outsider system relies for its efficiency, namely the take-over, detracts from its ability to form long lasting contracts. Managers weary of the possibility that they can be replaced at any time, will not be prepared to forego current earnings for long term research and development projects. Companies maximise current profits, even if this approach sacrifices the potential for increases in future long-term profits (Breeden,1993).

The outsider system may therefore suffer from "short termism" - an inability to sustain long term investments. It is suggested that short termism is a reflection of contractual failures in the outsider system that is to a large extent brought on by the take-over process (Mayer and Franks, 1990) (Aoi, 1993).

A number of companies are simply unable to grow in a climate dominated by short termism. Examples exist of companies listing on stock exchanges and then delisting soon after as a result of the short-term focus of the capital markets. In the U.K. where the markets are efficient and an outsider system is firmly in place, a number of companies have delisted in the last two years with the reasons given that the market simply did not understand the long-term effects of the company's investment decisions. The Body Shop is just one example of a company which delisted in 1995 with the reason given by its owner, Annita Roddick, that the market suffers from "chronic short termism" (Van der Weyer 95).

The insider system, with its steadier set of contracts and shareholders, affords companies time to implement strategies and promote their ideas. Companies are given more freedom to invest in research and development projects and pursue long term goals (Franks and Mayer, 1990). This point will be worth investigating in section 4, when the sample sets of this study are defined. It is to be expected that companies operating under the insider system will operate in sectors where large amounts of Research and Development are

needed. The outsider system companies should operate in sectors where short-term results can be easily identifiable.

There seems to be a trade-off between the two different methods of correcting managerial failure (Margel and Singh, 1993).The outsider system, with its use of take-overs, may result in a higher level of managerial correction, but only at the expense of long term investments. The insider system fosters an atmosphere conducive to promoting long term investments; however, this is created at the expense of a high level of managerial correction (Franks and Mayer, 1990).

2.4.2) Equity and Debt Markets

The efficient working of the capital market is the cornerstone of the outsider system (Franks and Mayer, 1990). Without efficient capital markets, potential take-overs can never take place, as would-be purchasers could never properly evaluate the true worth of companies (Franks and Mayer, 1990). The insider system relies much less on capital markets, as the need for managers to be disciplined via the workings of the market does not exist. The tight holding of insider-company stocks helps to render the threat of a potential market take-over useless (Aoki and Kim, 1995). Stock markets receive varying amounts of attention, depending on the system in which they operate.

2.4.2.1) Outsider

The outsider system relies heavily on liquid equity markets that are as efficient and fair as possible (Aoki and Kim, 1995). The flaw with the outsider system is that it tends to promote efficient equity markets and investor protection at the expense of good governance (Bhide, 1994). The rules that protect investors and the integrity of the stock market tend to foster antagonistic, arms length relationships between shareholders and managers (Bhide, 1994).

In theory, market liquidity makes it easier for investors to diversify their risks and thus reduces the cost of capital for companies. The outsider system does afford shareholders the opportunity to diversify their stock portfolios. The problem is that rules which protect investors drive a wedge between shareholders and managers. Instead of yielding long-term shareholders that concentrate their holdings in a few companies, the laws have promoted diffused, arm's length stockholding (Aoi, 1994). Market liquidity itself

weakens incentives to take an active role in a company's performance. The free-rider problem prevents shareholders with a small stake in a company from exerting their own personal efforts to promote company performance (Demsetz and Lehn, 1985), the reason being that any improvement will accrue to all shareholders and only marginally to the shareholder responsible (Bhide, 1994).

The liquid market creates shortsighted stockholders who can easily sell their stock (Bernstein, 1993). Thus in times when companies face crises, short sighted stockholders are quick to sell their holdings and salvage as much wealth for themselves as possible. In illiquid markets, shareholders cannot easily sell their stocks and are forced to pull together to solve problems. Thus shareholders are given a cheap exit in liquid markets (Bhide, 1994).

2.4.2.2)Take-overs

The outsider system relies on markets for corporate control to discipline management (Franks and Mayer, 1990). The capital market (Manne, 1965) and the managerial market (Fama,1980) act as conduits for change and supply necessary vehicles through which incumbent managers can be swiftly removed and easily replaced.

Potential management teams monitor companies via the capital market. If companies are poorly managed, their stock prices will reflect the incompetence of the management team and will be lowly valued. Potential managers, realising that the company is undervalued and that the potential exists to turn the company around, will attempt to buy out the current stockholders, assume ownership of the company and fire the existing managers. This threat of take-over is a strong influence in ensuring managers perform (Franks and Mayer, 1990). The underperformance of management will result in their company being underpriced and therefore becoming a likely take-over target. Take-overs define the outsider system and epitomise the fluid workings of a market based system which relies on market forces to induce efficiency (Franks and Mayer, 1990).

Henry Manne (1965, pp113) first emphasised the importance of the market for corporate control on managerial performance.

"Only the take-over scheme provides some assurance of competitive efficiency among corporate managers and thereby affords strong protection to the interests of vast numbers of small, non-controlling shareholders."

In principle, ownership changes should allow assets to be employed in their most productive activity. Take-overs permit those who attribute the highest value to running a managerial failure. They ensure that only those who are able to achieve the highest level of productivity and lowest costs of production remain in control of organisations. (Franks and Mayer, 1990).

The argument against the outsider systems is that the threat of take-overs can lead to welfare losses to society. In a climate of potentially hostile take-overs, the incentive to invest in long-term relationships between management and employees may be reduced, since there is a high probability that at some time in the future they may be broken. The outsider system of diffuse ownership and potential take-overs leads to an inability to make pre-commitments. This inability may have an adverse impact on the strategy of the firm's investment decisions. Firms may be forced to invest in short term projects that in the long run are less productive.

2.4.2.3) Insider Markets

Capital markets operating in the insider system are shallow and may not reflect the true value of shares. The high concentration of ownership and stable share holdings do not allow the equity markets to accurately evaluate companies. This factor detracts from the equity market's ability to serve as a conduit for companies to raise new capital (Aoki and Kim, 1995).

The equity market control so prevalent in the outsider system is rendered useless in the insider system, as companies are protected by stable shareholdings and a capital market that is both illiquid and inefficient (Aoki and Kim, 1995). The insider system places a great deal of emphasis on the debt market as a source of raising finance (Johnson, 1993). Financial intermediaries such as banks and other types of investment houses, take on added importance in the insider system, due mainly to their ability to loan funds to companies in need (Johnson, 1993).

One of the reasons why the equity markets assume a less important role in the insider system is the fact that the insider system creates a certain harmony among debt and equity holders. This is achieved by combining the two classes; joint equity and debt positions are held by the investors (Yoshikawa, 1995). Countries such as Japan and Germany see the biggest debt holders, being the largest equity holders. It is not unusual in these economies to witness shareholders and debtholders assuming each others roles (Prowse,

1990). This commingling of debt and equity holders allows insider firms to compensate lenders less. This is achieved as the mistrust which develops between these two stakeholders in the outsider system is nullified. as the stakeholders are effectively one avoided and stakeholders are able to be more focused on what is best for the company, rather than what is best for themselves (Prowse, 1990).

Commingling of stakeholders also has an effect on the firm in the times of hardship or near bankruptcy. The mixing of positions makes it easier for companies to be rescued from financial distress (Grundfest, 1990). Stakeholders are said to own strips of the company (Grundfest, 1990). These strips combine an equity and debt portion together and thus the conflict of interests which might arise between debt and equity holders when a company is liquidated, is avoided. Companies are in a position to have more freedom in their ability to continue trading in times of adversity (Grundfest, 1990). This ability to set aside the traditional stockholder-debtholder conflict is seen as a considerable advantage of the insider system.

2.4.3) Disclosure

The contractual nature of the outsider system ensures that such a system places a high premium on information disclosure. Equal access to information for all shareholders is seen as an important aspect of the system. The outsider system, through its rigid regulations, prevents shareholders from forming any close links with managers (Bhide, 1994). Diffuse shareholders who own only small quantities of a company's equity are numerous and can not establish any meaningful contact with senior executives. In turn, senior executives are hampered from sharing any sensitive information with shareholders and are forced to conceal strategic information from them. Disclosure announcements and signals from management therefore become the only manner in which managers can inform shareholders of the company's performance (Whittington, 1993). The system relies on disclosure laws to ensure that shareholders are informed about company related specifics as comprehensively as possible (Bhide, 1994); this disclosure helps investors make informed decisions and promotes the efficiency of the market. It is through proper disclosure that a number of potential investors are able to judge the true worth of a company. Thus proper disclosure facilitates likely take-overs, which in turn ensures that managers are kept in check.

The declaration of dividends therefore takes on an added importance in the outsider system. Dividends not only represent an important source of income to investors, but take on further importance in their signalling value. Dividends can be seen as a very important tool which managers can utilise to signal to the market company specific information and

intentions. Thus dividends assume an important role in the outsider system. In the insider system where signalling plays a much less important role, dividends assume less importance (Johnson, 1993).

The need for explicit disclosure is not as great for investors operating in the insider system (Porter, 1992). Insider companies are generally owned by a small number of shareholders. These owners take an active part in the managing of the company and are mostly aware of company performance and strategy. The system therefore relies less on managerial signalling, as stockholders have opportunities to talk on a far more personal level to managers (Porter, 1992).

The insider system, with its greater scope for personal discussions, allows company strategies to be discussed in quiet meetings, free from public disclosure (Breeden, 1993). Managers are monitored by insiders with representation on the board; this nullifies the need for extensive disclosure, as the necessary monitors have full access to valuable information. Thus whereas the outsider system relies on the efficient disclosure regulations to ensure companies are properly monitored, the insider system places little if any importance on such disclosure regulations.

2.4.4) Managers

The two systems exert different pressures on managers. Each system uses a different approach.

The outsider system forces managers to take cognisance of the strong capital markets, where the real threat of a take-over is a constant reminder to managers to perform or face dismissal. The insider system provides managerial autonomy and managers are protected from the restraints of short-term capital markets (Johnson, 1993). Incumbent managers are favoured in the insider system, whereas the outsider system favours management teams that compete amongst each other in contests for corporate control (Grundfest, 1990).

The stable intragroup shareholdings of the insider system ensure that take-overs can never occur and managers are firmly entrenched. While the entrenchment of management has its negative aspects, in certain cases it may be desirable. The long term success of implicit contracting which is founded upon trust relationships, depends critically on preserving continuity of management at the trading interface. As Schleiffer and Summers (1988, pp) stated :

shareholders will find it value maximising to seek out and train individuals who are capable of commitment to stakeholders, elevate them to management and entrench them.

The insider system relies on a small, select circle of executives who run the large industrial groupings. The tight circle provides a potentially effective, even if informal, information network. Executives often serve on a number of boards and the interlocking directorships narrows the scope for hidden actions and magnifies the adverse reputation effects of opportunistic behaviour (Jenkinson and Mayer, 1993). The insider system has a closed nature towards its managers and mangers are placed under much less public scrutiny regarding their decisions than those managers in the outsider system (Breeden,1993). The outsider system facilitates openness and accountability for managers who are given the responsibility of running public corporations (Breeden,1993). The system encourages a great number of managers to attempt to run companies and gains efficiency from the number of management teams competing to ensure that companies are run at their most efficient level.

The problem of managers shirking their responsibility is not unique to any one system. Both systems devise methods to measure managerial behaviour and ensure such behaviour is kept in check (Kester, 1993). The agency problem is addressed in the insider system through extensive mutual monitoring and early selective intervention when performance falters (Kester, 1993). The outsider system relies on the capital market to ensure that managers do not underperform (Porter, 1992).

In the insider system the board of directors of each company in the industrial grouping serves a vitally important safeguard through its monitoring and control activities. Unlike the boards of companies that operate in an outsider system, the boards of the insider system tend to mirror the company's most important long-term stakeholders. It is not uncommon to find banks and other major providers of capital well represented on the boards of Swedish, Japanese and German companies (Roe, 1991) (Prowse, 1990).

The boards of the outsider system tend to be split between inside executive directors and outside directors with some special expertise, but no substantial capital stake in the company. The composition of the insider board allows the board to understand and appreciate the company's contractual relationships with its major stakeholders (Porter, 1992).

The insider system has no real disciplining mechanism for its managers. If firms underperform, the major stakeholders send in their best managers to turn the company around. A team effort is attempted, with established managers learning from the designated advisors. The established managers are then reinstated and allowed to manage

the firm. It is very rare that a real dismissal takes place. This extra security that the insider system affords managers is believed to spur managers on to perform. In return for having their job security, it is assumed that managers will voluntarily increase their efforts and commitment to the company, resulting in higher productivity and higher returns to the shareholders in the long run. There is, however, the possibility that management assured of employment may become lazy and work less (Internet, 1996).

This possibility is strictly limited in an outsider system, where the system prospers on dismissing underperforming managers. The outsider system is far more robust in its dealings with managers, and attempts to ensure that only the best managers are running the company.

Summation

The outsider system favours economies where vast pools of managerial talent are available. In order for the system to succeed it is imperative that a large and competitive market exists for managerial skills. This ensures that managers are always compelled to perform efficiently or else face the possibility of being replaced by other management teams. The insider system favours economies where large reserves of managerial skills are not available. The system relies on a stable set of managers performing.

2.4.5) Linkages

It is important that the linkages of the above characteristics of each system be understood.

The outsider system relies on strict, stipulated contracts. A general atmosphere of scepticism is present in most business contracts and this is evident in the manager/shareholder relationship. The system therefore promotes full disclosure. The disclosure serves as a signal to shareholders who do not have opportunities to build relationships with managers. The disclosure also contributes to the essential workings of the efficient market. The efficient market is the key to the outsider system disciplining management. Through the workings of the efficient market, potential take-overs can occur. Managers are therefore forced to perform, or else be replaced by new management teams.

Shareholders have opportunities to easily diversify their portfolios and are able to buy and sell on liquid markets at low transaction costs. Shareholders have short time expectations and if their expectations are not met, they simply sell one stock and buy another. This further adds to the suspicious nature of stakeholders, as long relationships are discouraged.

The insider system promotes contracts of trust. Shareholders usually invest large sums in one company and therefore are not able to easily divest. It is the shareholders who discipline management and the workings of the capital market are therefore not needed to discipline management. The necessity for disclosure is eliminated, as no efficient market is needed and shareholders gain access to sensitive information through their relationships with managers. Shareholders have long time expectations and do not simply invest to make a short-term profit.

The following diagram presents a summary of the differences between the insider and outsider system in a table format.

Summary Table

SYSTEM COMPARISONS

	INSIDER SYSTEM	OUTSIDER SYSTEM
Contracts	Loose / Unspecified / Based on trust	Strict / To the law / Based on mistrust
Shareholders	- Small number of shareholders - Highly concentrated ownership - Each shareholder owns large percentage of stock	Large number of shareholders Ownership patterns dispersed Shareholders own small percentage of stock
Equity Market	- Not much focus - Illiquid and inefficient	Large focus Liquid and efficient
Disclosure	- No stringent regulations needed	Stringent regulations in place
Discipline Management	- Through group structures	Through take-over market
Shareholder/ Manager Relationship	- Close ties built over lengthy time frame	Distant relationship / short time frame
Dividends	- No real importance	Assume significant importance (signalling)
Investors	- Long time frame	Short time frame

2.4.6) Summation:

The two systems may reflect basic differences in the manner in which large corporations are perceived. The insider system views the corporation as an institution with personality, character and aspirations of its own. Its objectives encompass the interests of a wide range of stakeholder groups: investors, employees, suppliers, customers and managers, but cannot be equated with any of them. The corporation is therefore perceived as a social institution with public responsibilities. The outsider system views the corporation as a private rather than a public body, defined by a set of relationships between principal and agent. Shareholder-owners, too busy and too numerous to undertake the responsibility of managing companies themselves, hire salaried executives to manage their affairs (Internet, 1996).

The outsider system is said to promote an amoral institution, with its professional managers or "hired guns", who pursue goals of measurable efficiency. The outsider system, which focuses on economic performance, directs energy and resources to achieving financial results which are easily measurable, as opposed to social goals (Mintzberg, 1984). The system has been criticised for its failure to align the interests of individuals, investors and corporations with those of the economy and nation as a whole (Porter, 1992). In contrast, the insider system promotes long term goals. The system does not focus solely on short term shareholder's profits and it is possible that in the short run profits will not be maximised (Internet, 1996). The longer-term approach of the insider system does, however, allow managers more freedom to manage companies in the short run. The advantage of this is that companies can perform better in the long run, as concentrated projects can be undertaken to ensure long-term results. The disadvantage is that managers may perform poorly, as they are not properly and timeously monitored.

2.5) SELF SYSTEM

At the beginning of this section shareholders were assumed to be given an option of deciding whether to choose the insider or outsider system. There is, however, a third option which shareholders may utilise to monitor managers. This option is referred to in this thesis as the "self system".

The "self system" relies on the shareholders running their companies themselves. Majority stakeholders manage companies in which they have invested large portions of their own personal wealth. The managers, as shareholders, will ensure that the company is run efficiently and care is taken to maximise shareholder wealth.

The "self system" is similar in its workings to the insider system. Whereas the insider system relies on group formations to take up large equity stakes and monitor managers, the "self system" relies on individual owners to perform the same tasks. Both systems avoid the potential market threats which ensure that managers are monitored in the outsider system. It is the owners' personal wealth and reputation which is the driving force behind the success of companies being run under the self system.

The self system does, however, leave minority shareholders at the mercy of the owner-manager. Often owners may prefer certain prestige investments rather than investing in the most profitable investments. Sport sponsorships and luxurious office blocks are just a few of the investments owner-managers may insist on. The minority shareholders have no real power to prevent the owner-managers from investing in these investments, other than to disinvest. The effective disciplines of the outsider system with its take-over markets are nullified, as owners have majority stakes and are immune to take-over forces. It is therefore conceivable that the owner-manager will make decisions that are favourable to himself, but which lower the value of the shares and thus afflict the minority shareholders.

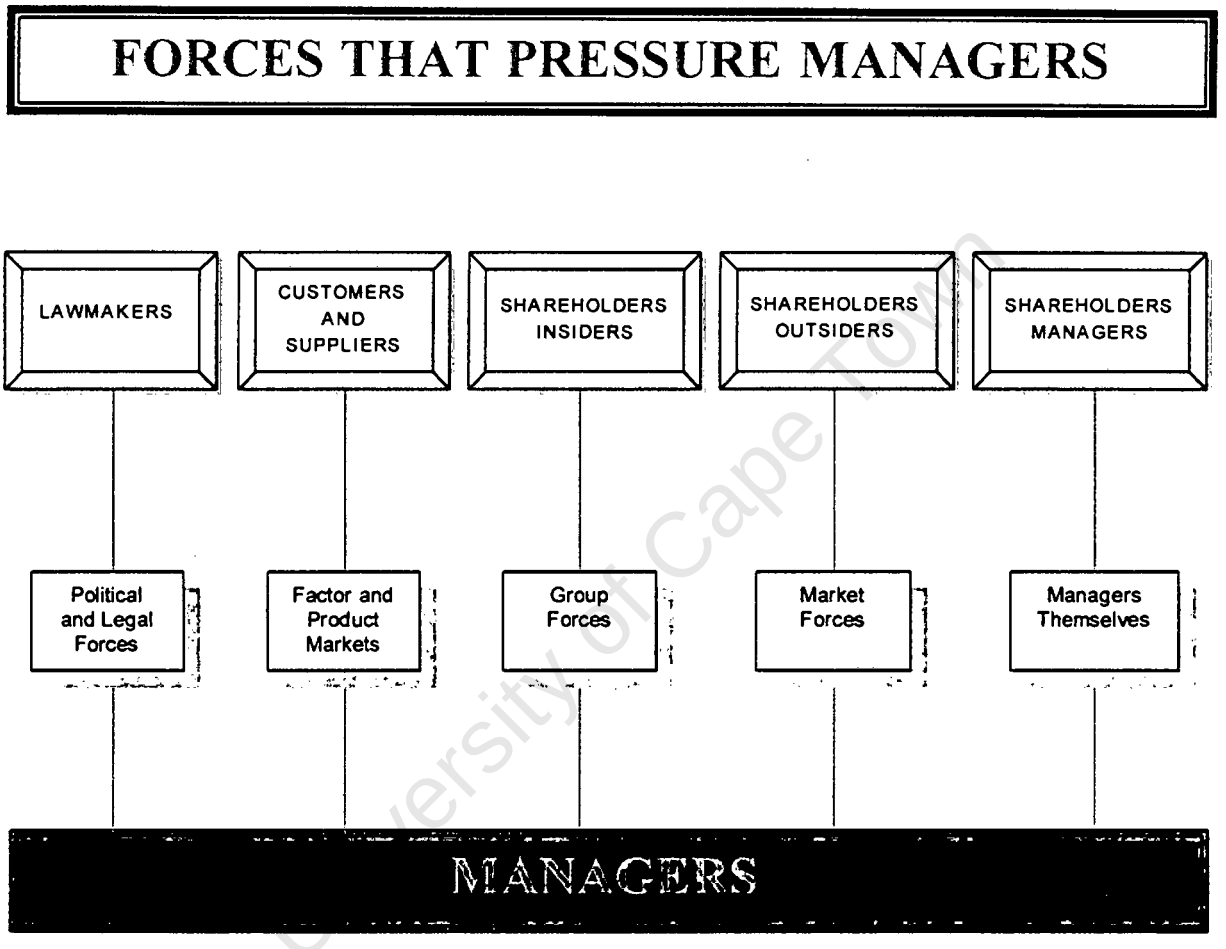
However, rational minority shareholders expect owner-managers to invest in projects that may not necessarily provide the greatest return. The minority shareholders therefore safeguard themselves by demanding a low subscription price when the managers turn to the capital markets for funds. The owner-manager thus directly bears the cost of not maximising the shareholder wealth. The loss to the owner-manager is in the lower offer price (Bergstrom and Rydqvist, 1990). It is suggested that the discount of the offer is a reflection of the owner-managers reputation (Gerson, 1992).

Owner-managers are therefore forced to own a large proportion of shares in a company. This large holding serves as a credible guarantee to minority shareholders that owners will not invest in underperforming projects, since it is the owner himself who will be affected the most - on account of his large shareholding - by any investment decisions which cause the share prices to decrease (Bergstrom and Rydqvist, 1990).

Owner-managers are thus forced to maximise shareholder wealth on account of their large personal holdings. Even if the owner hired additional managers, he would be forced to monitor their performance tightly, as any loss in efficiency would directly affect his own personal wealth. The self system, with its insistence that owners take on large holdings, eliminates any possibility that the owners would free-ride their responsibility as monitors. The free-riding that is dominant in the outsider system is therefore absent in the self system (Bergstrom and Rydqvist, 1990).

The diagram below presents a graphical summary of Section 2:

Summary Diagram



The three systems closely resemble the three models listed by Gerson (1992) and which appear in the introduction of this thesis. The outsider force and the monitoring system that has evolved from this force can be equated to Model 1. The shareholdings of such a system are widely dispersed and the capital market forces are relied upon to monitor managers. The insider force relies upon two different forms of pressure to monitor management. Both forces represent the original controllers of the firm and as such represent "insiders" which monitor management. The self system relies on families or small groups to monitor managers and as such can be equated to Model 2, whereas the insider force as defined in this thesis, relies on large corporate or financial groupings to monitor management (model 3).

2.6) Other Monitors of the Agency Problem

Shareholders, as a stakeholder group of a company, do not necessarily have to be responsible for monitoring managers. Shareholders have the option of assuming the monitoring role or passing the burden of monitoring over to another stakeholder of the firm (Prowse, 1990).

Often debt is used as a conduit by shareholders to move the onus of monitoring to the creditors. Jensen (1986) argued that as debt ensures that the firm has to make periodic payments, it reduces the control managers have over the firm's cash flow and incentive for managers to engage in non-optimal activities. Grossman and Hart (1982) argued that the existence of debt forced managers to consume fewer perquisites and become more efficient. The greater efficiency lessened the probability of bankruptcy and the resulting poor reputation of managers. Debt does, however, have its price and the cost of debt is often felt by the shareholders themselves (Prowse, 1990)(Hoshi, Kashyap and Scharfstein, 1990). High levels of debt may subject the managers of the firm to make decisions that would not necessarily create the maximum value for the firm (Chenchuramaiah, Bathala, Moon and Rao, 1994) (Smith and Jensen, 1985).
A firm that is carrying the burden of too much debt may be forced to cancel certain long term projects and focus on short term, less profitable projects, so as to meet its debt obligations.

Conclusion

This section defines the forces that monitor managers and the managerial monitoring systems which have evolved on account of these forces. Each force relies on a different pressure point to keep management in check. This thesis is only concerned with the forces which rely on the shareholders to monitor managers. Three systems were defined and it is these three systems which will be analysed to determine which system best monitors managers. Remembering that the thesis tends to perform its analysis in the South African context, it was felt that the most dominant monitoring system of the SA economy should be highlighted.

The next section deals with the development of the insider system in SA and how it became the dominant system.

Section III

The Development of S.A. Corporate Groupings

Introduction

The previous section identified three structures which shareholders could choose from in order to discipline management. It is the intention of this section to discuss the structures that have developed in the SA economy and the reasons for their development. While it is not within the scope of this thesis to explain the entire history of the South African economy, it is felt that an outline of how corporate groups evolved in S.A. is necessary to enable the reader to fully place the study in context.

The South African economy has over the years been dominated by a small number of very large firms. As Savage (1987, pp28) commented:

All available evidence points to a mounting concentration of economic resources, a more concentrated pattern of ownership of these resources, and a growing centralisation of significant economic decision making in fewer hands. In short, there is an increasing pattern of concentration of economic power in South Africa. However it is measured, South African economic life is becoming more dominated by fewer firms, fewer significant owners and fewer decision makers.

Savage, 1987, pp28

There is a large amount of evidence that suggests that the South African corporate landscape is dominated by five or six large, diversified groups of companies (Botha, 1994). The table below was extracted from Mcgregor's(1996) and clearly demonstrates the control these large corporations have.

History of Group Controlled Companies

Quoted on the Johannesburg Stock Exchange

(based on market capitalisation)

Percentage Total Control of the Market Capitalisation of the Johannesburg Stock Exchange

Controlling Body	1990	1991	1992	1993	1994	1995	1996
Anglo American	44.2	42.4	33.7	38.2	43.3	40.5	37.1
Sanlam	13.2	13.2	15.6	12.0	10.5	12.8	12.4
Rembrandt	13.6	15.2	14.6	15.5	13.0	10.3	7.8
SA Mutual	10.2	10.4	14.2	10.7	9.7	8.9	11.2
Liberty	2.6	3.7	4.7	6.2	7.2	6.0	7.3

Top Five Groups Control (%)	1990	1991	1992	1993	1994	1995	1996
	83.8	84.9	82.8	82.6	83.7	78.5	75.8

The reasons for the severe concentration of economic power in South Africa may be found to a large extent in the policies which the South African, Nationalist Government followed (Savage, 1987, p10). The policy of Apartheid led the international community to adopt certain restrictive practices in their dealings with South Africa and South African firms (Uliana and Cohen, 1990). Many international companies withdrew their investments from South Africa (Bhana, 1987).

The international disinvestment from S.A., which was used as a weapon by foreign countries to change the Apartheid policy (Bhana, 1987), left a chasm in the S.A. economy which only local companies could fill. This chasm, coupled with the SA Government's stringent exchange controls and the sanctions which foreign countries implemented, further exacerbated the already tight concentration of S.A economic power (Financial Mail, 1995).

Large South African companies had no real option but to invest in the opportunities which were created for them locally as a result of the foreign disinvestment from South Africa. The stringent exchange controls, coupled with the fact that a large number of off-shore markets were closed to South African companies as a result of sanctions, afforded S.A. companies very little oppurtunity of investing in any markets outside the borders of South Africa. In a sense, the local opportunities provided much needed investment avenues for many of the larger S.A. corporates (Savage, 1987). Thus large SA companies began to divest locally into new areas of business, areas in which they had not previously operated. The powerful mining companies with their already strong infrastructure and relatively secure income streams, were ideally positioned to take advantage of these potential diverse investment opportunities (Savage, 1987). Another group of companies to take advantage of the investment opportunities were the South African mutuals (large insurance companies such as Old Mutual and Sanlam, which had a secure income stream).

At more or less the same time international sanctions began affecting the South African economy. The economy experienced a shift in individual housing savings from conventional sources, such as banks, to mutual companies (Kantor, 1992). This provided the mutuals with large cash reserves and enabled them to invest in the opportunities created by the foreign withdrawals. Thus the mining houses and mutual companies formed the nucleus of the groupings currently present in South Africa.

The S.A. Government policies also had a marked effect on the skilled professionals of the S.A economy. A number of S.A professionals emigrated in what has colloquially become known as the "Brain Drain". This draining of skilled professionals had an enormous effect on the pool of skilled managers. Only a limited number of skilled managers remained in the country (King, 1994) (King Report, 1994) and, as such, the market for managers which Fama (1980) described as being so important to control managers, was not very effective in the S.A economy (Uliana, 1988).

The S.A. economy began to lean more and more towards the insider system of control. Large company groupings were established and these groupings began to effectively control the economy. Unlike the New York Stock Exchange, the Johannesburg Stock Exchange did not outlaw the creation of pyramid structures (Barr, Gerson and Kantor, 1995). These structures further enhanced the ability of corporate groupings to control

companies. The pyramid structures allowed group owners to raise more capital without losing the required corresponding control. Thus groups became powerful and concentration of control became tighter (Gerson, 1992). The S.A economy therefore developed a number of large, listed companies which operated under the insider system (Gerson, 1992).

The South African corporate landscape came to be dominated by few directors sitting on a number of company boards (King, 1994). Many executives from the controlling companies sat on the boards of the companies which they controlled. It was found that 86% of the top fifty companies interlocked at the directorate levels with one of the major financial institutions in the country (Savage, 1987). This interlocking of directors is typical of an insider system of monitoring.

All the above developments in the S.A. economy were at the expense of the outsider system. The S.A. capital markets, through the withdrawal of many foreign investors and the ability of owners to issue shares without losing control (pyramid structures), became mostly ineffective as a means for controlling managers. The illiquidity in the market and the near impossibility of shareholders to execute hostile take-overs, due to the pyramid structures, rendered the capital market ineffective as a means of monitoring managers. This, combined with the lack of skilled managers in the S.A. economy, ensured that the ability of an outsider system to control managers was severely restricted. Large corporate groupings evolved which attempted to monitor their managers through the workings of the insider system.

3.1) Group Structures

The South African economy is dominated by five or six large diversified group companies. To define these corporate groupings as conglomerates is wrong. Gerson (1992) defined a conglomerate as a *single defined company engaged in several unrelated fields of activity.* Therefore some of the individual companies associated with the large groupings are indeed conglomerates, in that they operate in several unrelated fields.

However the defining point of difference between conglomerates and groupings is:

The Shareholders of a conglomerate all have the same pro rata claim to dividends in its various branches or subsidiaries. This condition is not met with respect to the various shareholders involved in the South African corporate groupings.

Gerson 1992, p 10

Another characteristic of the South African groupings is their size. All of the six groupings controlled at least two percent of the market capitalisation of the JSE at the beginning of the 1991 calendar year. (See table Mcgregors table, p46)

Business groupings are by no means limited to the South African corporate environment. Groupings of one form or another are evidenced in countries such as Sweden, Japan, West Germany and Korea. Buzzachi and Colombo (1996, pp) defined corporate groupings as :

Economic entities composed of a set of juridicially independent firms connected through equity linkages which jointly guarantee common control over all group assets.

Gotto(1982) made a distinction between what he defined as A type associative groupings, typical of Japanese [4]*Keiretsu,* and B type hierarchical groupings, which prevail in Europe. Gotto defined type A groups as those companies grouped around a predominant financial intermediary. In Japan type A groupings are formed around banks. Type B groupings are those groupings that are composed around large firms and their subsidiaries. An important difference between the two group structures is that members of type A groups are usually all large-scale firms, whereas type B groups consist mainly of only one large-scale firm and its subsidiaries (Gotto, 1982).

[4] Large corporate group structures that developed in Japan. (Yoshikawa, 1995)

3.2) The South African Corporate Groupings

Gerson (1992) identified six large corporate groupings in South Africa. It is possible to divide the six groupings into type A and B groupings using Gotto's criteria. Type A groupings are those groupings which are formed around a predominant financial intermediary and type B groupings are those groups which are formed around a predominant company.

Type A Groupings

The South African type A groupings have predominantly been formed around large life insurance companies. The three groups are the Old Mutual, Sanlam and Liberty Life groupings. Both Old Mutual and Sanlam are mutual organisations and as such are not owned directly by shareholders; indirectly they are owned by their policyholders. Liberty Life, unlike Old Mutual and Sanlam, is not a mutual company and is a listed company owned by its shareholders. The Liberty Life Group was started by Donald Gordon in 1958 and has rapidly become a large player in the South African economy. It is the youngest of the three companies, but has nevertheless quickly gained a large controlling block of JSE listed companies.

Type B Groupings

The type B Groupings have predominantly been started by a family or a coalition of families which formed a large company. These companies then grew and expanded and eventually industrial groupings were formed. The three main groupings are the Rembrandt, Anglovaal and Anglo American Corporation groups. The Anglo American Corporation was formed in 1917 by Sir Ernest Oppenheimer. The Rembrandt group was formed in 1948 by Anton Rupert and Dirk Hertzog and these two families, Hertzog and Rembrandt, are still very much in control of the group. The third and smallest of the three groupings is the Anglovaal group, founded in 1933 by the Hersov and Menell families. Both the Anglo American Corporation and the Anglovaal group were first established as mining companies and then later expanded to form the large industrial groupings that they are today (Gerson, 1992).

In general, group controlled companies are able to draw on a huge network of associated companies. In times of trouble it is not unusual for weak companies to be bailed out by some of their stronger siblings. An example of such a bailout is the manner in which the Anglo American group assisted O.K. Bazaars (1929) Limited ("O.K."), when O.K. was experiencing financial difficulty. O.K. was controlled by South African Breweries, which formed part of the Anglo group. The group, on seeing the poor performance of O.K., delisted its stock from the JSE and is currently attempting to restructure O.K. in order to

ensure it becomes profitable (SAB Financial Statements, 1994). Thus one of the group systems biggest drawbacks is highlighted. There are times when profitable companies in the group are forced to lose money, due to their attempts to assist weaker subsidiaries. This can be done through cheap loans or sale of assets at below market rates (Oliver, 1995).

The unique structure of the corporate grouping allows the group to develop what has become known as an internal capital market (Bhide, 1993). The group formation allows the group to form an extra administrative layer. Managers report to a corporate or general office, rather than having to answer to their owners. The corporate office performs functions that would otherwise be executed by the external capital markets. These functions include the raising and distribution of capital for the many units of the group (Bhide, 1993).

The insider capital market provides the group with the ability to handle sensitive data efficiently. Sensitive data is kept within the firm and prevented from falling into the wrong hands. The structure of the insider market may also allow managers the ability to act quickly and timeously on new projects. The insider system does, however, create certain disadvantages. The extra administrative layer results in higher overheads for the group companies. The insider market may also be slow to react, especially on changes to managerial decisions (Bhide, 1993).

Conclusion

It is interesting to note from the development of the South African monitoring systems, the marked influence that political developments have had on economic and financial decisions. It seems that the event which gave the South African insider system its greatest impetus was the apartheid era. Apartheid and the resulting economic actions which S.A. companies were subjected to, firmly entrenched the insider system of control within South African corporates.

South Africa is certainly not the only country in the world which has embraced the insider system of control. Countries such as Japan, Germany and Sweden would all fit the mould of countries dominated by the insider system.

It will, however, be interesting to observe, as the S.A. economy opens and begins to become more and more accepted by the international community, what effects these changes will have on the S.A. system of monitoring managers.

It would be difficult to imagine a South African economy not controlled by Anglo American or Rembrandt. However, as times change and monitoring systems adapt, one may very well see the South African economy turn more to the outsider system of control.

If one were to see a change in monitoring patterns, it would be a pre-requisite that the JSE become more of an effective tool in helping mount take-overs. For this to occur, the potential for companies to create pyramid structures would have to be eliminated and the JSE would have to become a far more liquid exchange.

Currently in South Africa, as this chapter sets out, the majority of South African companies control their managers via the insider system. The exact ability of such a system to monitor accurately managerial behaviour, will be examined in the following sections of this thesis.

Section IV

The Analysis and Methodology

Introduction

Section 2 identified three possible methods that shareholders had at their disposal to discipline managers. Each method relied upon a certain distinctive ownership structure of a company in order to operate. For example, an outsider system relied upon a disperse shareholding structure, whereas the insider and self system relied on shareholders taking on significant, large, equity stakes in a company.

Recalling that the lack of managerial monitoring results in a firm producing less efficient results, it is important for shareholders to ensure that managers are well monitored so as to gain the maximum returns from their investments. It is the objective of this thesis to analyse the effect that monitoring systems, which are determined to a large extent by the ownership structure of a company, have on management. This study attempts to define which managerial monitoring system produces the best return for shareholders.

This thesis is concerned with the ability of the managerial monitoring systems to create efficiency. This ability is in the systems adeptness to prevent managerial excesses. These excesses are manifest in the systems inability to produce shareholder returns. Thus the system which best prevents managerial excesses - and therefore monitors managers best - is the one which ensures that shareholders receive the maximum return on their investment.

Specific attention will be paid to the performances of the insider/group controlled companies. These large groups have recently come under pressure to discontinue. Many believe that they are preventing the South African economy from balanced development. The results from this thesis will add to the current debate as to whether these groups should be prevented from developing, or whether they indeed provide efficiencies in their ability to monitor managers.

This section deals with the actual statistical study, methodology and hypothesis. It sets out the various group classifications and the assumptions related to the study.

4.1) Hypothesis

The objective of the study, as stated above, is to determine which monitoring system monitors managers best. The study defines companies into various groupings depending on the monitoring system which the companies employ. It is the company's ownership structure that directly influences the managerial monitoring system implemented by the company. Companies are divided into three distinct groupings, namely: Insider companies, Outsider companies and Self companies.

The objective is to determine whether any of the monitoring systems monitors the managers more efficiently than the others. Using shareholder returns, the Null hypothesis is tested.

The Null hypothesis is that: **No monitoring system monitors managers differently to the other systems.**

The alternative hypothesis is that: **One of the systems monitors managers differently to the others.**

Stated mathematically:

$\mathbf{H}_0$: $RgIns = RgOut = RgSelf$

$\mathbf{H}_a$: $RgIns \neq RgOut \neq RgSelf$

Where R = The return to shareholders. This measure is defined as being the change in the market capitalisation of a company plus the dividends the company has issued.

$$R = \frac{(MC1 + D1) - MC0}{MC0}$$

MC1 = The market capitalisation of the company at the end of the year.
D1 = The dividends issued in the year under review.
MC0 = The market capitalisation of the company at the beginning of the year.

And

gIns = The insider group. (See group definitions listed later in this section)
gOut = The outsider group.
gSelf = The self group.

The study analyses the performance of the various companies over a five year period. The period is from Jan 1991 - Jan 1996. It was felt that a period of less than five years would not allow for any meaningful conclusions to be drawn from the sample set. The period chosen represents the most recent five year period available. An analysis of a ten year period provided a very small sample set. The reason for this was that a large number of companies had changed their ownership structures over the period. The five year period thus provided sufficient duration and an adequate sample set to analyse.

4.2) Assumptions

4.2.1) The Objective of the firm is to maximise shareholder wealth

Perhaps the most important assumption of the study is that the objective of the firm is to maximize shareholder wealth. A debate currently exists in financial literature as to whether or not this assumption holds true. As Doyle (1994, pp5) stated :

Currently the most intellectually respected business objective is shareholder value.

A number of other reputable finance texts such as Ross, Westerfield and Jaffe (1993, p18) and Copeland and Weston (1988, p20) agree with Doyle's statement and accept that the maximisation of shareholder wealth is the primary objective of the firm.

It is argued, however, that the objective of firms maximising shareholder value is an objective which is valid only for firms operating in the outsider system, such as the USA. Such companies rely more on increasing shareholder value as opposed to companies operating in Japan, in the insider system, which appear to focus more on multiple goals,

weighting approximately equally market share, profitability and innovation (Dole, 1994, p4).

In the South African context, a study conducted by Bosch and du Plessis (1982) found that 90% of South African executives believed that the primary objective of the firm was to maximise the rate of return on equity capital. A further South African study by Fasol and Firer (1995) found that 88% of CEO's believed that it was management's primary responsibility to look after the interests of the shareholders. It therefore seems that this thesis's assumption that the objective of the firm is to maximise shareholder return is quite reasonable in the light of studies conducted in South Africa.

4.2.2) The Return to Shareholder measure, as defined in the study, is an accurate measure of shareholder wealth

It is assumed that the return to shareholder measure, as defined later in this section, accurately measures shareholder wealth. A number of early American studies used non-market measures to measure effects that changes in company ownership had on the firm (Oswald and Jahera, 1991). Measures such as net income, sales and owners equity were used. In a study conducted by Strickland, Wise and Zennet (1995) a number of measures were used to measure the efficiency of firms. Measures included the market value of equity, the book value of assets and total sales. The measure in this study is based on market returns to shareholders and is not effected by any accounting data. Companies are therefore all compared using the same measure. No room has been allowed for any accounting manipulation of the data.

4.2.3) The ownership structure of the firm dictates the managerial monitoring system

The study assumes that companies that have adopted comparable ownership structures monitor their managers in a similar fashion. Therefore companies with particular ownership structures are defined into specific groupings. It was assumed that the ownership structure of a company dictates the system that the company utilises to monitor its managers.

4.2.4) Debt used to assist in monitoring, not as an option to monitor

It is this thesis's assumption that levels of debt are used in assisting shareholders to monitor managers, rather than as an option for shareholders to stop monitoring managers. The reason for this assumption stems from the practical difficulties of being able to gain information from companies that rely solely on debt to monitor their managers. These companies are usually unlisted companies and, as such, do not declare much company sensitive information.

4.2.5) Control of a Pyramid is equivalent to control of company

South African owners have been allowed to make use of a system of multi-tiered holding companies to ensure that the issue of new equity does not result in them losing control of their company's (Barr, Gerson and Kantor, 1995). This system of pyramiding is used by owners once their equity stake in their company reaches the 50% mark. Instead of issuing and thereby relinquishing control, the owners simply vest their entire 50% holding into a holding company and then sell equity in the newly formed holding company. This process of equity dilution, or pyramiding, can theoretically continue indefinitely, provided investors are prepared to invest in the holding companies (Barr Gerson and Kantor,1995).

South African owners have therefore used a system of pyramid holding companies as a means to raise extra equity without yielding control. The pyramid structures, like dual class shares, break the link between the distribution of the shareholders voting power and their effective holding of the underlying equity (Barr and Gerson, 1994).

For the purposes of this study the possible effects of this pyramiding are not discussed. In analysing the actual ownership structures of companies, it was assumed that if one group had obtained control over a pyramid and that pyramid had control over the underlying operating company, then the identifiable group had control over the operating company.

4.3) Measures of the Study

Following the stated assumptions, the following measures were used in determining the results of the study. These measures had to be defined in order to present a meaningful study.

4.3.1) Return to Shareholder Measure

The measure is defined as the growth in the market capitalisation of the company plus the dividends issued by the company for a specific year. The use of the growth of the market capitalisation of a company enables any complications which may arise due to share splits and capitalisation issues, to be ignored. The measure effectively accounts for these changes in share capital, as it takes the total shares in issue and multiplies these by the price. Therefore, if a company had a share split, the total shares in issue would increase while the share price would decrease, thus eliminating any effect in the calculation. The same is true for the capitalisation issue. The one problem that was encountered in using the growth of the total market capitalisation as a measure, was when new shares were issued, such as a rights issue or an issue of shares for cash. In such a situation these shares were excluded from the calculation, using the end of the year share price.

The revised R would therefore be stated as follows:

$$R = \frac{(MC1 + D1) - (MC0 + NS1)}{MC0}$$

NS1 = New shares issued in the year under review

The information needed for the measure was acquired using the monthly JSE bulletins. The average share price of each firm for the month in January was used as the share price and it was multiplied by the number of shares in issue at the end of January. Each year was calculated and the difference between the year was used as the growth in the market capitalisation of each company. January 1991 was used as the base year. The changes were then calculated as percentage movements over the base year. This ensured that any size effects which may have favoured larger companies, were effectively eliminated.

The dividends issued by the company were included in the companies total market capitalisation figure. Thus, when changes were analysed, they included all dividends issued. With the introduction of STC (secondary tax on companies), a large number of South African companies have begun to issue scrip dividends, either as an alternative to conventional dividends, or in place of conventional dividends. The issue of such dividends may have an effect on the shareholder returns for the year. In an attempt to standardise the study, all dividends were assumed to be issued as cash. This alleviated the problem of attempting to define which shareholders had chosen the cash dividend as opposed to the scrip dividend.

4.3.2) Risk Measure

Ideally, all firms should be identical apart from their control structures. This would allow the differences in shareholder returns to be absolutely explained by different control structures; however this is not the case. Companies operate in different sectors, have different capital structures and may even operate in different markets, such as local versus international; all these factors affect company performance. In an effort to isolate the control structure effect, company returns were adjusted by their risk measure.

$$R = [\ \frac{(MC1 + D1) - (MC0 + NS1)}{MC0}\ ] / \text{Beta 1}$$

Beta 1 = The risk weighting of the company as determined in the year under review.

(Refer to group tables) The risk measure used in this study is the beta measure as defined by the Financial Risk Services (Bradfield and Bowie,1992-1996). The beta measure is a measure of a company's returns when compared to the market as a whole, the systematic risk. It is therefore the correlation of a company's earnings with the performance of the entire market. The measure used correlated the company's performance to the performance of the overall market index. This may be the reason why the beta measures as a whole are relatively low. The unique structure of the JSE, with its apparent division between the mining and industrial sectors, may result in the correlation between the industrial shares and the overall indices being relatively low.

The insider companies may have been expected to have a much lower risk measure than the other two groupings. The structure of the insider companies and their close ties to the large South African groupings, allows the groupings to manipulate the earnings of the company and thus may lower the risk estimate of each company. The outsider and self companies do not have this opportunity to manipulate the earnings of their particular

companies. One would therefore expect the beta measures of these two samples to be greater than that of the insider sample. The average beta is calculated using the companies beta for each of the five years, adding them and then dividing the total by five. This is not a perfect measure to define each sample's risk, but it does allow comparisons to be drawn of the risk between the various groupings.

The average risk measure for the insider companies was 0.65, slightly lower than the measure for the outsider companies, which was 0.66, but quite a bit higher than the measure for the self companies, which was 0.51. The high risk measure of the outsider companies may have been expected, but the low measure of the self companies is surprising.

The disadvantage of using the average beta measure, as defined above, when calculating the risk estimate of each group, is that it does not weight the companies according to their size. Thus the risk estimates of small and large companies were treated in the same manner. When looking at the various categories collective average beta's, these measures may therefore be slightly distorted. The reason for the distortion is that instead of properly weighting each company's beta on the particular company's size in the grouping, all betas were treated equally. This non-weighting of the betas biased the average beta in favour of the betas of the smaller companies. This bias may be the reason for the somewhat unexpected results in the samples risk estimations.

4.3.3) The Concept of Control:

The third measure that needed to be defined by the study was the measure of control. It was the concept of control that played a significant role in the group definitions; this will be explained later in this section. Companies were divided into groupings based on their ownership structures. It was the ownership structures that defined the ultimate controllers of the company. The controller of a company dictates what managerial monitoring system is to be utilised. In order to classify the groupings, a definition had to be derived for control.

Hunt (1986) concluded that the concept of control was the ability to select a company's board of directors. Smith (1976) in his study interpreted control of a company as the power to direct the affairs of the corporation. It was his belief that control does not necessarily imply active decision making of the firm, but it implies the ability to make the more fundamental decisions of the firm, such as the selection of management.

In this study in order for an individual person, corporate grouping or any other coalition to be in control, it is implied that they are not afraid of market forces that can effectively destroy their power to run the firm. Therefore, ideally, any group which controlled more than 50% of a company's equity(voting rights), would be in control, as no matter what proportion of equity a rival bought on the market, he could never wrestle control from the group. In effect, the group had no fear of market forces, as their position of control was always assured. The 50% holding of equity was used by Gerson, Barr and Kantor (1992) as their measure of control, however the measure was felt to be too stringent for this study.

In a study conducted by Demsetz and Lehn (1985), they used a 20% equity holding as indicating control. The American system, as mentioned previously in this thesis, relies on very diffuse shareholdings and, as such, Demsetz and Lehn believed that a 20% holding was sufficient to allow for effective control of a corporation. The 20% limit was felt to be too lax a measure for the South African economy and thus was not used as a measure in this study. The S.A. Securities Regulation Panel (SRP) identified control as 30% of the voting rights of a company (SRP, 1991). The 30% measure is believed to be a reasonable estimate of control and this measure was used as defining control in this study.[5]

As yet no definition exists in financial literature which spells out the precise amount of ownership that constitutes control over a corporation. Hunt (1986) reviewed the available data and revealed that no consensus exists over the amount of ownership which constitutes effective control of the corporation. Evidence supporting Hunt's view reveals that the amount of shares needed to attain control over a corporation may indeed be firm specific, change with shifts in ownership patterns and may indeed be unquantifiable by outside researchers (Uliana and Cohen, 1990). The 30% limit in this thesis is merely a benchmark and it is not the purpose of this thesis to define the exact percentage that is needed for control to be secured.

[5] The SRP changed the Definition in 1995 to 35%, however 30% was still used as the measure of control in this study.

4.4) The study

In order to execute the objective of the study, namely to conclude whether or not a particular managerial monitoring system monitored managers differently to the rest, companies listed on the JSE were analysed.

The sample of operating companies compiled for this study was confined to the Industrial Board of the JSE. The mining sector, which contributed approximately 10% of the country's gross domestic product and comprised 25% of the JSE's Actuaries Overall Index at the end of 1990 (Mathison and Hollidge, 1991), was excluded from the study. The omission was motivated by the fact that the mining companies have different dynamics of ownership and control to that of the industrial companies. Many of the mines are governed by very long term management contracts. These contracts create marked differences between the manner in which mining companies are owned, in contrast to the industrial companies (Gerson, 1992, p19).

The full sample of the study covered 337 firms listed on the Industrial Board of the JSE, which includes all sectors other than mining, property, property trusts and financial services. The industrial companies comprised 47% of the JSE Overall Index for the 1991 year (JSE Monthly Bulletin, 1992).

The study analysed companies over the same five year period (Jan 1991- Jan 1996) and thus any abnormalities which may have been caused by the changes in the economy were eliminated. All companies in the sample experienced the same general business conditions, as the period under review remained the same.

4.5) ***Exclusion of Firms***

A number of firms were excluded from the study and the reasons for their exclusions are listed as follows:

4.5.1) Changes in Ownership Structure

If a firm's ownership structure changed in such a manner that it no longer adhered to the stringent group definitions for any one year under the five that were studied, the firm was excluded from the sample set.

4.5.2) Foreign Controlled Firms

If firms were controlled by foreign companies or individuals, they were excluded from the sample set. Foreign companies have their own regulations which govern them (Uliana) and it was felt a comparison between South African controlled firms and foreign controlled firms would not result in the ability to draw fair conclusions.
25 Foreign firms were identified in 1991 and excluded from the sample.

4.5.3) "Mini" Groupings

Group controlled firms are distinguished by their size. Each one of the six identified groupings controlled greater than 2.5% of the market capitalisation of the JSE. A number of smaller groupings were identified; these groupings were considered to be too small to utilise a system of insider control. These groupings were still very much controlled by a dominant person or family. There may have been a reason to include these groupings in the self sample set. It was decided to exclude these mini groupings from the sample, as it could not be identified which system of monitoring they implemented.

The mini groups identified were:
Pepkor Group - Controlled by C Wiese
FS Group - Controlled by J Liebesman
Ventron Group - Controlled by W Venter

4.5.4) Delisted Companies

All companies that had delisted from the JSE at any time during the five years under review, Jan 1991-1996, were excluded. This point is raised further in the limitations of the study.

4.5.6) Holding Companies

It was decided to exclude industrial holding companies from the sample set. The holding companies do not function as normal business operations. It is the methods used to monitor managers with which this study is concerned and not the performance of holding companies, which is invariably a reflection of the operating companies results. The study therefore reflects the performances of the operating companies of the South African groups, rather than the entire group's performance. This point is perhaps most relevant in relation to the insider group, which is defined later.

The exclusion of the holding companies ensured that any double counting of results was prevented. Holding companies were defined using two distinct characteristics. The first was that those companies which were merely used as shells by owners to ensure that they maintained control over the underlying operating company, were excluded. These shells had no real business operations and their results were simply a reflection of the underlying operating companies. The Pikwik-Pick n Pay shell relationship is an example of such a holding company. Pikwik owns 50% of Pick n Pay and has no business operations of its own. The company, Pikwik, is used as a shell to enable Raymond Ackerman to keep control of Pick n Pay.

The second definition was that those companies which controlled companies of similar significance in more than one sector, were defined as holding companies and excluded from the sample set. This allowed the sample set to reflect companies that operated in one specific industry. An in depth analysis could then be made on the sample set in relation to the sectors which it comprised. A 75/25 rule was used as a yardstick when analysing the companies. Therefore, companies which were operating in more than one industry and their minor operations were greater than 25% of their total operations, were excluded.

The detail of the sample set is illustrated in Table Following :

Total Sample Analysed (1 January 1991)	: 337
Foreign Companies	: 25
Holding Companies	: 85
Outsider Controlled	: 33
Self Controlled	: 100
Insider Controlled	: 46
No Classification (not fit any system)	: 31
Small Groupings	: 17

Of the Samples identified, the following represent the final groupings :

Outsider Controlled : 1/1/1991	**33**
Delisted / Changed Structure	**20**
Outsider Controlled : 1/1/1996	**13**

Self Controlled : 1/1/1991	**100**
Delisted / Changed Structure	**69**
Self Controlled : 1/1/1996	**31**

Insider Controlled : 1/1/1991	**46**
Delisted / Changed Structure	**23**
Insider Controlled : 1/1/1996	**23**

4.6) The Defining Characteristics of the Groupings

The companies were divided into three groupings :

- gIns = Group Controlled (Insider System)
- gOut = Manager Controlled (Outsider System)
- gSelf = Owner Controlled (Self System)

In order for a company to be classified in a particular grouping, it was necessary that such a company had to have maintained the same ownership structure, which complied with the group definitions, for the entire five year period under review. Therefore, companies which were selected in a particular grouping, were truly representative of a company managed by that particular system.

The Mcgregors Who Owns Whom was used in order to determine the ownership structures of the various companies. Where the exact ownership structure of the company was not clear, the company had to be excluded from the sample sets. In cases where nominee companies were used and it was not possible to identify the ultimate owner of the nominee company, the company had to be excluded.

4.6.1) Group Controlled Companies (Insider system)

These companies are controlled by any one of the large South African groupings. Six large groupings were identified in this study and these groupings were the same as those identified by Gerson (1992).

- Anglo American
- Sanlam
- Old Mutual
- Rembrandt
- Anglovaal
- Liberty Life

These six groups together have controlled at least 70% of the market capitalisation of the JSE over the five years of the study. (Mcgregors table p46)

In order for a company to be classified as a Group Controlled company, it is necessary that one of the six large South African groupings controls more than 30% of the company's equity and that no other coalition controls a significant portion of the stock. These stipulations ensure that the company is firmly under the group's control and that the group is under no threat from any market forces. Therefore it is assumed that an insider system of monitoring is in place.

If two parties each held a significant shareholding in a company and each holding was less than 50%, it is possible that market forces could play a large role in determining who actually controls the company. If one party controlled the company and the company underperformed, it would be easy for the rival party to purchase stock on the open market and eventually take control of the firm. Therefore the controlling shareholder must be wary of market forces and it is for this reason that such companies were excluded from the sample set, as there was scope to believe that such companies were not run according to the insider system.

The large percentage of equity (voting rights) owned by the group and the relatively small holdings by other shareholders, place the group in an almost invincible position against potential market take-overs. The absence of the take-over threat leaves the monitoring of managers to the group structure (insider system). The group is motivated to ensure managers perform, as it has invested large amounts of wealth into the company and any mismanagement will have an adverse effect on the group's performance. A further motivating factor to ensure that the groups maintain proper monitoring, is that the group's reputation is built on the ability of its companies to perform. Therefore group structures attempt to ensure their operating companies are run efficiently.

The study identified 23 companies that had complied with all the restrictions of the group definition. The sample is listed in table 2.

Table 2 : Insider Group Controlled Companies

Company Name	Nature	Sector	Av. Beta
Adcock Ingram	SA Mutual	Pharm & Medical	0.42
AECI	Anglo American	Chemicals & Oils	0.78
A. B. I. Ltd	Anglo American	Beverages & Hotels	0.73
CG Smith Foods	SA Mutual	Food	0.68
Chemical Services	Anglo American	Chemicals & Oils	0.57
C.M.I	Anglo American	Steel & Allied	0.63
Da Gama	Anglo American	Cloth, Foot & Textiles	0.95
Edgars	Anglo American	Retail & Wholesalers	0.62
Ellerines	Sanlam	Furniture & Household	0.72
Highveld Steel	Anglo American	Steel & Allied	0.9
Hortors	Anglo American	Paper & Packaging	0.29
I&J	Anglovaal	Food	0.76
Medi Clinic	Rembrandt	Pharm & Medical	0.40
Nampak	SA Mutual	Paper & Packaging	0.81
Oceana	SA Mutual	Food	0.21
PPC	SA Mutual	Building & Construction	0.67
Romatex	SA Mutual	Cloth, Foot & Textiles	0.67
Siltek	Anglovaal	Electronics,Elec & Battery	0.76
Solchem	Anglo American	Printing & Publishing	0.83
SA Druggists	Sanlam	Pharm & Medical	0.9
Std Engineering*	Sanlam	Engineering	0.66
Teljoy	Sanlam	Retail & Wholesalers	0.39
Times Media	Anglo American	Printing & Publishing	0.53

*Standard Engineering was delisted in October 1995, It is nevertheless included in the study for the four years it was in operation
For a more detailed break down of the sample, see appendix 1.

Analysis of sample

Of the 23 firms identified, only one, Medi Clinic corporation, was controlled by Rembrandt and no firms were identified as being controlled by the Liberty Life group. The main reason for the small representation of these large groupings is the method in which they control their companies. Both groupings use a complex method of holding companies to ensure their companies are properly controlled; unfortunately due to this study's exclusion of holding companies, it was not able to include a large percentage of Rembrandt and Liberty Life controlled companies.

The sample grouping included :

10 Companies - controlled by Anglo American
6 Companies - controlled by SA Mutual
4 Companies - controlled by Sanalm
2 Companies - controlled by Anglovaal

It was expected that this grouping should contain a number of firms which relied heavily on research and development projects. The unique insider system provides an opportunity for long term projects to be undertaken by companies which operate in it.

The sector break down of the sample:

Pharmaceutical and Medical	3	13%
Chemical and Oils	2	9%
Beverages and Hotels	1	4%
Food	3	13%
Steel and Allied	2	9%
Clothing and Footwear	2	9%
Retailers and Wholesalers	2	9%
Furniture and Household	1	4%
Paper and Packaging	2	9%
Building and Construction	1	4%
Electronics	1	4%
Printing and Publishing	2	9%
Engineering	1	4%

The sample is not dominated by one large sector; rather, it is a representative collection of almost all the sectors listed on the JSE industrial board. In total, 14 different sectors are represented in the sample. This result serves to illustrate the diversification of the large South African corporate groupings. The corporate groupings control companies in almost every sector. The biggest representation is nevertheless from the pharmaceutical sector. If the pharmaceutical sector and oil sector contributions were added together, they would comprise nearly 25% of the sample. This may have been expected, as it is these two sectors which rely greatly on research and development projects and large capital expenditures which take time to pay-off.

4.6.2) Management Controlled Companies (Outsider System)

These companies are not controlled by any one dominant shareholder. Management in these companies is left to run the company as it wishes. Without a dominant group or individual to ensure management performs, the company is left at the mercy of the incumbent management. However, if management perform badly, they run the risk of being taken-over by a hostile rival (Jensen, 1987). These potential rivals are easily able to use the capital market to buy enough equity to dispose of management. Those companies in which a single set of stakeholders did not own greater than 30% of the equity were said to fall into this category. For these companies the threat of a take-over is a very real threat and, as such, the managers are motivated through take-over fears. Thus companies utilise the outsider system of monitoring to ensure that they are properly managed.

This classification was dependent on the amount of outsider shares which were not owned by significant shareholders. It was assumed that it is harder for potential purchasers to buy stock from significant stockholders than from the general market. Significant stockholders are usually long time investors that have developed relationships with management. It is therefore assumed that these significant investors would be reluctant to sell their stock. Companies were therefore only included in this group if the outstanding shareholding not held by significant stockholders, was great enough to ensure its purchase could dislodge the incumbent management team.

Table : Outsider Controlled Companies

Company Name	Sector	Av. Beta
Crookes Brothers	Food	0.81
General Optical	Pharm & Medical	1
Iscor	Steel & Allied	0.38
Jasco Engineering	Electronics, Elec & Battery	0.83
Macadams Bakery Supplies	Food	0.5
Natal Ocean Trawling	Food	0.37
Penrose	Printing	0.07
Sasol	Chemicals & Oils	0.77
Sterling	Cloth, Footwear & Textiles	0.67
Towles Edgar Jacobs	Cloth, Footwear & Textiles	0.36
Usko	Steel & Allied	1.22
Waltons	Retailers & Wholesalers	0.88
Wooltru	Retailers & Wholesalers	0.73

For a more detailed break down of the sample see appendix 2.

13 Companies were identified as being outsider companies for the entire period. This grouping is the smallest in size of the three groups. It is to be expected that companies in this sample set would not rely heavily on research and development projects. The potential short term approach of such a system would ensure that no long term projects were undertaken by such companies.

Sector Break Down

Clothing, Footwear and Textiles	2	15%
Retailers and Wholesalers	2	15%
Steel and Allied	2	15%
Food	3	23%
Chemicals and Oils	1	7.5%
Pharmaceuticals	1	7.5%
Electronics	1	7.5%
Printing and Publishing	1	7.5%

Together the retail and clothing sector account for 30% of the sample; this was expected, as neither of these two sectors rely on major research and development projects. The inclusion of Sasol and Iscor in this group may add a certain extra dimension to this sample. Both Iscor and Sasol were state owned companies which were sold off by the state through the issuing of equity. These companies may have different characteristics to the other companies which were identified, but nevertheless it was decided to include these companies in the sample set.

4.6.3) Owner Controlled Companies (Self system)

Owner controlled companies are those companies which are controlled by individuals, families or consortiums other than groups. The owners are responsible for managing the firm. In order to qualify for this grouping, the controllers had to own more than 30% of the equity (voting rights) of the company and one of the members of the identifiable coalition or family had to serve on the companies board of directors. If the company was owned by one individual, then it was required that the individual served as a director.

It is the controllers that pressure management to perform. These companies are under no direct threat from the take-over market and it is the owners themselves who manage the firm. The difficulty of classifying firms into this grouping was in the defining of the coalition. It is for this reason that most of the firms listed in this sample are family controlled. Family controlled firms are almost all typical of the owner controlled system.

Table of Owner controlled Firms

Company Name	Nature	Sector	Av. Beta
Adonis Kniwear	Beneen Family	Clothing, Foot & Textiles	0.14
Adv. Tech. Systems	Directors	Elec, Electrical & Battery	0.67
Aries Packaging	Directors	Paper & Packaging	0.54
Aroma Liquor	Kovensky Family	Ret & Wholesalers	0.39
Arthur Kaplan Jewellers	A Kaplan	Ret & Wholesalers	0.47
Bowler Metcalf	Directors	Paper & Packaging	0.52
Brenner Mills Ltd.	Brenner Family	Food	0.43
Burlington Industries	Kawitsky Family	Clothing, Foot & Textiles	0.21
Décor Investments	Directors	Ret & Wholesalers	0.75
Ensign Clothing	Roy Family	Clothing, Foot & Textiles	0.26
Foschini Ltd.	Lewis Family	Ret & Wholesalers	0.61
Glodina Holdings	Balladon Family	Clothing, Foot & Textiles	0.87
IB Joffe Ltd.	Joffee Family	Retailers & Wholesalers	0.24
Ilco Homes	Demmers Family	Building & Construction	0.32
Italtile	Directors	Building & Construction	0.66
Kopp Electronics	Directors	Elec, Electrical & Battery	1.07
Mas Holdings	Van Embden Family	Retailers & Wholesalers	0.39
Mathieson & Ashley	Ringo Family	Furniture & Household	0.35
Ninian & Lester	Shroder Family	Clothing, Foot & Textiles	0.26
Nu-World Holdings	Directors	Elec, Electrical & Battery	0.46
Pals Holdings	Kagan Family	Clothing, Foot & Textiles	-0.02
Pick 'n Pay Stores	R Ackerman	Retailers & Wholesalers	0.67
Publico Ltd.	Directors	Printing & Publishing	0.47
Putco	Carleo Family	Transport	0.96
SA Bias Industries	Seabrooke Family	Clothing, Foot & Textiles	0.68
Spescom Electronics	Farah Family	Elec, Electrical & Battery	1.06
Strebel group	Strebel Family	Clothing, Foot & Textiles	0.32
Transpaco	Abelheim Family	Paper & Packaging	0.65
Trencor Ltd.	Jowell Family	Transport	0.54
WB Holdings	Directors	Food	0.55
York Timber	Tucker Family	Building & Construction	0.22

For a more detailed analysis of the sample see appendix 3.

31 Companies were identified as being controlled by one particular family or identifiable coalition. The majority of these companies had begun as small family businesses and then expanded to their present form. The South African system of allowing companies to issue low voting stock through the pyramid schemes, has allowed a number of families to maintain control of their firms, even though their effective holding of the firm's equity is less than the required rate for control. Thus the JSE has a large number of its companies owned by single, identifiable owners.

Sector Break Down

Sector	No.	Percentage
Clothing	8	26%
Retailers and Wholesalers	7	23%
Electronics	4	13%
Paper & Packaging	3	9.5%
Food	2	6.5%
Building & Construction	3	9.5%
Printing and Publishing	1	3%
Furniture & Hoiusehold	1	3%
Transport	2	6.5%

4.6.4) Group Constructions

The actual number of companies identified in each category of this study is similar to the numbers identified by Uliana and Cohen in their 1990 study. Using slightly different group definitions, Uliana and Cohen (1990) identified 39 owner controlled companies and 28 Conglomerate controlled companies. Unfortunately the Uliana and Cohen (1990) study did not specify manager controlled companies.

In grouping companies according to control classification, Uliana (1988) selected sample companies such that three matched groups based on industry and size resulted. In a similar study Shuttleworth (1987) did not employ matched groups. The findings of both the Uliana (1988) and Shuttleworth (1987) study were similar and thus indicate that there does not seem to be a bias in favour of or against groups constructed on different bases with regard to industry or size (Uliana and Cohen, 1990). The groups in this study were not constructed on the matching bases, but the risk adjustment (see section 4.7) and the use of a base year were utilised to ensure that the size and industry effects were accounted for in the final results of the study.

In a study conducted by Savage (1978) of the 100 largest S.A industrial companies quoted on the JSE, it was found that only 14% of these companies were management controlled. Although this study uses slightly different criteria to categorise management controlled companies, it nevertheless indicates that management controlled firms are in the minority in South Africa. The small management controlled grouping is therefore consistant with the Savage (1978) findings.

4.7) Limitations of the Study

4.7.1) Winners Bias

The study parameters excluded any firms that may have delisted in the sample period. These exclusions limited the study to only analysing those companies which had been successful for the five year period. The study may therefore have taken on what may be defined as a "winners bias". The sample analysed represented those companies that had succeeded under their particular monitoring system and not necessarily the monitoring systems true performance. The study may therefore be measuring the relative successes of each system relative to the other, rather than the actual ability of the various systems to monitor managers. In order to ensure that all firms met the five year criteria and were compared over the same time frame, companies which had delisted over the period had to be excluded from the study. A further problem created by companies delisting is that available information on these companies is seldom acessible. It was therefore impossible to use companies that had delisted in the sample set.

4.7.2) Change in Ownership Structure

If ownership structures are changed and this results in a change of monitoring systems, it may take some time before the company is affected by the new system. The problem for researchers is, therefore, deciding when a new system has changed managerial styles. In order to avoid such problems, this study analyses firms with management styles which have remained constant for the full five year period. Perhaps better conclusions could have been drawn by analysing firms which changed monitoring styles; this method would have allowed for the monitoring systems to be compared directly. However, such a study

would encompass the problem stated: that it would have to define when the changes to the monitoring system took effect. It is possible to expect that different companies would have different time horizons for changes to take effect and as such the feasibility of such a study is seriously questioned.

4.7.3) Combination of A & B type groupings

A limitation of the study may lie in the fact that firms which were controlled by A and B type groups (as defined in section 3) were included in the same sample. It may have been more accurate to divide the group controlled companies into A and B groupings. However, in order to get a meaningful sample size, it was decided to combine the A and B type groupings into one. There is a sense, however, that it is not strictly correct to compare the management of a mutual organisation to that of a conventional industrial company (Gerson, 1992, p14). There may thus be a case to leave out the Sanlam and Old Mutual controlled companies; however, as these companies control such a large percentage of the companies listed on the JSE, a study without them would provide no conclusive results.

Conclusion

Section four details the appproach which was taken to define the three groupings and the measurements which will be used to conclude on the study's null hypothesis: that all monitoring systems monitor managers equally. The following section will elaborate on the statistical methods which were used to test the null hypothesis, the reasons for using the various statistical techniques and the results which were obtained.

Section V

Statistical Tests And Results

Introduction

THis section details the statistical tests used in the study, as well as the findings. This research was concerned with identifying differences in the populations examined. In order to reach this objective, the means of the samples were used and analysed to ascertain whether they differed. It was important that if differences were identified, they represented real differences in the population, rather than merely arising from the random sampling process. Consequently, it was necessary to test the means for the significance of difference.

The t-test compares the means of two samples and identifies the probability that the difference between the sample means is due to sample variation. In certain instances where more than two samples are identified for analysis (in this case, three), it is not appropriate to merely carry out the t-test across all pairs of samples. This approach would increase the probability of error. At a 95% level of confidence, there is a five percent probability of a Type 1 error occurring. Type 1 errors occur when the statistical testing indicates significant difference and in reality no real significant difference exists. Since there are three combinations of samples, the t-test would be performed three times and would increase the probability of an error (Underhill and Bradfield, 1994).

The Analysis of Variance technique (ANOVA) tests for significant differences in the means of more than two samples (Underhill and Bradfield, 1994). At a 95% level of confidence, the probability that the test would conclude an erroneous result is limited to five percent.

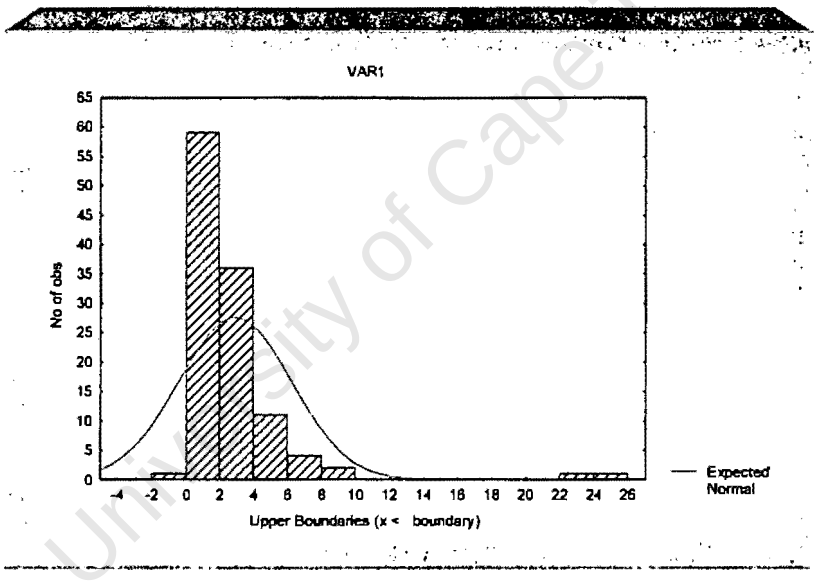
5.1) *Statistical Assumptions*

Both the Anova test and the t-tests are parametric tests. The main assumption when using a parametric test is that the underlying data set is normally distributed (Underhill and Bradfield, 1994). Thus before using these tests, it is imperative to define whether the underlying data set is normally distributed or not.

Distribution of the Underlying Sample Sets.

Histograms were run in order to test the underlying data.

Histogram : Sample of Insider Companies

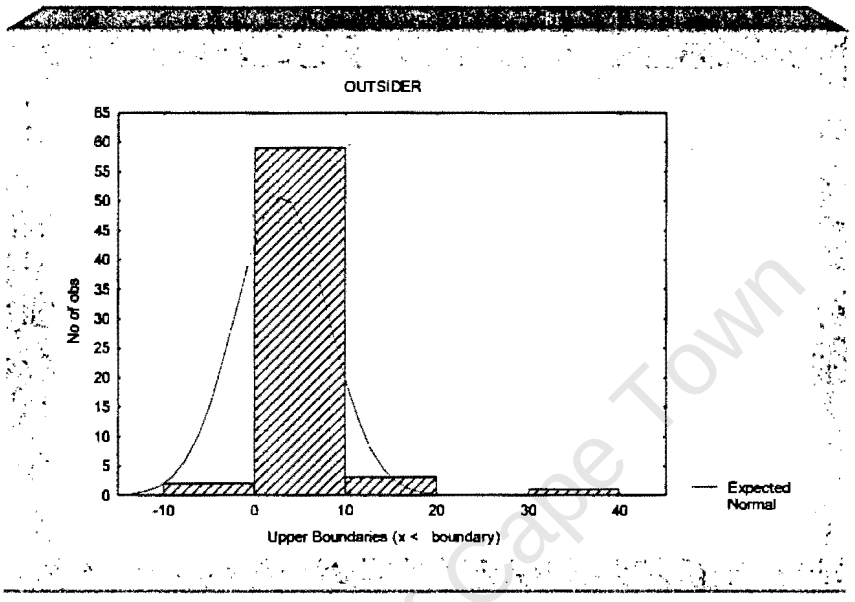


Summary

Descriptive Statistics

	Obs.	Mean	Min	Max	Var.	Std Dev	Skew	Kurt.
Insider	115	2.86	0	25.77	11.01	3.32	4.85	28.75

Histogram : Sample of Outsider Companies

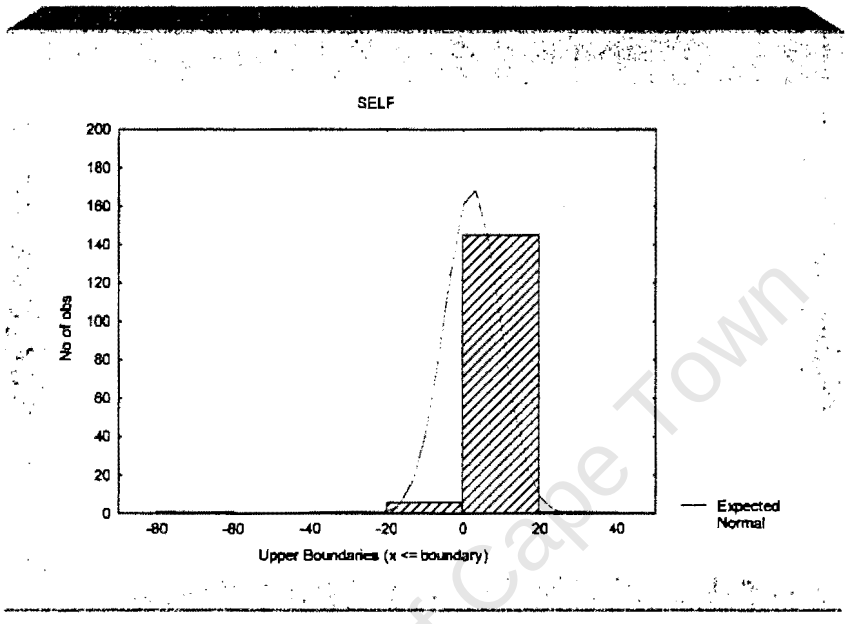


Summary

Descriptive Statistics

	Obs.	Mean	Min	Max	Var.	Std Dev	Skew	Kurt.
Insider	65	2.90	-4.92	36.81	25.99	5.1	4.96	31.17

Histogram : Self Companies



Summary

Descriptive Statistics

	Obs.	Mean	Min	Max	Var.	Std Dev	Skew	Kurt.
Insider	154	2.33	-68.43	34.64	52.18	7.22	-5.96	63.71

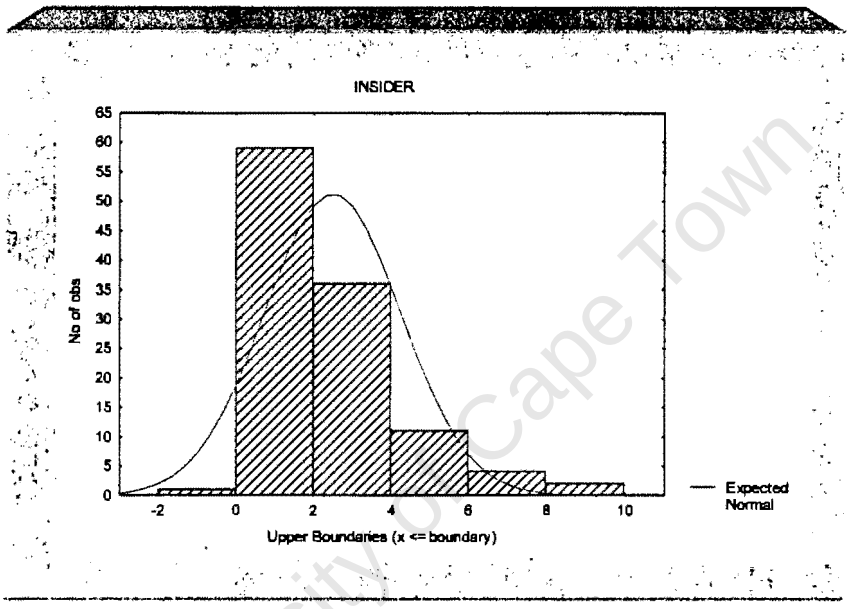
The normal histograms which are documented above, indicate that the three samples do not comply with the normal assumption. All three groupings had exceptionally high skewnes and kurtosis measures. The Insider grouping had a skewness level of 4.85, which was evident from the histogram in the manner that the data was skewed to the right. Similarly the Outsider sample had a skewness level of 4.96 and this was also evident from the slanting of the data to the right. The Self grouping had a skewness level of – 5.97, caused by the data being skewed to the left. All three samples also had very high kurtosis measures, with the Self sample having a kurtosis of over 60. It is generally accepted that a skewness level of less than two implies that the underlying sample set is normally distributed (Daniel, 1983). It was evident that none of the presented sample groupings complied with this normality assumption.

In such a scenario, one has two options. Either adjust the sample groupings for outliers and continue with a more normally distributed sample set, or else make use of a statistical testing technique which does not rely on the underlying data sets being normally distributed. A statistical technique which does not rely on the underlying samples being normally distributed is known as non-parametric testing. Such testing, while not being as powerful as the parametric tests, nevertheless supplies a valuable method from which to test the null hypothesis (Daniel, 1983).

It was decided to adjust the samples for outliers and attempt to structure the sample sets in a more normal, fitting manner. The samples were therefore adjusted for outliers. The outliers are clearly visible from the frequency counts below.

The new sample sets were tested for normality.

Insider Grouping (adjusted)



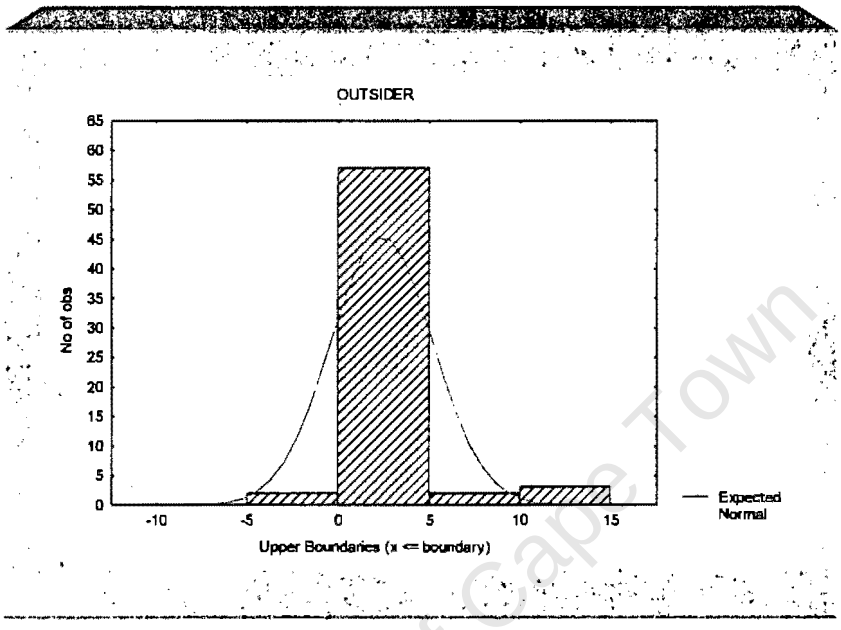
Summary

Descriptive Statistics

	Obs.	Mean	Min	Max	Var.	Std Dev	Skew	Kurt.
Insider	**113**	**2.48**	**0**	**9.73**	**3.09**	**1.76**	**1.9**	**4.23**

- 2 Outliers Removed (22 and 26)

Outsider



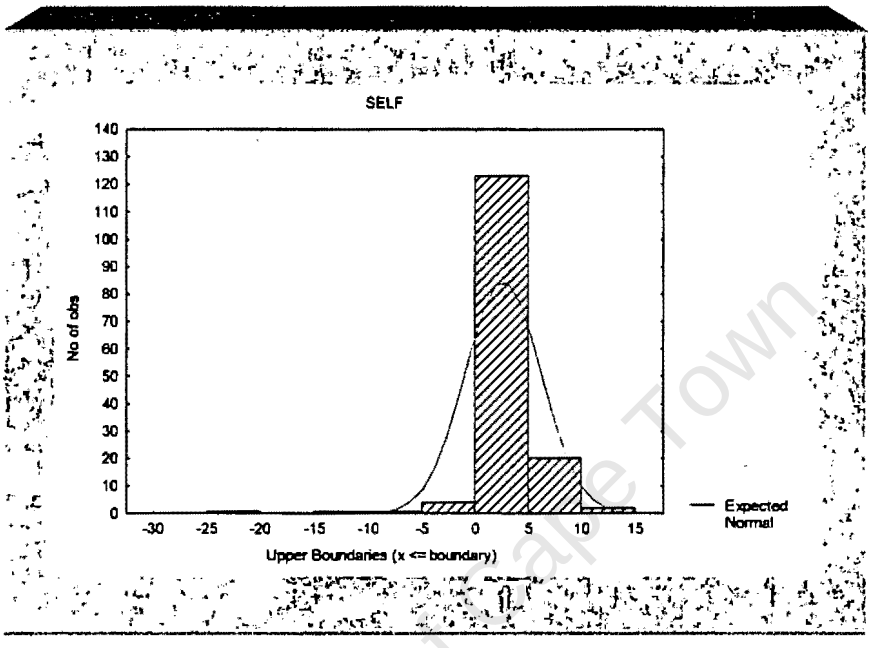
Summary

Descriptive Statistics

	Obs.	Mean	Min	Max	Var.	Std Dev	Skew	Kurt.
Insider	**64**	**2.37**	**- 4.92**	**12.91**	**7.87**	**2.81**	**1.94**	**6.45**

- 1 Outlier Removed (37)

Self



Summary

Descriptive Statistics

	Obs.	Mean	Min	Max	Var.	Std Dev	Skew	Kurt.
Insider	**152**	**2.58**	**- 23.96**	**14.77**	**12.7**	**3.56**	**-3**	**22.44**

- 2 Outliers Removed (-68 and 35)

The new results indicate that the adjusted samples presented a much closer normal distribution set. The only sample which was slightly above the 2 point skewness measure was the Self sample.

Further evidence of the samples conforming to normality can be obtained from a closer inspection of the central limits theorem. The central limits theorem indicates that as one's sample increases and moves closer to infinity, so the underlying assumption of normality can be assumed (Underhill and Bradfield, 1994). It is generally accepted that a sample of 100 observations is sufficient to assume normality (Underhill and Bradfield, 1994). In two of the three cases, the samples presented have observations of well over 100. The Self grouping, even after it has been adjusted for outliers, has over 150 observations.

It can therefore be assumed that the adjusted samples all comply with the underlying assumption that they are normally distributed. Parametric testing can, therefore, be executed on the adjusted samples. It was felt that to execute parametric testing on the adjusted samples would provide a more conclusive test than if non-parametric tests were run on the unadjusted sample. Nevertheless, the unadjusted samples were tested non-parametrically to determine whether the test results differed.

One further test was run on the adjusted samples to ensure that normality was adhered to. The test known as the Schapiro Wilk W Test was executed in order to test that the underlying samples all had homogenity in their variances. The findings of this test further added to the evidence that the adjusted samples were normally distributed.

5.2) Parametric Testing

5.2.1) *Anova Test*

The Anova results for the adjusted sample set indicate that there is no significant difference at the 95% confidence level between the three groupings mean returns. The p value of the Anova table is 0.8878 and is higher than the 0.05 level of significance parameter.

Anova Test

Overall p value : $p < .8878$

	Insider (2.48)	Outsider (2.37)	Self (2.58)
Insider	-	.8076	.7909
Outsider	.8076	-	.6337
Self	.7909	.6337	

The summary of mean table (below) illustrates the precise value of each groupings mean returns. The Self grouping, with a mean return of 2.58, is greater than both the Outsider (2.37) and Insider (2.48) groupings.

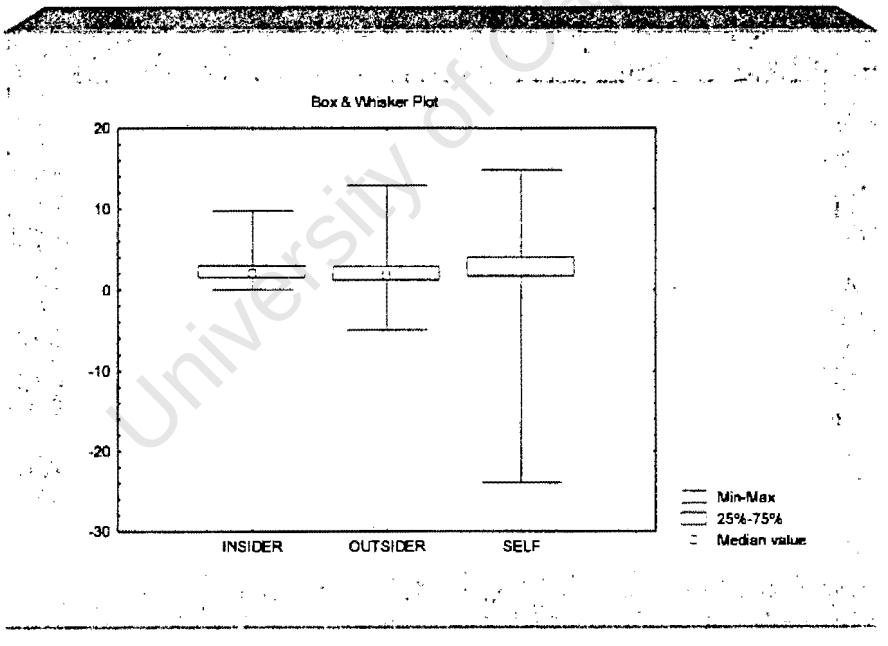
Mean Table

Insider Mean	**2.4848**
Outsider Mean	**2.3738**
Self Mean	**2.5808**

The box and whisker plot for the adjusted sample further demonstrate the close proximity of the various sample groupings. The samples overlap to a large extent and there is very little difference between them. This illustrates the relative closeness of the returns.

Box and Whisker of Adjusted Sample.

Box and Whisker



5.3) Frequency Distributions of the Sample Data

From the median plot it is possible to gauge the distribution of the sample sets. The box indicates where 50% of the observations were identified. The cumulative counts adds further to the analysis. The insider group consisted of 115 observations. This was the return of the 23 companies identified in table 2 for all five years under review. The outsider group consisted of 65 observations (13 companies for five years) and the Self group consisted of 154 observations (one observation, Standard Engineering, was excluded in the final year).

The Insider returns are mostly distributed between the 0 and 4 return marks. 83% of the data points lie in this region. The majority of the returns - 51% - lie in the region between 0 and 2. Translated into ordinary returns, this is between –100% and +100%. Of the Outsider returns, 55% of the returns were positioned between the 0 and 2 marks. For the Self sample set it was illustrated that 92% of the data set was in the range 0-10. On closer inspection it was established that just over half of the data was to be found between the 0 and 2 range.

The frequency plots add further to the evidence that there is very little difference between the different samples.

Frequency Plots

Self : Frequency Plot

Category	Count	Cumul Count	% in Count
-70 < X < -60	1	1	0.649
-60 < X < -50	0	1	0
-50 < X < -40	0	1	0
-40 < X < -30	0	1	0
-30 < X < -20	1	2	.649
-20 < X < -10	1	3	.649
-10 < X < 0	5	8	3.247
0 < X < 10	143	151	92.857
10 < X < 20	2	153	1.299
20 < X < 30	0	153	0
30 < X < 40	1	154	.649

Outsider Frequency Plot

Category	Count	Cumul. Count	% in Count
-6<X <-4	1	1	1.539
-4<X <-2	1	2	1.539
-2<X< 0	0	2	0
0<X< 2	36	38	55.384
2<X< 4	18	56	27.692
4<X< 6	4	60	6.153
6<X< 8	0	60	0
8<X< 10	1	61	1.539
10<X<12	1	62	1.539
12<X<14	2	64	3.077
14<X<16	0	64	0
16<X<18	0	64	0
18<X<20	0	64	0
20<X<22	0	64	0
22<X<24	0	64	0
24<X<26	0	64	0
26<X<28	0	64	0
28<X<30	0	64	0
30<X<32	0	64	0
32<X<34	0	64	0
34<X<36	0	64	0
36<X<38	1	65	1.539

Insider

Category	Count.	Cumul. Count	% Count
-4<X<-2	0	0	0
-2<X< 0	1	1	0.8696
0<X< 2	59	60	52.1739
2<X< 4	36	96	83.4783
4<X< 6	11	107	93.0435
6<X< 8	4	111	96.5217
8<X< 10	2	113	98.2609
10<X<12	0	113	98.2609
12<X<14	0	113	98.2609
14<X<16	0	113	98.2609
16<X<18	0	113	98.2609
20<X<22	0	113	98.2609
22<X<24	1	114	99.1304
24<X<26	1	115	100.00

In an attempt to clarify the debate as to whether or not adjusting the sample set for outliers had any bearing on the final outcome of the study, it was decided to test the unadjusted samples on a non-parametric basis.

5.4) Non Parametric Tests

Although non-parametric testing is not as powerful as parametric testing, it nevertheless has a number of advantages :

5.4.1) Advantages of Non-Parametric Testing (Daniel, 1983, pp 16)

- As most non-parametrics have very few assumptions, the chances of the tests being used improperly are very small.
- Computations can be quickly and easily performed for some procedures.
- Concepts and Methods are generally easier to understand than with parametric testing.
- Non parametric testing can be used when data is measured on a weak scale, such as count data or rank data.

5.4.2) Scheffe's Test

The Scheffe's Test was used as the non-parametric test to determine whether the null hypothesis held true or not.

Scheffe's Test

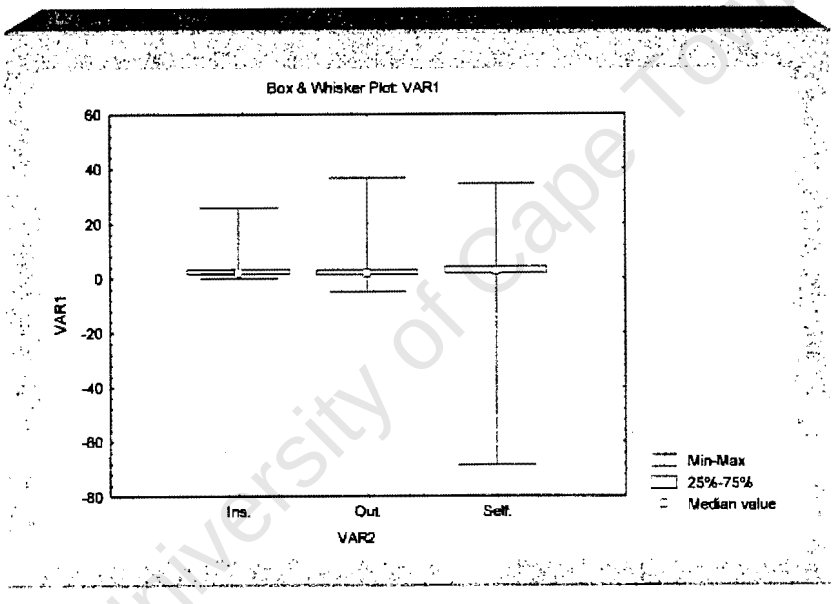
Marked Differences are significant at $p < .05$

The following table illustrates the various p values

	Insider : Mean = 2.86	Self : Mean = 2.33	Outsider : Mean = 2.38
Insider Group	-	.7307	.8504
Self Group	.7307	-	.9980
Outsider Group	.8504	.9980	-

The test delivered the same result as did the Anova test with adjusted samples. Both tests confirmed that the null hypothesis of the study held true and that there were no differences in the various sample's means.

Box and Whisker of non-adjusted samples



5.5) *Conclusions*

The first and most important conclusion that can be drawn from the study, is that the null hypothesis holds true: no significant differences exist between the mean returns of the three groupings. We can therefore conclude that the monitoring system used by listed companies to monitor managers has no effect on the companies' results.

This conclusion must, however, be qualified in light of the various assumptions and limitations of the study, as detailed in Section IV.

It is possible, as has already been stated in this thesis, to assume that different companies, depending on their operations, will perform better under different monitoring systems. The results of this study tend to indicate that there is a certain performance measure that the market demands. If a company and its monitoring system can not provide the acceptable return, then either the company will have to change its monitoring system, or else the market will not tolerate its survival and it will have to delist.

This conclusion is similar to the survivor approach adopted by Fama and Jensen (1983b). It was their belief that all forms of organisations compete with one another in their ability to provide goods and services at the lowest cost. It is concluded in this thesis that all forms of monitoring compete with one another and that only the best monitoring systems survive. This does not mean to say that only one form of monitoring should exist, but rather that the best monitoring system will prevail. If a particular system can not meet the requirements of the market, it will soon be replaced by another system. It is possible that this will continue until the best monitoring system for that company is determined. There seems to be an acceptable return requirement which the market dictates. All monitoring systems must therefore ensure that they provide a return which is within the acceptable region.

The question may well be asked: why do all three monitoring systems still operate? A possible answer is that certain monitoring systems operate better under different conditions. Each particular firm may have its own optimal monitoring system, but it is feasible that these optimum monitoring systems differ from firm to firm. In much the same way that a partnership, as opposed to a closed corporation or company, may be the more appropriate business form for a given business enterprise, so it may be that the internal monitoring system may be the more appropriate system for that firm, as opposed to the alternatives.

5.6) *The Results of this Study in Relation to Others*

5.6.1) International

The results of international studies must be viewed with a degree of caution. Most foreign countries have different economic environments to South Africa and thus their findings may not hold true for the South African setting.

An American study conducted by Oswald and Jahera (1991) concluded that increased ownership of companies resulted in increased shareholder returns. The conclusion of the Oswald and Jahera study favours the insider and self form of monitoring, as opposed to the outsider form. Both the insider and self monitoring systems rely on shareholders increasing their ownership stakes in companies and assuming a role as monitors. The outsider system, which is so prevalent in the USA, does not encourage shareholders to form large holdings.

It is interesting to note that a number of American studies have demonstrated that the forming of large shareholder blocks, significant shareholders, has resulted in increased shareholder returns (Holderness and Sheehan, 1988) (Oswald and Jahera) (Shome and Singh, 1995). This evidence tends to illustrate that a system of internal or self monitoring may, in fact, be more efficient for American companies to utilise.

5.6.2) South African Studies

Uliana and Cohen (1990) concluded in their study that no difference existed regarding the return on shareholder equity and shareholder compensation, between conglomerate controlled, foreign controlled and owner controlled firms. The results of this study tend to support the Uliana and Cohen (1990) finding. Both studies concluded that no difference existed between the returns of the various control structures. It appears that the Uliana and Cohen (1990) finding, which included foreign firms, would add to this study's results. Foreign controlled firms, it is suggested, would have to provide shareholders the same competitive returns that the other firms in the market were providing, or else they themselves would face extinction.

Uliana and Day (1990) performed a study on owner controlled companies versus professionally managed companies. The study examined financial differences between the two sets of companies. The study concluded that owner managed companies were marked by financial conservatism in relation to professionally managed companies. This result appears to be consistent with the risk profiles of the sample groupings in this study. However, the Uliana and Day (1990) study differed substantially from this study in its group classifications. The study also used only accounting measures to test its findings and, as such, a comparison between this study and the Uliana and Day (1990) study is not drawn, as the two studies are too different to compare.

In a study conducted in 1988, Affleck-Graves, Burt and Cleasby concluded that the shareholder returns of South African conglomerates do not differ significantly at the 95% level of confidence from the returns offered by a randomly selected market portfolio. These results further substantiate this study's findings, as the conglomerate grouping used by Affleck-Graves, Burt and Cleasby was similar in form to the insider grouping used in this study.

5.7) *Concluding Comments*

The South African Government appears determined to see that a number of the major South African companies unbundle. The Government believes that such an unbundling of corporate control would enable new entrepreneurs to gain power and it would facilitate the growth of the South African economy. The Government has even commissioned a committee to develop an unbundling law, which will then ensure that companies are legally forced to unbundle (Volschenk, 1996).

The Insider system of control was not found to monitor its managers any worse than the other systems of control. It would seem that any legislation which impeded the insider type of monitoring system could have only a negative consequence for the South African economy, as a relatively efficient monitoring mechanism would be eliminated.

If the Government implemented a law which prevented companies from operating in a pyramid form, it is debatable whether such a law would actually affect the Insider system at all. The recent unbundlings have shown that the large groups can afford to hold high portions of equity, even when their pyramid structures have collapsed. For example, the recent unbundlings of the Sanlam and Old Mutual grouping have left both Sanlam and Old Mutual controlling the majority stakes in the newly formed unbundled companies. Sanlam still maintains the greatest individual stake in Gencor and its unbundled parts,

whereas Old Mutual still controls more than 30% of Barlows and its newly formed unbundled parts (Barr, Gerson and Kantor, 1995).

The forced unbundling would probably have the most effect on those companies which are owned and managed by the same people, ie, those who make use of the self system. Thus it is feasible that an unbundling policy may indeed further concentrate the control of the South African economy.

Certainly the elimination of the pyramid structures on the JSE would make forming new groupings much harder. In the light of this study's results, it is suggested that the government attempt to create a favourable climate for groupings to evolve, as this would encourage the insider monitoring system to develop and create an important alternative from which shareholders can choose when monitoring managers.Already new black groupings such as Nail seem set to attempt to manage their companies via the insider system (Barr, Gerson and Kantor, 1995). The findings of this study thus support the view shared by Barr, Gerson and Kantor (1995) and Barr and Kantor(1994) that the unbundling of the large South African groupings is contrary to the best interests of the shareholders

5.8) *Future Studies*

This thesis has attempted to analyse the various monitoring systems which have dominated the South African corporate environment. The results of this thesis are thus limited to the South African economy. It is believed that future studies may attempt to establish why certain monitoring systems have evolved in the countries in which they are found. An in depth analysis focussing on a number of countries may establish which system provides which countries with the most efficiency.

On a local level, it is felt that a further break down of the monitoring systems into more defined groupings may add to the findings of this thesis. A stricter definition of the insider system, with type A and B groupings being classified separately, may provide an interesting analysis of the performance of the mutuals as monitors.

Section VI

Summary

Introduction

The results of this study provide evidence that no significant difference exists at the 95% confidence level between the mean returns of the three monitoring systems identified.

Companies that had maintained the same monitoring systems for the five years under review, all obtained a similar return for their shareholders. This finding has led to the conclusion that if a particular monitoring system is not efficient for a company, it will soon be replaced by a monitoring system that provides the company's shareholders a competitive return.

The findings thus indicate that different companies, depending on their culture, industry and form of operation, will be better suited by different monitoring systems.
The study originally set out to determine whether, in fact, one monitoring system outperformed the other two. It is therefore concluded that no single monitoring system is better than the rest on a country level, but rather that particular systems provide better solutions to the agency problem for different companies.

This finding therefore explains to a degree the reason why all three monitoring systems still operate in the South African economy.

The other intended objective of the study was to add to the current debate on whether unbundling and, in particular, the tight concentration of economic power, is detrimental to the South African economy.

The results of the study tend to suggest that insider companies, those controlled by the major South African groupings, do not underperform compared to the other companies. The findings, therefore, support the current status quo of the South African economy.

It is concluded that the current attempts by the South African government to force the large South African groups to relinquish control of their operating companies is, in fact, detrimental to the efficiency of the economy as a whole. It is further highlighted that forced unbundling may affect the self monitoring system and the owner/managers to a greater degree than it would the group structures.

The group structures provide an efficient alternative to the other monitoring systems and it is felt that any attempts to eliminate this option would only impede on the efficiency of South African corporations.

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Appendix 1

Insider/Group Controlled Companies

Company name	Year 1992	Year 1993	Year 1994	Year 1995	Year 1996
Adcock Ingram Controller : SA Mutual	"+/- 74%	"+/- 74%	"+/- 74%	"+/- 74%	"+/- 74%
AECI Controller : Anglo American	>70%	>70%	>70%	>70%	>65%
Amalgamated Beverage Industries Ltd Controller : Anglo American	"+/- 68%	"+/- 68%	"+/- 68%	"+/- 68%	"+/- 68%
CG Smith Foods Ltd Controller : SA Mutual	"+/-83%	"+/-83%	"+/-83%	"+/-83%	"+/-83%
Chemical Services Ltd Controller : Anglo American	>65%	>65%	>65%	>65%	>65%
Consolidated Metallurgical Industries Controller : Anglo American	>55%	>55%	>55%	>55%	>55%
Da Gama Textiles Controller : Anglo American	>66%	>65%	>65%	>60%	>60%
Edgars Stores Controller : Anglo American	>62%	>64%	>64%	>64%	>64%
Ellerine Holdings Ltd Controller : Sanlam	"+/- 68%	"+/- 68%	"+/- 68%	"+/- 69%	"+/- 69%
Highveld Steel & Vanadium Controller : Anglo American	>53%	>62%	>62%	>62%	>62%
Hortors Ltd Controller : Anglo American	>88%	>88%	>88%	>88%	>81%
Irvin & Johnson Ltd Controller : Anglovaal	"+/- 70%	"+/- 70%	"+/- 70%	"+/- 70%	"+/- 70%
Medi Clinic Corporation Controller : Rembrandt	"+/- 93%	"+/- 93%	"+/- 86%	"+/- 85%	"+/- 81%
Nampak Ltd Controller : SA Mutual	"+/- 65%	"+/- 65%	"+/- 65%	"+/- 65%	"+/- 65%
Oceana Fishing Group Ltd Controller : SA Mutual	"+/- 70%	"+/-69%	"+/- 68%	"+/- 68%	"+/- 68%
Pretoria Portland Cement Controller : SA Mutual	>63%	>63%	>63%	>63%	>63%
Romatex Ltd Controller : SA Mutual	>55%	>55%	>55%	>55%	>55%
Siltek Ltd Controller : Anglovaal	>65%	>65%	>63%	>57%	>57%
Solchem Investments Holdings Controller : Anglo American	>76%	>79%	>79%	>79%	>79%
South African Druggists Controller : Sanlam	"+/- 89%	"+/- 85%	"+/- 85%	"+/- 84%	"+/- 84%
Standard Engineering Controller : Sanlam	>77%	>77%	>77%	>77%	>83%
Teljoy Holdings Controller : Sanlam	>70%	>54%	>54%	>60%	>60%
Times Media Ltd Controller : Anglo American	>65%	>65%	>65%	>74%	>74%

Appendix 2

Outsider Controlled Companies

	1992	1993	1994	1995	1996
Crookes Brothers					
Most Significant Shareholder :	Crookes Family	Crookes Family	Crookes Family	Crookes Family	Crookes Family
% Held	20%	20%	20%	22%	22%
General Optical					
Most Significant Shareholder :	Nedbank	Nedbank	Nedbank	Nedbank	Nedbank
% Held	21%	21%	21%	21%	21%
Iscor Ltd					
Most Significant Shareholder :	Ind. Dev. Corp	Ind. Dev. Corp	Ind. Dev. Corp	Standard Bank	Standard Bank
% Held	16%	16%	16%	19%	22%
Jasco Electronics					
Most Significant Shareholder .	Delta PLC	Delta PLC	Delta PLC	Delta PLC	Delta PLC
% Held	21%	21%	21%	21%	21%
Macadams Bakery Supplies					
Most Significant Shareholder :	Poulliart, R	Poulliart, R	Poulliart, R	Poulliart, R	Poulliart, R***
% Held	16%	25%	25%	26%	30%
Natal Ocean Trawling					
Most Significant Shareholder :	Libertas Admin.	Libertas Admin.	Libertas Admin.	Libertas Admin.	Libertas Admin.
% Held	27%	27%	27%	22%	21%
Panrose Holdings					
Most Significant Shareholder :	Mekler, J	Nat. Pers. Bpk.	Alletzhauser, A	Uys, D	Uys, D
% Held	21%	29%	29%	23%	30%
Sasol Ltd					
Most Significant Shareholder :	Konoil P/L	Konoil P/L	Konoil P/L	STD Bank	STD Bank
% Held	16%	15%	16%	13%	16%
Sterling Clothing					
Most Significant Shareholder :	SA Mutual	SA Mutual	SA Mutual	SA Mutual	SA Mutual
% Held	21%	22%	22%	22%	22%
Towles, Edgar, Jacobs					
Most Significant Shareholder :	Jacobs, R	Jacobs, R	Jacobs, R	Jacobs, R	Jacobs, R
% Held	16%	16%	16%	17%	17%
Usko					
Most Significant Shareholder :	Iskor	Iskor	Iskor	Iskor	Iskor
% Held	28%	27%	28%	28%	28%
Waltons Stationery ***					
Most Significant Shareholder :	CNA Gallo	CNA Gallo	CNA Gallo	CNA Gallo	Pepkor
% Held	16%	16%	16%	16%	30%
Wooltru					
Most Significant Shareholder :	SA Mutual	SA Mutual	SA Mutual	SA Mutual	SA Mutual
% Held	27%	27%	27%	28%	28%

Appendix 3

Self / Owner Controlled Companies

	1992	1993	1994	1995	1996
Adonis Knitwear & Holdings					
Majority Shareholder :	Bencen Family	Bencen Family	Bencen Family	Bencen Family	Bencen Family
% Held	>70%	>70%	>70%	>70%	>70%
Advanced Technical Systems					
Majority Shareholder :	Directors	Directors	Directors	Directors	Directors
% Held	>75%	>75%	>75%	>55%	>55%
Aries Packaging					
Majority Shareholder :	Directors	Directors	Directors	Directors	Directors
% Held	>70%	>70%	>70%	>70%	>55%
Aroma Liquor					
Majority Shareholder :	Kovensky Family	Kovensky Family	Kovensky Family	Kovensky Family	Kovensky Family
% Held	>75%	>80%	>80%	>70%	>70%
Arthur Kaplan Jewellery					
Majority Shareholder :	Kaplan. A	Kaplan. A	Kaplan. A	Kaplan. A	Kaplan. A
% Held	>70%	>70%	>70%	>70%	>70%
Bowler Metcalfe					
Majority Shareholder :	Directors	Directors	Directors	Directors	Directors
% Held	>80%	>80%	>80%	>70%	>70%
Brenner Mills					
Majority Shareholder :	Brenner Family	Brenner Family	Brenner Family	Brenner Family	Brenner Family
% Held	>75%	>75%	>75%	>75%	>75%
Burlington Industries					
Majority Shareholder :	Kawitsky Family	Kawitsky Family	Kawitsky Family	Kawitsky Family	Kawitsky Family
% Held	>65%	>65%	>65%	>65%	>65%
Decor Investments					
Majority Shareholder :	Directors	Directors	Directors	Directors	Directors
% Held	>70%	>70%	>70%	>70%	>53%
Ensign Clothing					
Majority Shareholder :	Roy Family	Roy Family	Roy Family	Roy Family	Roy Family
% Held	>50%	>50%	>50%	>50%	>50%
Foschini* **					
Majority Shareholder :	Lewis Family	Lewis Family	Lewis Family	Lewis Family	Lewis Family
% Held	>50%	>50%	>50%	>50%	>50%
Glodina					
Majority Shareholder :	Balladon Family	Balladon Family	Balladon Family	Balladon Family	Balladon Family
% Held	>70%	>70%	>70%	>70%	>70%
IB Joffee					
Majority Shareholder :	Joffee Family	Joffee Family	Joffee Family	Joffee Family	Joffee Family
% Held	>75%	>75%	>75%	>75%	>75%
Ilco Homes					
Majority Shareholder :	Demmers. A	Demmers. A	Demmers. A	Demmers. A	Demmers. A
% Held	90%	90%	90%	90%	90%
Italite					
Majority Shareholder :	Directors	Directors	Directors	Directors	Directors
% Held	>65%	>65%	>65%	>65%	>65%

Appendix 3
(contd)

Kopp Electronics					
Majority Shareholder :	Directors	Directors	Directors	Directors	Directors
% Held	>60%	>60%	>60%	>60%	>60%
Mas Holdings* **					
Majority Shareholder :	Van Embden Family	Van Embden Family	Van Embden Family	Van Embden Family	Van Embden Family
% Held	>60%	>57%	>57%	>58%	>58%
Mathieson & Ashley Holdings					
Majority Shareholder :	Ringo Family	Ringo Family	Ringo Family	Ringo Family	Ringo Family
% Held	>74%	>75%	>75%	>75%	>75%
Ninian & Lester Holdings					
Majority Shareholder :	Directors	Directors	Directors	Directors	Directors
% Held	>50%	>50%	>50%	>50%	>60%
Nu - World Holdings					
Majority Shareholder :	Directors	Directors	Directors	Directors	Directors
% Held	>70%	>70%	>70%	>60%	>60%
Pals Holdings					
Majority Shareholder :	Kagan Family	Kagan Family	Kagan Family	Kagan Family	Kagan Family
% Held	>50%	>50%	>50%	>50%	>50%
Pick n Pay Stores* **					
Majority Shareholder :	Ackerman. R	Ackerman. R	Ackerman. R	Ackerman. R	Ackerman. R
% Held	>50%	>50%	>50%	>50%	>50%
Publico* **					
Majority Shareholder :	Directors	Directors	Directors	Directors	Directors
% Held	>45%	>40%	>40%	>70%	>70%
Putco					
Majority Shareholder :	Carleo Family	Carleo Family	Carleo Family	Carleo Family	Carleo Family
% Held	>50%	>50%	>50%	>50%	>50%
SA Bias Industries* **					
Majority Shareholder :	Seabrooke Family	Seabrooke Family	Seabrooke Family	Seabrooke Family	Seabrooke Family
% Held	>80%	>80%	>80%	>80%	>80%
Spescom Electronics					
Majority Shareholder :	Directors	Directors	Directors	Directors	Directors
% Held	>50%	>40%	>40%	>40%	>40%
Strebel Group					
Majority Shareholder :	Strebel Family	Strebel Family	Strebel Family	Strebel Family	Strebel Family
% Held	>65%	>65%	>65%	>65%	>65%
Transpaco					
Majority Shareholder :	Abelheim Family	Abelheim Family	Abelheim Family	Abelheim Family	Abelheim Family
% Held	>45%	>45%	>45%	>45%	>45%
Trencor * **					
Majority Shareholder :	Jowell Family	Jowell Family	Jowell Family	Jowell Family	Jowell Family
% Held	>48%	>48%	>48%	>48%	>48%
WB Holdings					
Majority Shareholder :	Directors	Directors	Directors	Directors	Directors
% Held	>40%	>50%	>50%	>50%	>50%
York Timber					
Majority Shareholder :	Tucker Family	Tucker Family	Tucker Family	Tucker Family	Tucker Family
% Held	>45%	>45%	>45%	>45%	>45%