

**BOARD ATTRIBUTES, FINANCIAL DISTRESS AND FRUITLESS AND
WASTEFUL EXPENDITURE IN SOUTH AFRICAN STATE-OWNED
ENTERPRISES**



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THSPHI002

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I hereby declare that I have read and understood the regulations governing the submission of Master of Commerce dissertations, including those relating to length and plagiarism, as contained in the rules of the University, and that this dissertation conforms to those regulations.

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Signed by candidate

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“Now thanks be to God for His indescribable gift” .

ABSTRACT

Purpose: Poor financial viability, perpetual inefficiencies and wastage are some of the challenges facing South African state-owned enterprises (SOEs). SOE boards are often criticised for failing to protect the financial sustainability of these entities and prevent the incurrence of fruitless and wasteful expenditure. Therefore, this study seeks to investigate the relationship between board attributes and financial distress and the relationship between board attributes and fruitless and wasteful expenditure in South African SOEs.

Methodology and research design: The study adopted a quantitative approach and used ordinary least squares regression on a sample of 27 South African SOEs over a five-year study period from 2016 to 2020. Five board attributes, being: board size, board activity, board tenure, board gender diversity, and board education, were selected as the independent variables of the study. SOE size and audit opinion were identified as the control variables.

Findings: The study results indicate that board size and board gender diversity have a negative and significant relationship with financial distress. However, a direct and statistically significant relationship was found between board education and financial distress. No statistically significant relationship was found between the study board attributes and fruitless and wasteful expenditure.

Research implications: The findings provide policymakers with insight on the board attributes that influence financial distress and fruitless and wasteful expenditure in SOEs.

Originality/value: Whilst there is a plethora of studies on board governance, many of these prior studies have focused on private sector companies. This study is, therefore, useful in understanding board attributes that affect financial distress and fruitless and wasteful expenditure in the context of South African SOEs. Moreover, we are not aware of any prior study that has empirically tested the relationship between board attributes and fruitless and wasteful expenditure.

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LIST OF ABBREVIATIONS

Abbreviation	Explanation
FWexp	Fruitless and wasteful expenditure
IDOSA	Institute of Directors of Southern Africa
JSE	Johannesburg Stock Exchange
NDP	National Development Plan
NPC	National Planning Committee
OLS	Ordinary least squares
PFMA	Public Finance Management Act No.1 of 1999
PRC	Presidential Review Committee
ROA	Return on asset
ROE	Return on equity
SEC	Securities Exchange Commission
SOE	State-owned enterprise
UK	United Kingdom
USA	United States of America
ZFC	Zmijewski financial distress score

CHAPTER ONE INTRODUCTION

1.1 INTRODUCTION

Over the past few years, there have been growing public outcries over the current status of South African state-owned enterprises (SOEs). The severe public backlash that SOEs have faced stems from the issues of dismal service delivery and the poor financial performance of these entities. The media has also reported allegations of corruption and mismanagement of resources, leadership instability, poor audit outcomes, deteriorating balance sheets, and a lack of financial sustainability as some of the challenges that SOEs face. Corporate governance deficiencies have been placed at the root cause of these challenges. Consequently, there are increasing calls for strengthening corporate governance in SOEs as a means of reform geared towards improving performance, strengthening their financial viability, and enhancing efficiency. Accordingly, this study seeks to respond to these calls and contribute to the body of literature on the role of board governance in South African SOEs.

This introductory chapter of the study will provide a background to the research problem by highlight the challenge of financial distress and rising fruitless and wasteful expenditure in South African SOEs. Then the research problem is presented, following which the research questions and objectives are formulated. Before concluding with a chapter summary, the organisation of the entire study is delineated.

1.2 BACKGROUND TO THE STUDY

The dawn of democracy in 1994 epitomised the death of an era of social and economic injustices, and the renaissance of the South African nation to new hope, opportunity, and freedom. Critical to this transition and promise of economic emancipation is the role of SOEs as instruments of socio-economic advancement. Moreover, SOEs are seen as important role players in South Africa's pursuit of a developmental state (Presidential Review Committee, 2012).

Globally, SOEs play a significant public service role in key sectors such as energy, water, public transport, communication, health, education, and social services (Taghizadeh-Hesary, Yoshino,

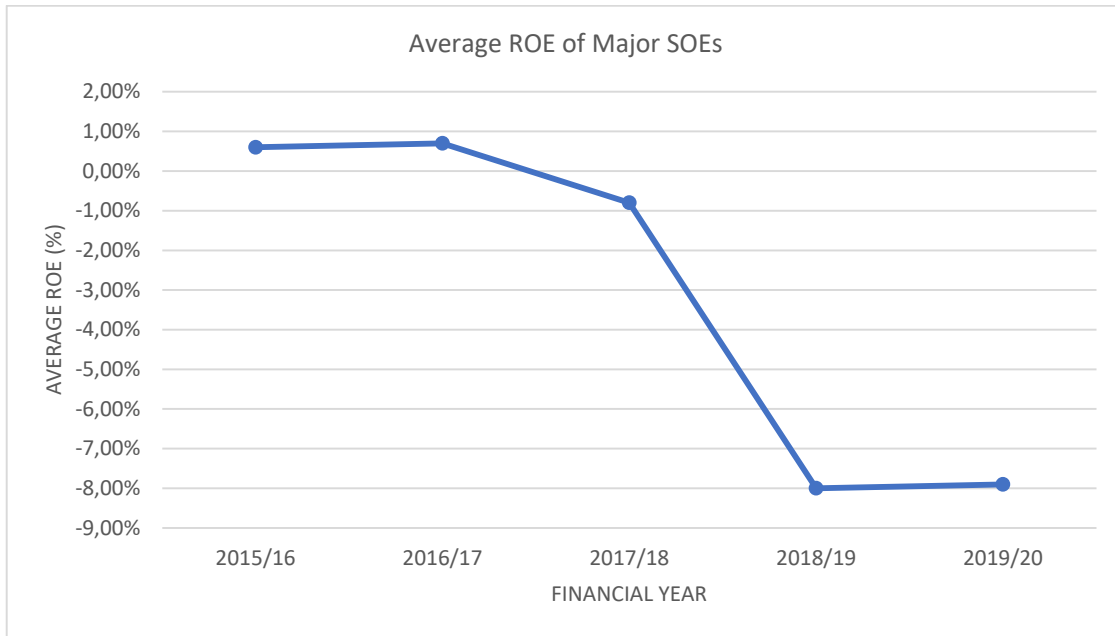
Kim, & Mortha, 2019). More importantly, in the South African context, since 1994 SOEs have been tasked with the role of achieving economic growth, advancing service delivery and socio-economic development, reducing poverty, addressing market failure, lessening the country's tax burden, and delivering key public infrastructure (Fourie, 2014; Kikeri, 2018).

Whilst SOEs have a developmental mandate, they are also required to be profitable and financially self-sustainable. This not only necessitates the generation of sufficient revenue, but it requires effective and efficient resource optimisation and expenditure management. The notion of efficiency in SOEs is critically imperative, given that they are financed from the fiscus. There needs to be value for money in the investments in SOEs for them to remain as the governments' toolbox for societal and public value creation (Botlhale, 2020).

Despite their role and potential contribution to the economy, South African SOEs, have progressively underperformed financially and mismanaged resources. There has also been a corresponding acute deterioration in their financial position, which has negatively affected their ability to discharge their mandates and resulted in an over-reliance on state guarantees and bailouts to remain operational (National Treasury, 2021).

Figure 1.1 shows the average return on equity (ROE) of the major SOEs listed in Schedule 2 of the Public Finance Management Act No.1 of 1999 (PFMA). The decline in average ROE over the five-year period depicts the poor financial performance and deterioration of shareholder value in the major SOEs.

Figure 1.1: Average ROE of Major SOEs Over a Five-Year Period



Source: National Treasury (2021)

Given their public interest status and the risk that they pose to the fiscus, concerns over the financial state and well-being of SOEs have led to wide public outcries. Consequently, South African SOEs have inherently attracted significant media attention and there is wide media coverage of the challenges that they face. Appendix 1 presents a summary of some of the media coverage of the issues facing SOEs in South Africa. The articles listed in the table are not exhaustive but are instead a selection to illustrate the problems prevalent in SOEs that have been reported in the media.

Despite the highly publicised inefficiencies and poor performance, SOEs still remain developmentally and socially relevant and essential for the South African economy. Consequently, the focal point of SOE reform is centred on addressing the root causes for the poor performance, inefficiencies, and failure of SOEs (Botlhale, 2020; Mbo & Adjasi, 2017).

Corporate governance is emerging as one of the most fundamental factors influencing the performance and financial efficiency of SOEs (Grossi, Papenfuß, & Tremblay, 2015; Mashamaite & Raseala, 2019; Simpson, 2014). The literature argues that high governance quality is associated with good performance, reduced risk of failure and operational efficiency (Botlhale, 2020; Curi, Gedvilas, & Lozano-Vivas, 2016; Heo, 2018; Kikeri, 2018; Iuqman, Ul Hassan,

Tabasum, Khakwani, & Irshad, 2018; Mbo & Adjasi, 2017; Simpson, 2014; Wong, 2004). Accordingly, in the South African context, there is an increasing interest in understanding the impact of governance practices, especially those relating to the board of directors, in addressing the issues of poor financial performance and mitigating financial distress and the inefficient and fruitless utilisation of resources (Mashamaite & Raseala, 2019). Consequently, this study seeks to explore and investigate the relationship between board attributes and financial distress and fruitless and wasteful expenditure.

1.3 RESEARCH QUESTIONS

Against this backdrop, the research problem of this study is to investigate whether board attributes in South African SOEs can explain the likelihood of financial distress and level of fruitless and wasteful expenditure incurred in these entities. In this respect, the two research questions that define this study are formulated as follows:

- What is the relationship between board attributes and likelihood of financial distress in South African SOEs?
- What is the relationship between board attributes and the incurrence of fruitless and wasteful expenditure in South African SOEs?

1.4 RESEARCH OBJECTIVES

This study seeks to achieve the following objectives:

- Examine, through empirical evidence, the relationship between board attributes and the likelihood of financial distress in South African SOEs.
- Examine, through empirical evidence, the relationship between board attributes and the level of fruitless and wasteful expenditure incurred in South African SOEs.

1.5 ORGANISATION OF THE STUDY

This study comprises of six chapters, beginning with the introduction where the contextual background to the research problem was presented. Chapter two highlights the importance of the SOEs role in the South African economy as well as the challenges SOEs face. Chapter three

provides the essential theoretical grounding for this study as well as the survey of prior empirical literature on the relationship between board attributes and financial distress and fruitless and wasteful expenditure. Chapter four presents the research methodology of this study. Chapter five presents the findings of this study, with chapter six providing this study's conclusions and future research recommendations.

1.6 SUMMARY

This chapter provided a brief overview of the challenges faced by SOEs in South Africa. Evidently, there are growing concerns over the financial efficiency and sustainability of these entities. Despite these challenges, SOEs are still seen to be of developmental significance and consequently there is growing interest in the board governance of SOEs as an antidote to address these challenges. Against this backdrop, the research problem and questions were formulated. In the next two proceeding chapters of this study, the literature will be explored to establish a theoretical grounding to answer the research questions of this study,

CHAPTER TWO LITERATURE REVIEW: OVERVIEW OF STATE-OWNED ENTERPRISES IN SOUTH AFRICA

2.1 INTRODUCTION

This chapter aims to provide a contextualised understanding and overview of state-owned enterprises (SOEs) in South Africa. The chapter begins by exploring the literature for the definition of the term SOE. The chapter then outlines the origins and historical context of SOEs in South Africa as well as their importance and significance in the South African economy. The legal and regulatory framework governing SOEs in South Africa is then discussed. Finally, the chapter concludes with an overview of the challenges and issues faced by SOEs in South Africa.

2.2 DEFINITION OF STATE-OWNED ENTERPRISE (SOE)

Globally, governments use SOEs as pivotal and quintessential vehicles for driving economic, social, and developmental transformation (Barac & Radasi, 2015; Thabane & Snyman-Van Deventer, 2018). Consequently, the term SOE has global recognition and is widely used by international organisations, businesses, governments, and academics (Grossi, Papenfuß, & Tremblay, 2015). Despite its global prominence and renown, there is no single universal and uniform definition of the term SOE (Chilenga, 2016; Gnan, Hinna, Scarozza, & Montaduro, 2010; Lenger, 2017; Sturesson, McIntyre, & Jones, 2015). Similarly, to the definition of SOE, there is also a variation in the terms used to refer to SOEs (Chilenga, 2016; Grossi et al., 2015; Makoni, 2015; Sturesson et al., 2015).

The variation in terminology and definitions used to define SOEs across various countries is attributable to the diversity in legal forms and structures of SOEs globally. This diversity, in legal form and structure, is a function of the following factors that differentiate SOEs and how they are defined: the level of government that owns the enterprise, the source of control, the constitution of the enterprise, the position of the enterprise in public administration, the purpose of the enterprise, the source of funding, the extent of government ownership and control, the listing of the enterprise on a stock exchange, the property rights granted to the enterprise, and the status of the enterprise if it is in the process of privatisation (Makoni, 2015; Sturesson et al., 2015).

The wide variety of terms used to refer to SOEs include the following: municipal-owned enterprises, government-owned companies, public enterprises, local corporations, government business enterprises, government sponsored enterprises, government corporations, public entities, state-owned agencies, state-owned companies, and parastatals, amongst others (Grossi et al., 2015; Makoni, 2015).

Aharoni (1986) defines an SOE as an institution whose capital is exclusively or partly funded by the state. This definition, whilst it acknowledges the role of the state in SOEs, it lacks comprehensiveness as it only responds to the economic funding aspect of SOEs. Yeung (2005), on the other hand, defines an SOE as a government business form expected to achieve economic and operational efficiency while simultaneously serving social objectives and being accountable to the public. SOEs are also more commonly and simply defined as, enterprises in which the government has control over through a full, majority, or significant minority ownership interest (Kim & Ali, 2017). Whilst government has ownership and control over SOEs, SOEs are however, constituted as independent bodies from government with separate legal entity status for the purposes of participating in activities on the behalf of government and performing specific functions and operations in accordance with a particular act (Monawer, 2017; Ovens, 2013).

Despite the existence of various definitions of the term SOE, the ownership role and involvement of government clearly distinguishes SOEs from other companies. SOEs are therefore seen as an important enabling tool for governments' involvement in the economy (Marimuthu, 2020). The reference to government, in the definition of a SOE, can either be at a national, provincial or local level (Madumi, 2018).

Table 2.1 below highlights the key characteristics of SOEs that distinguish SOEs from private sector companies. These distinguishing characteristics relate to the nature of ownership, the purpose, and the governance of these entities.

Table 2.1: Differences between SOEs and Private Sector Companies

	SOE	Private Sector Companies
Ownership	Non-transferable ownership held by the state	Transferable ownership held by various investors
	The state appoints, motivates, and disciplines the board.	The shareholders appoint, motivate, and discipline the board.
	Indirect principal is the public. Minister is the principal shareholder on behalf of government & political party	Direct principals are the shareholders.
Purpose	The entity has multiple goals imposed by government, including economic and operational efficiency and social contribution.	Much more focused goal of profit maximisation.
	Lack of goal clarity and often conflicted instructions.	More aligned and singular goal.
	Goals arise from a range of political and public participation processes.	Goals arise from the board and management.
	Government policy such as service delivery objectives, need to be considered.	Do not have additional government policy and legislation to comply with.
Governance	Multiple principals	Shareholders are the primary principal
	Not well monitored due to limited monitoring ability of political authorities.	Better monitoring capacity by shareholders
	Often government (through the shareholding minister) appoints the CEO.	Board appoints the CEO

Source: adapted from Mpanza (2016)

SOEs can be segmented into two categories; namely commercial/market entities and non-commercial/non-market entities (Ramantsi, 2017; Vicente, 2020). Commercial SOEs are government owned and/or controlled business entities that are exposed to market forces and influences whilst providing a good or rendering a service that is in the interest of the public and have the potential to generate a sustainable profit while promoting economic growth and fulfilling its mandate (Limbo, 2019). Similarly, Marimuthu (2020) states that commercial SOEs have a profit maximisation goal and carry out business along commercial lines whilst also tasked with service

delivery and economic development. Non-commercial SOEs, on the other hand, perform duties on the behalf of government with the main objective of providing public goods and services without pursuing any financially driven objectives (Marimuthu, 2019). Non-commercial SOEs include research entities, regulatory entities, and research bodies (Kikeri, 2018).

State ownership not only distinguishes SOEs from private sector companies, but it is also associated with certain competitive advantages for the SOE. SOEs enjoy the following advantages: limited pressure or no requirement to pay dividends, implicit government backing and can therefore raise debt capital easily, fiscal freedom to pursue their mandates, protection from bankruptcy and takeovers, lower investment and export financing costs, preferential access to state funding, lower or no domestic taxes, government subsidies and/or grants, preferential state procurement, and favour from international organisations (Afrika, 2020; Chilenga, 2016; Nielsen, 1981).

Whilst, state ownership may yield some competitive advantages for SOEs, it is also the subject of criticism in SOEs. SOEs are often levied with the following critiques due to the inherent government ownership role: inappropriately using government tax resources to compete with operationally efficient private sector companies, diverting government resources from service delivery and developmental needs, high propensity for political interference, operational and financial inefficiencies and poor expenditure control due to the availability of government bail-outs (Chilenga, 2016; Gumede, 2015; Madumi, 2018).

2.3 THE HISTORY AND DEVELOPMENT OF SOEs in SOUTH AFRICA

The establishment and historical development of SOEs is globally diverse and dependent on each country's circumstances (Masekoameng & Mpehle, 2018; Sánchez, 2016). The diversity in the historical backgrounds of SOEs is testimony to the uniqueness in the role and importance of SOEs across various countries. The role and importance of SOEs is often influenced by the political and economic strategy adopted by the country (Madumi, 2018). Consequently, SOEs are present across different industries in different countries (Mpanza, 2016).

The early 1920s were a significant period in the development of SOEs in South Africa and saw the rise of SOEs to play a more instrumental role in the economy (Fourie, 2014). The happenings of the early 1920s were primarily motivated by the notion that government should be responsible

for large utilities such as electricity, railway and water supply (Gumede, 2015). Furthermore, there was a need to improve and support the import-substitution industries established by Paul Kruger's government to prohibit British control of the economy (Chilenga, 2016; Clark, 2019). This led to the establishment of The Electricity Supply Commission (ESKOM) in 1922 and subsequently the Iron and Steel Corporation (Iskor) in 1928 (Afrika, 2020).

From 1948, more SOEs were established when the National Party came into power and established the apartheid regime (Afrika, 2020). The establishment of SOEs under the apartheid government was politically motivated and SOEs served three main purposes. Firstly, to advance and economically empower the Afrikaner nation through employment opportunities (Gumede, 2015; Ngqumeya, 2012). This resulted in the establishment of SOEs such as the South African Broadcasting Commission (SABC). Secondly, to mitigate the effect of international economic sanctions placed against the apartheid government for its crime against humanity. The response by the government of the day led to the establishment of SOEs such as the South African Coal, Oil and Gas Corporation (SASOL) (Gumede, 2015; Ngqumeya, 2012). Thirdly, SOEs were established to provide the government with access to arms, resulting in the establishment of SOEs such as the Armaments Corporation of South Africa (ARMSCOR) (Ngqumeya, 2012).

The 1980s saw the start of the debate on the privatisation of SOEs. This was driven by the dismal financial performance of SOEs and the economic and political pressures faced by the apartheid government (Mekwe, 2015). In 1987, the White Paper on Deregulation and Privatisation in South Africa was released with the aim of setting in motion the privatisation of SOEs (Gumede, Asmah-Andoh, & Kabir, 2016). This White Paper aimed to contextualise and promote the reducing of government expenditure, creating opportunities for the private sector, reducing the size of the public sector and raising funds through the disposal of state assets (Marimuthu, 2019).

The notion of privatisation was received with strong opposition by the African National Congress (ANC) led-government during the transition into democracy (Marimuthu, 2019). The developmental role, strategic mandates, and transformation imperative motivated for the retention of state ownership in SOEs (Marimuthu, 2019; Mekwe, 2015). This led to a policy shift away from privatisation but aimed at corporate restructuring, improving efficiency and effectiveness; and reorientating SOEs to achieve social objectives and other wider economic development goals in line with the new dispensation (Balbuena, 2014).

The debate on the configuration of SOEs in South Africa is still ongoing. In 2011, former President Jacob Zuma commissioned the establishment of the Presidential Review Committee (PRC) on State-Owned Entities. The purpose of the PRC was to review the relevance and positioning of SOEs in the developmental agenda of South Africa. The PRC found that SOEs have an essential role to play in service delivery, economic growth, and transformation. However, there are weaknesses that pose a threat to their contribution to the South African economy. The PRC emphasised the need for reform to strengthen SOEs and address matters relating to the oversight of SOEs, establishment/disestablishment of SOEs, strategic planning, funding, legal and regulatory policy, institutional structures, systems, capacity, as well as critical performance evaluation measures of SOEs (Presidential Review Committee, 2012).

2.4 THE ROLE AND SIGNIFICANCE OF SOES IN SOUTH AFRICA

Notwithstanding, the difference in historical reasoning for establishing SOEs and the country-level uniqueness in mandate and importance of these enterprises, it is, however, commonly accepted that the role of SOEs comprises of a mix of economic, social, developmental and strategic imperatives (Afrika, 2020; Masekoameng & Mpehle, 2018; Mpanza, 2016; Vicente, 2020). SOEs are therefore hybrid in nature, as whilst they are meant to be profit-driven, they also have a role and purpose that extends beyond the confines of the enterprise but rather incorporates the potential to be catalysts for public value creation, growth and development (Mamaile, 2020; Sturesson et al., 2015).

According to The Organisation for Economic Co-operation and Development (OECD, 2018) governments may explicitly or implicitly express their rationale for SOEs. The rationale is often embedded in either a decision, regulation, or decree; policy statement; specific legislation; overall legal framework; and/or SOE-specific measures. From a South African perspective, the National Development Plan of the National Planning Committee (NPC, 2012), defines the role and significance of SOEs in the context of South Africa being a developmental state. These sentiments are echoed by the PRC (2012) which states that the agenda for SOEs in South Africa is to help build a developmental state. A developmental state is defined as a country where government uses a variety of instruments and policies to drive economic growth and development (ETU, n.d.). In essence, this means that SOEs need to achieve a balance between economic, social and political objectives (PRC, 2012).

At the heart of the role of SOEs in a developmental state is their responsibility to deliver critical public goods and services that are deemed to be of national interest and essential for development (Barac & Radasi, 2015; Mamaile, 2020; Thabane & Snyman-Van Deventer, 2018). This means that the relevance of SOEs in emerging economies is in operating in strategic sectors which are vital for growth and development, especially energy, water, road infrastructure and transport, education, health, telecommunications, and manufacturing (Barac & Radasi, 2015; Bussin & Ncube, 2017; Fourie, 2014; Mamaile, 2020; Masekoameng & Mpehle, 2018). These services are essential for improving the standard of living of the population and SOEs increase public access to these services through relatively lower prices and thereby ensuring that the state provides effective and efficient services to all citizens (Sturesson et al., 2015; Tleane, 2020).

Moreover, SOEs play an important role in addressing capital market failure (Mamaile, 2020). State intervention in the economy is often motivated by the failure of markets to efficiently allocate resources to the most welfare enhancing assets that yield significant economic and social externalities (Madumi, 2018; Sánchez, 2016). Consequently, SOEs have a presence in natural monopolies such as electricity supply (OECD, 2018). SOEs are established to prevent the abuse by the private sector in these monopoly industries and ensure that there is fair and affordable pricing whilst maintaining adequate service quality (Sánchez, 2016; Tleane, 2020).

SOEs are also seen as important vehicles in driving new investments in infrastructure, utilities, and technology (Thabane & Snyman-Van Deventer, 2018; Tleane, 2020). They can also play a key role in reviving sunset industries and sustaining special interest sectors (Sturesson et al., 2015). As SOEs are revenue-generating, they have the potential to reduce a country's tax burden whilst generating more public funds for further capital investment in strategic assets (Fourie, 2014; Tleane, 2020). Therefore, SOEs can bring about the strengthening of the local economy and limit the risks associated with private and foreign control of the domestic economy (Thabane & Snyman-Van Deventer, 2018).

Critically, in the context of South Africa and other developing nations, SOEs are seen as important agents for socio-economic change (NPC, 2012; Tleane, 2020). Firstly, SOEs assist government create employment opportunities and thereby alleviating poverty (Masekoameng & Mpehle, 2018; PRC, 2012). Secondly, SOEs can help narrow the gap between rich and poor, and the gap between urban and rural populations by providing quality and affordable goods and services and targeting disadvantaged groups (Barac & Radasi, 2015; Sturesson et al., 2015). Finally, SOEs

are usually seen as government's model employers for the private sector as they can demonstrate good labour relations and employment equity (Ngqumeya, 2012; Sturesson et al., 2015).

2.5 THE LEGAL AND REGULATORY FRAMEWORK FOR SOEs IN SOUTH AFRICA

The Public Financial Management Act No. 1 of 1999 (PFMA) is the primary legislative tool that governs SOEs in South Africa. The PFMA uses the terms national/provincial government business enterprise and national/provincial public entity to refer to SOEs.

A government business enterprise is defined in Section 1 of the PFMA as:

- “a juristic person under the ownership control of the (national/provincial) executive;
- has been assigned financial and operational authority to carry on a business activity;
- as its principal business, provides goods or services in accordance with ordinary business principles; and
- is financed fully or substantially from sources other than—
 - (i) the National (Provincial) Revenue Fund; or
 - (ii) by way of a tax, levy, or other statutory money.”

On the other hand, a public entity is defined as follows:

- “a (national/provincial) government business enterprise; or
- a board, commission, company, corporation, fund, or other entity which is:
 - (i) established in terms of (national/provincial) legislation;
 - (ii) fully or substantially funded either from the National (Provincial) Revenue Fund, or by way of a tax, levy or other money imposed in terms of national legislation; and
 - (iii) accountable to parliament (provincial legislature).”

The definition of public entity incorporates commercial and non-commercial SOEs whilst the definition of government business enterprise is associated with commercial SOEs only. The SOE universe of South Africa is found in Schedule 2 and 3 of the PFMA. The schedules are used to classify and categorise SOEs based on the level of government (national or provincial) that has ownership in the entity and the nature of the business activities (commercial or non-commercial)

that the SOE is engaged in (Bronstein & Olivier, 2011). South African SOEs have a diverse legal status varying from being a part of government, to being wholly-owned by government, or to being listed with government having majority shareholding (Marimuthu, 2019). Table 2.2 below sets out the various categories of SOEs as per Schedule 2 and 3 of the PFMA.

Table 2.2: SOEs Listed in the PFMA

Schedule	Classification	Characteristics	Examples
Schedule 2	Major Public Entities	<ul style="list-style-type: none"> - Commercial and operates under business principles. - Own financing, although they have access to Government guarantees, capital injections and loans. - Can raise funds in capital markets. - Accountable to a governing board that reports to the relevant Minister of the parent department. - Minister exercises shareholder interest on behalf of State. - Enabled through own legislation and shareholder compacts between Minister and entity. 	Eskom, SABC, ACSA, Telkom
Schedule 3A	National Public Entities	<ul style="list-style-type: none"> - Fully or substantially funded from the fiscus. - Mostly non-commercial but some level of cost recovery. - Established by their own enabling legislation. - Consists of stewardship entities, research entities, service delivery entities, regulatory entities, and statutory advisory entities. 	Housing Development Agency, Competition Commission, Museums, National Nuclear Regulator
Schedule 3B	National Government Business Enterprise	<ul style="list-style-type: none"> - Commercial and operates under business principles. - Own financing, although they have access to Government guarantees, capital injections and loans. - Can raise funds in capital markets. - Accountable to a governing board that reports to the relevant Minister of the parent department. - Minister exercises shareholder interest on behalf of State 	PIC, Water Boards, Khula Enterprise Finance, South African Bureau of Standards

		<ul style="list-style-type: none"> - Enabled through own legislation and shareholder compacts between Minister and entity. 	
Schedule 3C	Provincial Public Enterprise	<ul style="list-style-type: none"> - Fully or substantially funded from the fiscus. - Mostly non-commercial but some level of cost recovery. - Established by their own enabling legislation. - Consists of stewardship entities, research entities, service delivery entities, regulatory entities, and statutory advisory entities. 	KwaZulu-Natal Gambling Board, Western Cape Investments and Trade Promotion Agency
Schedule 3D	Provincial Government Business Enterprise	<ul style="list-style-type: none"> - Commercial and operates under business principles. - Own financing, although they have access to Government guarantees, capital injections and loans. - Can raise funds in capital markets. - Accountable to a governing board that reports to the relevant Minister of the parent department. - Minister exercises shareholder interest on behalf of State - Enabled through own legislation and shareholder compacts between Minister and entity. 	North West Development Corporation, Mpumalanga Agricultural Development Corporation

Source: Adapted from (Marimuthu, 2019; National Treasury, 2019; Ngqumeya, 2012; Presidential Review Committee, 2012; Vutabwarova, 2018)

As shown in Table 2.2, Schedule 2, 3B and 3D consist of the commercial and self-sufficient SOEs. Schedule 2 lists those commercial SOEs that have been deemed as major whilst Schedule 3B and 3D lists all other non-major commercial SOEs owned by a national and provincial government, respectively. Schedule 3A and 3C, list the non-commercial SOEs at a national and provincial government level, respectively.

2.6 AN OVERVIEW OF THE CHALLENGES FACING SOEs IN SOUTH AFRICA

Despite, their socio-economic importance and developmental potential, SOEs in South Africa have progressively become ineffective and inefficient in discharging their mandates and strategic objectives (Mashamaite & Raseala, 2019). This means that the challenges facing South African SOEs, pose a threat to the relevance of these entities in the context of South Africa's developmental objectives.

Many South African SOEs have become characterised by perennial financial underperformance and a perpetual state of financial distress (Awuah, 2019; Marimuthu, 2020). According to the Auditor General of South Africa (AGSA), SOEs are in serious financial difficulty and there is an uncertainty on whether many will be able to continue operating as a going concern (Auditor-General South Africa, 2021). The deterioration in the financial performance and the weak financial position of SOEs has resulted in a culture of financial dependence on government bailouts (Thabane & Snyman-Van Deventer, 2018). Chilenga (2016) alleges that government guarantees and subsidies, inhibit the efficient allocation of resources and deteriorates the quality of the managerial decision-making process which further perpetuates the financial underperformance and distress in South African SOEs. This notion was supported by Marimuthu (2020) who found that government guarantees, and subsidies have a negative significant effect on the financial performance of South African SOEs.

SOEs have also been criticised for having weak internal controls and poor accountability. According to Mutize and Tefera (2020), SOEs lack internal control policies that ensure the safeguarding of assets, accountability, operational efficiency, and the prevention of fraud. This leads to a mismanagement of resources in SOEs evidenced by the poor long-term strategic direction, lack of transparency and growing fruitless and wasteful expenditure (Thomas, 2012). In a root-cause analysis study on inefficiencies in the public sector, Fourie and Poggenpoel (2017), found that deficiencies in expenditure management were the most recurring root-cause for inefficiencies in South African SOEs and the public sector in general.

The financial problems facing SOEs are often associated with board governance and leadership problems. SOEs face criticism relating to poor leadership and board irregularities (Thomas, 2012).

Firstly, the board leadership challenge in South African SOEs can be attributed to irregular and questionable board appointments (Mashamaite & Raseala, 2019; Thabane & Snyman-Van Deventer, 2018). The criticism levied against board appointments in SOEs are often centred around allegations of political interference, nepotism, and corruption in the appointment process (Mutize & Tefera, 2020; Thomas, 2012). Furthermore, these appointments often lead to a shortage of appropriate qualifications, experience, and competence in SOE boards (Awuah, 2019; Masekoameng & Mpehle, 2018; Thomas, 2012).

Secondly, the board leadership challenge in South African SOEs, emanates from the lack of board stability. SOE boards are often characterised by high executive turnover, frequent board resignations, shareholder interference, high number of acting executives, interim board members, delays in permanent appointments, and a lack of succession planning (Makoni, 2015; Thabane & Snyman-Van Deventer, 2018; Thomas, 2012).

Thirdly, board remuneration in SOEs has attracted the attention of various stakeholders. SOE boards have been criticised for having inappropriate remuneration policies and excessive compensation and benefits to board members (Thomas, 2012). Furthermore, there is a lack of alignment between the performance of the company and the remuneration of the board (Marimuthu & Kwenda, 2019).

Finally, SOEs also face the challenge of board apathy. This is evidenced by a low and irregular attendance of board meetings, excessive concurrent board appointments, and a lack of adherence with the fiduciary duties (Thomas, 2012). According to Thabane and Snyman-Van Deventer (2018), SOE board of directors face the risk of being declared delinquent due to a lack of compliance with the requirements of the Companies Act.

2.7 SUMMARY

This chapter provided a background and overview of SOEs in South Africa. The survey of the literature showed that despite the lack of a uniform definition of the term SOE, the government ownership role is a key distinguishing characteristic for SOEs. The chapter then presented the historical development of SOEs over different economic and political periods. The role of SOEs in balancing economic, social, political imperatives was then discussed. Following which the regulatory framework for SOEs was detailed. Then the challenges and issues facing SOEs in South Africa were presented.

The following chapter will build on the foundation laid in this chapter by reviewing the literature to ascertain the role of board governance in addressing the issues of financial distress and fruitless and wasteful expenditure in SOEs.

CHAPTER THREE LITERATURE REVIEW: BOARD GOVERNANCE

3.1 INTRODUCTION

The previous chapter highlighted the important role played by state-owned enterprises (SOEs) in South Africa. Furthermore, the chapter discussed the challenges that these entities face. These challenges have led to growing calls for corporate governance reform in SOEs. Consequently, the role of the board of directors in addressing the challenges faced by SOEs has been at the focal point in discussions on governance reform. This chapter provides a survey of the literature on board governance. Firstly, the concept of corporate governance is defined and the main theoretical frameworks underpinning corporate governance are discussed. The chapter then outlines the historical development of corporate governance from both an international and local perspective. As the study is premised on SOEs in South Africa, the major corporate governance regulatory frameworks for SOEs in South Africa are then explored. The chapter then discusses the role and importance of the board of directors in SOEs. Thereafter, the chapter presents a survey of the literature on prior empirical studies on the relationship between board attributes and financial distress and fruitless and wasteful expenditure. Prior to the chapter concluding with a summary, the gaps identified in the survey of the literature are highlighted.

3.2 DEFINITION OF CORPORATE GOVERNANCE

Over the past few decades, debates in the corporate, academic and policy circles have been centred and focussed on the concept of corporate governance. The intense and heightened interest in corporate governance is mainly attributable to two key factors that have also been instrumental in the development of corporate governance. Firstly, the series of epidemic corporate failures and financial crises have brought to light the devastating consequences of corporate governance deficiencies and paved the path for greater emphasis on corporate governance by policymakers (Ahmed & Hamdan, 2015; Dzingai & Fakoya, 2017; Manzaneque, Priego, & Merino, 2016; Tshipa, 2015). Deficiencies in corporate governance are seen to have long-term economic and financial repercussions for companies and as posing a threat to the financial stability of economies (Claessens & Yurtoglu, 2012; Khatab, Masood, Zaman, Saleem, & Saeed, 2011). Lee and Yeh (2004) argue that corporate governance variables provide stronger and better

explanatory power for the past financial crises than macroeconomic variables. Secondly, the globalisation of financial markets has contributed to the rapid surge in corporate governance interest by placing a demand on companies to stimulate their corporate governance competitiveness (Baig & Das, 2020).

Despite the monumental interest in corporate governance, there is no universally uniform and accepted definition of the concept (Alqatan, 2019; Gadi et al., 2015; Zalewska, 2014). The lack of a universally accepted definition of corporate governance emanates from the inherently diverse corporate governance practices and mechanisms that different countries have adopted. Evidently, there are several different codes of best practice, laws and policies on corporate governance that have been implemented across the globe. According to Alqatan (2019) the diverse definitions of corporate governance are a function of the timing of the definition, the country's legal system and the country's economic culture. Jingura (2019) also recognises the influence of the political, religious, cultural, and moral setting as key determining factors in defining corporate governance and hence contributing to the divergence. Furthermore, the term corporate governance is also widely used in various disciplines such as accounting, organisational behaviour, law, politics, management, business ethics and finance (Ntim, 2017).

One of the most basic and foundational definition of corporate governance and, which is commonly cited in the literature, is provided by the Cadbury Committee in the United Kingdom which defines corporate governance as the system by which companies are directed and controlled (Committee on The Financial Aspects of Corporate Governance, 1992). According to Abdullah and Valentine (2009) this means that corporate governance incorporates the decision-making and decision implementation processes. Moreover, corporate governance aims to align the decisions and actions made within a company to the company's purpose, goals, and values (Siew Tee & Nizam, 2020). Subsequent, to the definition put forward by the Cadbury Committee many other authors have expanded on this definition. Khan (2011) expands on the Cadbury Committee definition by stating that corporate governance is a broad concept that includes the processes, customs, policies, laws, and institutions that directs the organizations and corporations in the way they act, administer, and control their operations.

The Organisation for Economic Co-operation and Development (OECD, 2015) defines corporate governance as a set of relationships between a company's management, its board, its shareholders, and other stakeholders. Corporate governance also provides the structures through

which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Similarly, Mansur and Tangl (2018) state that corporate governance refers to the set of interlocking rules that guide the rights and responsibilities in the relationship between various participants.

From a South African perspective, the recent King IV Report on Corporate Governance issued by the Institute of Directors of Southern Africa (IODSA) defines corporate governance as the exercise of ethical and effective leadership by the governing body towards the achievement of ethical culture, good performance, effective control, and legitimacy (Institute of Directors of Southern Africa, 2016). This definition highlights the evolution and development of corporate governance to a much broader and extended sense. Likewise, and in the same spirit, Jingura (2019) acknowledges that corporate governance involves ethical values, company integrity, and best practices to manage companies and ensure that they meet their objectives.

Irrespective of the definition adopted to define corporate governance, scholars categorise corporate governance efforts as either internal or external corporate governance mechanisms (Anandasayanan & Thavarasasingam, 2019; Gillan, 2006; Nguyen, Locke, & Reddy, 2015; Soriya & Kumar, 2018).

Internal corporate governance mechanisms encompass micro-level organisational processes, routines and arrangements put in place within the internal environment of the company and in the context of internal relationships (Ciftci et al., 2019). Internal control mechanisms are focussed on the implementation of internal control and monitoring activities over the actions of the company (Soriya & Kumar, 2018). These mechanisms include ownership structure, board structure, board committees and function thereof, CEO duality, institutional shareholding, remuneration structure and policy, shareholder activism, capital structure and transparency of disclosures (Anandasayanan & Thavarasasingam, 2019; Gillan, 2006; Soriya & Kumar, 2018).

On the other hand, external corporate governance mechanisms focus on macro-level economic and socio-economic arrangements that influence the activities and direction of the company. The concern of external corporate governance mechanisms is on the relationship between societal level institutions with the company (Ciftci et al., 2019). External corporate governance mechanisms include labour market, capital markets, product market, market for corporate control and laws and regulation (Anandasayanan & Thavarasasingam, 2019; Gillan, 2006).

The focal interest of this study is on board attributes in South African SOEs. This means that this study specifically premises on internal corporate governance mechanisms.

3.3 MAIN CORPORATE GOVERNANCE THEORIES

3.3.1 Agency Theory

One of the most fundamental and dominant theory underpinning corporate governance is the agency theory. Agency theory is largely attributed to the seminal work of Jensen and Meckling (1976). The agency theory explores the dynamics in the contractual relationship between the principal (owner/shareholder) and agents (managers/executives) (Jensen & Meckling, 1976). This theory is premised on the notion that the separation between ownership and control, in the principal-agent relationship, results in a conflict of interest and fundamental tension known as the agency problem (Jensen & Meckling, 1976).

The agency problem stems from the key assumption adopted in agency theory, that corporate managers are self-serving agents that pursue their own wealth objectives instead of fulfilling their contractual obligation to the shareholder (Raelin & Bondy, 2013; Schillemans & Bjurstrøm, 2020). This means that managers are prone to act opportunistically by maximising their own interest at the expense of the company and shareholders. The opportunistic behaviour of managers can manifest in the following ways: excessive focus on short-term profits rather than the long-term viability and sustainability of the company, overpayment of salaries and bonuses, manipulation of financial records, non-disclosure of information, unjustifiably high risk-averse or risk-seeking decision-making and the abuse and misdirection of company resources (Dzingai & Fakoya, 2017; Hiebl, 2015; Raelin & Bondy, 2013). It is submitted that the opportunistic and self-serving behaviour of managers is due to a misalignment of goals, the divergence in risk preference, and information asymmetry inherent in the principal-agent relationship (Husnain et al., 2021; Panda & Leepsa, 2017).

Agency theorists argue that shareholders can only assure themselves that managers will make optimal decisions and protect their investment, if the actions of managers are monitored and good behaviour is incentivised (Bonazzi & Islam, 2007). Consequently, the agency theory adopts the position, that corporate governance is a mechanism to control self-interest that is expected to lead

to better performance (Jahja et al., 2020). Akbar, Hussain, Ahmad, and Hassan (2019) submit that corporate governance results in the reduction of the principal-agent problem by introducing rules and regulations aimed at protecting the shareholder's interest. There are, however, costs associated with the corporate governance mechanisms employed to address the agency problem. Firstly, monitoring costs are costs associated with the monitoring and assessing of the agent's actions and performance (Jensen & Meckling, 1976). Secondly, bonding costs are incurred to prevent the opportunistic behavior of managers and align their interest to the interest of the principal (Jensen & Meckling, 1976). Finally, residual costs which are costs associated with inefficient managerial decisions (Jensen & Meckling, 1976).

The board of directors is seen to play a pivotal role in alleviating the agency problem that arises between shareholders and managers (Merendino & Melville, 2019). Agency theorists hold the view that the primary responsibility of the board is to represent the interests of the shareholders and therefore the board is an essential tool for monitoring and controlling the behaviour of managers (Assenga et al., 2018).

3.3.2 Stewardship Theory

Stewardship theory is presented in the literature as an alternative to agency theory. In stewardship theory, managers are portrayed as dedicated stewards who strive and employ their best efforts to maximise the wealth of shareholders by utilising resources committed to their hands faithfully and are always committed to achieving the goals of the business (Donaldson & Davis, 1991). This means that managers are perceived as stewards who act in the best interest of shareholders rather than purely self-serving economic agents (Muth & Donaldson, 1998).

Stewardship theory assumes that managers and shareholders enjoy goal congruency (Barante & Arasa, 2018). This means that when the shareholders' wealth is maximised, through firm performance, the manager's own utility is maximised (Davis et al., 1997). Managers are therefore motivated to make decisions that maximise firm performance, value, and success (Kwame et al., 2017). The utility enjoyed by managers from maximising shareholder value is derived from non-financial motivates such as the need for recognition and achievement, the innate human satisfaction from successful performance, respect for authority and good work ethic (Muth & Donaldson, 1998). Furthermore, stewardship theorists argue that managers are effectively

managing their careers by acting as good stewards and that managers are establishing a good reputation with the financial markets (Abdullah & Valentine, 2009)

In contrast to agency theory, stewardship theory places emphasis on co-operation and collaboration, whilst the former focusses on control and conflict (Schillemans & Bjurstrøm, 2020). Consequently, stewardship theorists motivate for governance structures and mechanisms that empower the steward, offer maximum autonomy, and are built on trust (Abdullah & Valentine, 2009; Tshipa et al., 2018a) . According to Kwame et al. (2017) corporate governance, from a stewardship theory perspective, is founded upon five key pillars, namely: trust, open communication, empowerment, long-term orientation, and performance enhancement.

Unlike agency theory, stewardship theory views the board of directors as an important support structure for management rather than that of a mechanism for control. Stewardship theorists contend that the board should, therefore, facilitate and empower managers which will then lead to better performance and efficiency (Tshipa et al., 2018a).

3.3.3 Resource Dependence Theory

The resource dependence theory states that a company's existence and success is reliant on its ability to secure and access resources (Pfeffer, 1973). Resource dependence theorists believe that the accessibility of resources is dependent on the company's engagement in transactions with external parties (Pfeffer & Salancik, 1978). The company must therefore form connections and relationships with external parties. These linkages have positive externalities as they provide the company with critical access to scarce resources (Assenga et al., 2018).

From a resource dependence theory perspective, corporate governance involves operationalising the board of director's potential to co-opt resources (Muth & Donaldson, 1998). It is submitted that company value is maximised when the corporate governance mechanisms of a company ensure that the maximum yield is derived from external resources (Ararat et al., 2017). The board of directors is seen as playing a crucial role in securing resources for the company through its linkages with the external environment (Zona et al., 2018). Pfeffer & Salancik (1978) outline four advantages that the board of directors bring to a company: (a) information through advice and counsel, (b) access to channels of information between the company and the external environment, (c) preferential access to resources, and (d) legitimacy.

The function of the board, under the resource dependence theory, therefore, extends beyond controlling or motivating managers but includes acting as a provider of resources (Tshipa et al., 2018a). The access to resources leads to improved strategic decision-making and better performance (Assenga et al., 2018).

3.4 THE GLOBAL HISTORY AND DEVELOPMENT OF CORPORATE GOVERNANCE

Similarly, to its definition, there is no global definitive and uniform historical account and treatment of corporate governance (Cheffins, 2012). The rise to global prominence of corporate governance has unfolded in different periods in various parts of the world. Despite this fact, the United States and the United Kingdom are commonly recognised in the literature as key role players in the pioneering and development of corporate governance. The United States is acknowledged as the corporate governance first mover nation (Cheffins, 2015). Whilst, on the other hand, the United Kingdom's claim to recognition lies in its revolutionary contribution to modern-day corporate governance regulation (Johannes Tshipa, 2017).

The first move towards formal modern-day corporate governance reform in the United States was the enactment of the Securities Acts of 1933 and 1934 which aimed to regulate the stock market and protect the interest of shareholders (Grant, 2003). This was following the stock market crash of 1929 and the rise in court battles and shareholder reform actions.

The key purpose of The Securities Acts of 1933 and 1934 was to ensure that investors have access to true and fair decision useful financial information (da Costa, 2016). Moreover, the Securities Acts of 1933 and 1934 led to the establishment of the Securities and Exchange Commission (SEC) in 1934 which was empowered to administer and ensure compliance with these new legislations (Grant, 2003). The declassification of executive remuneration information was one of the first disclosure requirements to be stipulated by the newly formed SEC (da Costa, 2016). Companies were required to register and to file their audited financial statements with the SEC. In an attempt to restore stock market confidence a strict prohibition was placed on false and misleading statements (Grant, 2003).

The term corporate governance was used for the first time in 1976 in the federal register of the SEC which was beginning to address managerial accountability and corruption issues which were

brought to its attention for investigation(Cheffins, 2012). The 1970s were critical in highlighting the challenges of managerial capitalism (Cheffins, 2015). The collapse of the Penn Central Company in 1970 after revelations of financial misrepresentation and fraud was instrumental in the development narrative of corporate governance in the United States. In 1974 the SEC took legal proceedings against the directors of Penn Central for failing in their fiduciary duty (Cheffins, 2012). In 1977 the SEC held hearings on corporate governance and shareholder democracy which subsequently led to the passing of two bills in 1980 that mandated a governance responsibility on outside directors. (Cheffins, 2015). These happenings were critically in heightening public and media awareness and focus on corporate governance.

The surge of corporate scandals in the beginning of the twenty-first century once again brought the issues of corporate governance into the centre of academic, corporate, and political debates. The corporate scandals of the twenty-first century were characterised by the fall of corporate giants such as Enron and WorldCom, the arrest of highly remunerated executives and the mass erosion of shareholder value (Grant, 2003). The response of Congress to these scandals was once again legislative and saw the passing of the famous Sarbanes-Oxley Act of 2002 which was aimed at strengthening regulatory oversight over the securities industry in order to protect investors by instilling corporate governance in businesses and improving the accuracy and reliability of corporate disclosures (Dragomir, 2008).

Corporate governance in the United Kingdom rose to mainstream prominence much later relative to the United States. Prior to the 1990s, corporate governance in the United Kingdom was rather simplistic and placed reliance on the traditional provisions stipulated in the 1900 and 1948 Companies Act in respect of corporate financial statements and the audit thereof (Maltby & Wilkinson, 1997; Pletz & Upson, 2019). In 1967 the accounting profession constituted the Accounting Standards Committee (later known as the Accounting Standards Board) to harmonise financial reporting and provide guidance on issues such as the valuation of assets and liabilities and the preparation of consolidated financial statements (Pletz & Upson, 2019).

In the late 1980s and early 1990s the United Kingdom faced a corporate governance crisis marked by corporate scandals and the failures of companies such as Polly Peck and the Bank of Credit and Commerce International (Johannes Tshipa, 2017). These corporate scandals and failures paved the way for the introduction of new corporate governance reforms in the beginning of the 1990s. An important feature of the development of corporate governance in the United Kingdom

was the establishment of the Committee on the Financial Aspects of Corporate Governance (generally known as the Cadbury Committee) in May 1991 (Maltby & Wilkinson, 1997). According to (Keasey, Thompson, & Wright, 2005) the Cadbury Committee was established and mandated to respond to issues relating to the concern over the use of “creative accounting” by corporates to conceal poor performance, the notable increase in corporate failures especially involving high profile domineering CEOs and the public’s outcry over the rapid growth of executive remuneration.

In its 1992 report the Cadbury Committee made a number of best practice recommendations on corporate governance aimed at strengthening the indirect voice of the shareholder, decentralising power within a company and improving the monitoring role of non-executives by enhancing their independence (Keasey et al., 2005; Maltby & Wilkinson, 1997). The United Kingdom’s response to corporate governance paved the path to a new form of corporate governance regime based on the principle of “comply or explain”. This was in contrast to the United States prescriptive and stricter requirements stipulated in the legislated Securities Acts and the Sarbanes-Oxley Act (Johannes Tshipa, 2017). Whilst the recommendations of the Cadbury Committee Report were not legally binding, it was made a listing requirement in the London Stock Exchange for corporates to disclose their compliance with the report (Maltby & Wilkinson, 1997).

The Cadbury Report has been updated following its initial release in 1992. In 1995, the Greenbury Committee was constituted in the United Kingdom to provide best practice recommendations relating to the remuneration of directors (Maltby & Wilkinson, 1997). In 1998, the two reports were combined resulting in a new report known as the United Kingdom Code of Corporate Governance. The United Kingdom Code of Corporate Governance has subsequently been amended in 2010 and 2012 (Johannes Tshipa, 2017).

3.5 THE HISTORY AND DEVELOPMENT OF CORPORATE GOVERNANCE IN SOUTH AFRICA

South Africa is a commonwealth nation with a British colonial legacy and therefore the origins and development of corporate governance in South Africa, to a large extent, mirror those in the United Kingdom (Andreasson, 2011; West, 2009). Consequently, South Africa’s corporate governance system evidence characteristics of the Anglo-American system (Andreasson, 2011). Elements of the Anglo-American system present in South Africa’s corporate governance include: a single-tier board structure with only shareholder representation, sophisticated financial markets with an

active stock exchange, a banking system that plays a secondary and non-controlling role in corporates, adoption of the International Financial Reporting Standards and the passing of the Auditors Profession Act of 2005 to align the profession with its counterparts in other Anglo-American countries (Andreasson, 2011; West, 2009).

Prior to democracy, there was no formal corporate governance legislation or code that ensured a sound governance culture beyond protecting basic shareholder rights (Padayachee, 2013). Much of the practice of the time was guided by English Common Law (Natania, 2020). The first South African Companies Act was adopted in 1973 and was modelled after the English Companies Act of 1908 (West, 2009). The motive for the adoption of the act was to ensure investor protection which was largely driven by the international community's interest in South African commodities and investor interest in listed mining stocks (Kana, 2020). As a result, several sections in the act administered the regulation of the relationship between management, directors, shareholders, and the company. These include shareholders voting on director appointments and removals, requirements for declaration of interests and shareholder approval requirements for certain decisions (Rossouw et al., 2002). The old Companies Act did not apply to SOEs. Hence, the legal governing framework for SOEs was limited to each SOE's individual entity specific legislation. The enabling legislation for each SOE provides for its establishment, mandate, corporate status, control, function, and funding (National Treasury, 2006; PwC, 2011).

The dawn of democracy not only brought about a social transformation in South Africa, but it also led to an economic transition bringing about a change in corporates and the corporate governance environment. In 1992, following the request of Nelson Mandela, The King Committee on Corporate Governance, was constituted under the chairmanship of retired High Court Judge and director Mervyn King (Judin, 2020; Natesan, 2020). The committee's establishment was inspired by the release of the 1992 Cadbury Report in the United Kingdom and the growing interest in corporate governance due to the surge in corporate failures locally and internationally (Andreasson, 2011; West, 2009). The committee's terms of reference were broad but pillared on making recommendations of best corporate governance practices taking into account the prevailing social, economic and political environment of South Africa (Natesan, 2020; Rossouw et al., 2002). The need for improvement in corporate governance in South Africa and aligning with international best practice was also important in light of the reopening and reintegration of the economy into the global economy following a period of isolation during apartheid (Andreasson, 2011).

The release of the first King Report on Corporate Governance in 1994 was a monumental step in shaping South Africa's corporate governance and placing the country as a world leader in corporate governance reform. Whilst South Africa had always purely followed the Anglo-American corporate governance system, the King I report brought about a hybridisation of the shareholder imperatives together with the interest of other stakeholders taking into account the unique South African context and the principles of "ubuntu" which means humanity (Andreasson, 2011). Foster (2020) argues that contrary to its counterparts the King I report extended beyond the context of financial and regulatory corporate governance and adopted an integrated approach incorporating social, financial, ethical, and environmental aspects of good governance. Whilst being the key differentiator of the King I report from its' counterparts, it is however noted that the non-financial aspects of corporate governance were lacking detail and clarity in King I (Tshipa, 2017). The King Committee has on several occasions updated the code with the latest being King IV issued in 2016. The key provisions in the King Codes over time are discussed later in the next sub-section of this study.

In 1997, following the release of the first King Report on Corporate Governance, the Department of Public Enterprises published the first Protocol on Corporate Governance in the Public Sector. The Protocol encapsulates the principles in the King Report, while providing guidance on the application of the King Report principles in the context of SOEs and ensuring alignment with the Public Finance Management Act (PFMA). The Protocol was subsequently revised in 2003 following the release of the updated King II Report (National Treasury, 2006). The Protocol has not been revised to align with subsequent King updates and thus SOEs now apply the King Reports directly.

A critical development in shaping and defining corporate governance in the public sector was the introduction of the PFMA in 1999. The PFMA intends to secure accountability, good governance, and sound financial management in the public sector (Kanyane & Sausi, 2015). In promoting sound financial governance practices the PFMA adopts an outputs and responsibilities approach (PwC, 2011).

Another important milestone in the development of corporate governance in South was the promulgation of the new Companies Act 71 of 2008 in May 2011. The new Companies Act focusses on the fiduciary duties of directors; requiring directors to act with a degree of care, skill, diligence and in the best interest of the company (Natania, 2020). One of the key developments

in the new Companies Act was the introduction of SOEs within the regulatory scope of the Companies Act (Mashamaite & Raseala, 2019; PwC, 2011)

Despite South Africa's corporate governance framework and policies being highly rated and respected in emerging markets, it has not escaped several challenges (Chauke & Sebola, 2018). Afolabi (2016) conducted research on the key corporate governance challenges in Sub-Saharan African Anglophone countries and found that the current political environment poses a threat to the enhancement of corporate governance and there is an elevated risk of state influence on the process of acquiring ownership and politician's interference on the work of regulatory bodies. Moreover, in South Africa it was found that corruption may negatively affect the adoption of corporate governance policies by the government.

3.6 THE LEGISLATIVE AND REGULATORY CORPORATE GOVERNANCE FRAMEWORK FOR SOEs IN SOUTH AFRICA

The corporate governance regulatory environment for SOEs in South Africa is considerably complex (Mbele, 2015). It consists of both legislated and non-legislated frameworks that outline the main corporate governance provisions for SOEs. The regulatory frameworks also range from frameworks that are common to a range of enterprises, and to those sector-specific or individual regulatory frameworks and structures (Tleane, 2020). This section of the literature review discusses the major corporate governance frameworks that govern all SOEs in South Africa.

3.6.1 The Public Finance Management Act (Act 1 of 1999) (PFMA)

The core aim of the PFMA is to regulate the management of finances at a national and provincial government level by setting out the procedures for the effective and efficient management of revenue, expenses, assets, and liabilities and by specifying the fiduciary duties and responsibilities of boards, heads of departments, accounting officers, managers, and employees (Chilenga, 2016; Kanyane & Sausi, 2015). Therefore, the PFMA advocates for accountability, transparency, and sound management in SOEs under a national or a provincial government (Tleane, 2020).

The provisions relating to the financial governance of SOEs are outlined in section 46 through to section 86 of the PFMA (Tleane, 2020). In order to promote good governance in SOEs, provisions of the PFMA address the following issues:

- Establishment of a board of directors and the designation of the board as the accounting authority,
- Fiduciary and general responsibilities of the board,
- Requirements for annual budgets, corporate plans, annual reports, and annual financial statements,
- Financial responsibilities of executive authorities,
- Regulations on borrowings by public entities,
- Establishment of audit committees,
- Financial misconduct.

(Public Finance Management Act No. 1 of 1999, 1999)

3.6.2 The Companies Act (Act No. 71 of 2008) (Companies Act)

The Companies Act governs companies in South Africa by setting out the rules and legal framework for the incorporation, capitalisation, registration, organisation, administration, and management of companies. It further defines the relationship between a company and its respective stakeholders (Tleane, 2020). The objective is to achieve transparency, accountability, efficiency, sound business judgement, and regulatory certainty in the governance of companies (McGregor, 2014).

The Companies Act includes the following provisions:

- Requirements for accounting records and financial statements companies,
- Loans and financial assistance to directors
- Distributions and capitalisation
- Meetings
- Appointment of directors and eligibility
- Board committees
- Liability of directors
- Auditors and audit committees

(Companies Act, 2008)

3.6.3 The King Reports on Corporate Governance

(a) The King I Report on Corporate Governance

The King I Report on Corporate Governance was published in November 1994 (van der Merwe, 2020). The report gained its credibility through the support from reputable organisations such as the South African Chamber of Business (SACOB), the Institute of Chartered Secretaries and Administrators (ICSA), the South African Institute of Chartered Accountants (SAICA), and the Johannesburg Stock Exchange (JSE) (Rossouw et al., 2002).

Whilst the report covered many of the same issues as the Cadbury Report and paid attention to the board of directors, it however, differed as it introduced an integrated stakeholder approach to corporate governance in South Africa (van der Merwe, 2020; West, 2009). The report advocated for dynamic participation of stakeholders and the addressing of matters that concern them (van der Merwe, 2020). The report was anchored on four key principles being: fairness, responsibility, transparency, and accountability (Tshipa, 2017).

Similarly, to the Cadbury Report in the United Kingdom, the King I Report on Corporate Governance adopted the comply or explain approach. Some of its key recommendations on internal corporate governance include splitting of the role of CEO and chairman, suggesting that the board consist of at least two non-executive directors and the establishment of audit and remuneration committees (Tshipa, 2017).

(b) The King II Report on Corporate Governance

The King II Report on Corporate Governance came into effect on 01 March 2002 as a result of the review of the King I Report on Corporate Governance (Judin, 2020). The review of King I and subsequent release of King II was against the backdrop of major corporate failures such as Enron and WorldCom and domestic pressures for better governance (Rossouw et al., 2002; West, 2009).

The report was premised on the idea of an inclusive approach to corporate governance and emphasised the new concept of “triple bottom-line” (van der Merwe, 2020). In addition to the principles of fairness, responsibility, transparency and accountability, the King II report added

three more characteristics of good corporate governance being discipline, independence, and social responsibility (Tshipa, 2017; van der Merwe, 2020). These principles have remained consistent in subsequent releases of the King Report.

The King II Report on Corporate Governance also brought about the incorporation of information and communication technology issues into the governance framework (Judin, 2020). Key recommendations of the King II report include: the majority of directors should be non-executive, board members should serve no longer than three years and the establishment of a nominations committee and a risk management committee in addition to the committees already suggested in King I (Tshipa, 2017).

(c) The King III Report on Corporate Governance

The repealing of the old Companies Act and subsequent replacement with the new Companies Act of 2008 were the key motivation for the updating of the King Report (Judin, 2020). Some of the King II recommendations had been incorporated into the new Companies Act (van der Merwe, 2020). The King III Report came into effect on 01 July 2010 and was centred on ethical leadership, sustainability, and corporate citizenship (van der Merwe, 2020).

Whilst previous King Reports followed the “comply or explain” approach, King III brought a shift in perspective through the adoption of the “apply or explain” approach (Natesan, 2020). The idea was to move from a tick-box compliance approach and help boards better understand corporate governance.

The King III Report was a huge proponent of integrated reporting and South Africa became the first nation to incorporate integrated reporting into the listing requirements making it mandatory for JSE listed companies to produce an integrated report from 01 March 2010 (Jingura, 2019; van der Merwe, 2020).

(d) The King IV Report on Corporate Governance

The King IV Report on Corporate Governance which became effective on 01 April 2017 is the most recent and current corporate governance code for South Africa (van der Merwe, 2020). The recent update was shaped and influenced by issues such as social media and the millennial entry into the market (Judin, 2020).

The King IV Report also introduced the move from the “apply or explain” approach in King III to the “apply and explain” approach. The motivation for this transition was once again to highlight that good corporate governance cannot be achieved if companies treat the code in a “tick-box” manner. The report argues that the principles are universal and applicable to all organisations the difference is only in how the principles are applied (van der Merwe, 2020). Consequently, the principles have been reduced from seventy-five to sixteen plus one principle for institutional investors (Judin, 2020). The additional principle addresses the role that institutional investors play in ensuring good corporate governance practices in the companies that they invest in (van der Merwe, 2020).

King IV talks to the creation of value in a sustainable manner in line with the United Nation’s Sustainable Development Goals. Moreover, it encourages corporates to adopt an outcomes-based approach to corporate governance focussing on the achievement of an ethical culture, good performance, effective control, and legitimacy (Institute of Directors of Southern Africa, 2016)

One of the key distinguishing elements of the King IV Report is the inclusion of sector-specific supplements. Part 6 of the sector supplements speaks to corporate governance in SOEs. The King IV Report places significant emphasis on the importance of good governance in SOEs and states that good governance is essential for the success of SOEs.

The King IV Report on Corporate Governance includes the following provisions to promote good governance in SOEs:

- Governing body ethical and effective leadership requirements.
- Governing body composition guidelines.
- Fair, responsible, and transparent remuneration principles.
- Performance evaluations of the governing body.

3.7 THE ROLE AND IMPORTANCE OF THE BOARD OF DIRECTORS

Corporate governance literature recognises the board as one of the most quintessential internal corporate governance mechanisms (Torchia et al., 2015). The corporate governance theories discussed in sub-section 3.3 of this study highlighted the critical role of the board of directors in ensuring a good internal corporate governance environment. Based on the theories discussed,

the role of the board translates into: (a) monitoring and controlling managers in accordance with the agency theory; (b) motivating and empowering managers as per stewardship theory; and (c) co-opting and optimising of critical resources for the company in line with resource dependence theory (Assenga et al., 2018; Melón-Izco et al., 2020; Tshipa et al., 2018a)

Board effectiveness is, therefore, a focal point of good corporate governance, as boards are elected to maximise shareholder value by monitoring and providing strategic direction to managers (al Farooque et al., 2020; Masli et al., 2018). Gachie & Govender (2017) submit that good board governance results in an improvement in the quality of management. The efficiency and effectiveness in the board's monitoring of managerial activities encourages management to pursue value maximising projects and deters the expropriation of company resources (S. Akbar et al., 2016; Usman, 2016). Furthermore, the improvement in the quality of management is associated with better decision making and transparency (Radebe, 2017; Usman, 2016). This means that the boards role in protecting the interest of shareholders encompasses a responsibility for the performance and viability of the SOE and ensuring that it fulfils its mandate (Mekwe, 2015).

According to the National Treasury (2005), SOE boards have an oversight responsibility and are accountable to the shareholder for the performance and affairs of the SOE. This means that boards must exercise control over the SOE and ensure that it fulfils its mandate whilst being commercially sustainable.

The board's monitoring and direction role is not only important in the context of financial performance and viability, but good board governance is also associated with reducing wastage (Radebe, 2017). The board not only provides access to resources, but also ensures that they are employed in a sustainable manner that reduces environmental costs, increases economic innovation, and ensures optimal investment strategy (Gachie & Govender, 2017). Moreover, the board's oversight responsibility also ensures that management complies with laws and regulations which enhances the reputation of the company (Aluchna & Kuszewski, 2020; Mahmood et al., 2018; Melendy & Huefner, 2011).

The importance of good board governance is also evident in the King IV Report, which accentuates the crucial role of the board, as the custodian of corporate governance, in realising the intended four outcomes of corporate governance being: ethical culture, effective control, good performance, and legitimacy (Institute of Directors of Southern Africa, 2016).

This study focuses on the relationship between board attributes and (a) the likelihood of financial distress and (b) the incurrence of fruitless and wasteful expenditure in South African SOEs. The PFMA plays a vital role in establishing the board's legal responsibilities with respect to financial distress and fruitless and wasteful expenditure. The next two sub-sections of this section of the chapter outline the legal responsibilities of the board in relation to financial distress and fruitless and wasteful expenditure.

3.7.1 The Board of Directors and Financial Distress

The Companies Act (2008) states that a company is financially distressed if it is reasonably unlikely that it will be able to pay all its debts as they fall due and payable within the immediately ensuing six months, or it is reasonably unlikely that the company's assets will continue to exceed its liabilities within the immediately ensuing six months.

Section 51 of the PFMA stipulates the following responsibilities of the board as it relates to ensuring the financial viability of SOEs:

- collect all revenue due,
- manage working capital efficiently and economically,
- safeguarding of assets, and
- managing of revenue, expenditure, and liabilities of the SOE.

3.7.2 The Board of Directors and Fruitless and Wasteful Expenditure

Fruitless and wasteful expenditure is defined in Section 1 of the PFMA, as expenditure which was made in vain and would have been avoided had reasonable care been exercised.

Section 51 of the PFMA also addresses the role of the board in relation to fruitless and wasteful expenditure. According to the PFMA, the board must take effective and appropriate steps to prevent the incurring of fruitless and wasteful expenditure.

3.8 BOARD ATTRIBUTES AND FINANCIAL DISTRESS AND FRUITLESS AND WASTEFUL EXPENDITURE

This section of the chapter builds on the foundation laid in the previous sections. In this section of the chapter the survey of prior empirical studies on board attributes and financial distress and fruitless and wasteful expenditure. Table 3.1 then provides a summary of the prior empirical studies surveyed.

3.8.1 Board Size

Theoretically, board size can be approached from the perspectives of agency theory, stewardship theory, and resource dependence theory (Muchemwa et al., 2016). However, these theories present conflicting perspectives on board size.

Firstly, from an agency theory perspective, it is submitted that a larger board is more effective at monitoring and controlling the actions of management (Muchemwa et al., 2016). A greater number of directors involved in overseeing managerial actions, results in a more vigilant board (Pucheta-Martínez & Gallego-Álvarez, 2020). An increase in the board's capacity to supervise and control management will ensure that management works towards creating shareholder value and deters managerial expropriation (Kalsie & Shrivastav, 2016). Furthermore, it is argued that a larger board reduces the likelihood of an individual dominating the board which heightens the monitoring of management and increases the scope for accountability leading to a reduction in agency costs (Mohd Ali & Mohd Nasir, 2018; Puni & Anlesinya, 2020).

Secondly, resource dependence theory presents an argument in line with agency theory, which favours larger boards. The key argument presented is that larger boards offer a wealthier and diversified pool of resources, expertise, skills, talent, external linkages, and network (Muchemwa et al., 2016). Diversity and wealth in expertise of larger boards increases the quality of the advice given to management by the board (Wang et al., 2018). Arora and Sharma (2016) state that the greater depth of intellectual capital in larger boards leads to improved decision making.

Finally, stewardship theory presents an argument that is contrary to the agency theory and resource dependence theory. Stewardship theory advocates for smaller board sizes by submitting that smaller boards achieve cohesiveness, effective communication and efficient decision making

(Paniagua et al., 2018). Stewardship theorists contend that large boards tend to lose internal coordination and communication and the many interests represented on the board lead to conflict (Puni & Anlesinya, 2020). Moreover, large boards are also criticized for giving rise to the free rider problem as the board becomes too large to control leading to the dereliction of duties by some directors (Ghosh & Ansari, 2018).

South African law governing SOEs does not show consensus on the exact acceptable board size. King IV also does not specify the exact number of directors that should constitute the board, but rather requires that the board consider whether its size makes it effective.

Prior studies in the literature also show a lack of consensus regarding the ideal board size. Some studies on board size and likelihood of financial distress provide empirical support for the agency theory and resource dependence theory perspectives on board size. Other studies show empirical support for the stewardship theory position by evidencing a statistically significant and positive relationship between board size and likelihood of financial distress. There are also studies that yielded statistically insignificant results. However, as it relates to board size and the incurrence of fruitless and wasteful expenditure, we did not find any prior study on this relationship.

Manzaneque et al., (2016) found that board size is negatively correlated with the likelihood of financial distress in Spanish listed companies and that non-distressed companies tend to have a large board size with an average of twelve members. Their findings have been consistent with other later studies, which have supported the position of agency and resource dependence theorists on board size. These studies found a statistically significant and inverse relationship between board size and the likelihood of financial distress (Bravo-Urquiza & Moreno-Ureba, 2021; Chen et al., 2020; Darrat et al., 2016; Mariano et al., 2020; Ud-Din et al., 2020).

On the other hand, Salloum et al. (2013) found that board size has a statistically significant and positive relationship with the likelihood of financial distress. The study was based on the analysis of 178 Lebanese non-listed and family-owned companies. They argue that the lack of coordination in large boards renders them ineffective at monitoring management which in the long run may trigger financial distress.

Finally, some studies found no statistically significant evidence of the relationship between board size and financial distress. Based on a sample of 94 manufacturing companies listed on the

Indonesia Stock Exchange over the period 2010 to 2018, Handriani et al. (2021) found a statistically insignificant relationship between board size and likelihood of financial distress. These results concurred with a prior study by Mokarami and Motefares (2013) which was based on Tehran Stock Exchange listed companies.

Accordingly, the hypotheses of this study, as it relates to board size are asserted as follows:

H1a: There is a negative significant relationship between board size and the likelihood of financial distress in South African SOEs.

H1b: There is a negative significant relationship between board size and the incurrence of fruitless and wasteful expenditure in South African SOEs.

3.8.2 Board Activity

Board activity refers to the frequency of board meetings held to discuss various matters relating to the company (Ali & Nasir, 2018). Board meetings are considered as evidence of a board's diligence in discharging its duties and responsibilities (Kwame et al., 2017).

From a theoretical approach, the importance of board meetings can be described from agency theory and resource dependence theory perspectives. Firstly, board meetings are seen to serve as critical channels through which directors obtain information on the company and perform their monitoring and supervisory role over the actions of management (Rashid, 2015; Vitolla et al., 2020). Moreover, they allow for the evaluation of the performance of management and the resolving and minimisation of conflicts of interest and agency costs (Puni & Anlesinya, 2020). Secondly, board meetings not only allow directors to collect information on the company and management, but they also provide a platform for directors to provide strategic advice and appraise investment opportunities which increases the quality of decision making (Wang et al., 2020). In essence, frequent board meetings are associated with an increased ability of the board to effectively advise, monitor, and discipline management (Ntim & Osei, 2011).

However, some researchers have expressed scepticism regarding the effectiveness of board meetings. It is argued that instead of discussing strategic issues often board meetings are used to discuss routine matters (Puni & Anlesinya, 2020). There is limited time for meaningful

engagement and probing of managers by directors (Johl et al., 2015; Puni & Anlesinya, 2020). Furthermore, board meetings are associated with a diversion of managerial productive time, costly travel and administrative expenses, and exorbitant meeting fees (Johl et al., 2015). Boards meetings are also criticised for being reactive rather than proactive (Ali & Nasir, 2018).

The legislative framework governing SOEs in South Africa does not define the exact number of board meetings that should be held in a financial period. King IV also does not prescribe the number of times the board should meet, but rather as principle, requires that board members should attend board meetings and devote sufficient time and effort to prepare for those meetings.

Our survey of prior empirical literature on board activity and likelihood of financial distress showed mixed results. Some studies show a negative relationship between board activity and financial distress, some studies showed a positive relationship, whilst other studies yielded statistically insignificant results.

Bravo-Urquiza and Moreno-Ureba (2021) studied the relationship between compliance with corporate governance codes and likelihood of financial distress in Spain, using the 36 IBEX-35 listed companies as a sample for the period 2013 to 2016. Their analysis found that board meeting frequency is negatively related to financial distress.

However, Ali and Nasir (2018), found that board activity has a positive significant relationship with financially distressed companies. This study was based on Bursa Malaysia listed companies over the period 2010 to 2016. Similarly, Khurshid et al. (2018) found that the frequency of board meetings was positively correlated with financial distress in Pakistan Stock Exchange listed companies.

Brédart (2014) and Ningrum et al. (2017) found that board meetings had no significant influence on financial distress in US and Indonesian companies, respectively.

We did not find any prior empirical studies on board activity and the incurrence of fruitless and wasteful expenditure.

Accordingly, the hypotheses of this study, as it relates to board activity are asserted as follows:

H2a: There is a negative significant relationship between board activity and the likelihood of financial distress in South African SOEs.

H2b: There is a negative significant relationship between board activity and the incurrence of fruitless and wasteful expenditure in South African SOEs.

3.8.3 Board Tenure

Board tenure refers to the average number of years the company's directors have served on the board and is an indication of the company's stability (Livnat et al., 2021). The theoretical significance of board tenure can be viewed from a resource dependence theory and agency theory perspective. Resource dependence theorists submit that board tenure is a critical aspect of board capital (de Maere et al., 2014). Longer board tenures are associated with increased company knowledge and experience (Ng et al., 2016). This improves the quality of strategic decision making and board members can provide greater and better resources (in the form of advice and counsel) to the company (de Maere et al., 2014).

From an agency theory perspective, longer board tenure is seen to strengthen the board's ability to effectively monitor managers and reduce agency costs (Livnat et al., 2021). The more time a director serves on the board, the more intrinsic company knowledge they gain which allows them to detect and respond in a timely manner to problems, and they are in a better position to control managerial opportunistic behaviour (Lajili & Zéghal, 2010).

However, a conflicting view on board tenure is also presented. It is argued that long board tenure poses a risk that the board members grow too close and become friendly to management, which may undermine their ability to control and monitor managers (Al-Absy, 2020).

The South African legislative framework governing SOEs does not prescribe the number of years that directors should serve on the board. King IV also does not define the exact board tenure, but it requires the board to consider the effect of long tenure on the independence of non-executive directors classified as independent.

Prior literature on board tenure and likelihood of financial distress shows mixed results. However, we are not aware of any study on the relationship between board tenure and the incurrence of fruitless and wasteful expenditure.

In Belgium, de Maere et al. (2014) found that companies with long-serving directors are less likely to face bankruptcy. These findings were consistent with an earlier study in the US, which found that financially distressed companies face shorter director tenure (Lajili & Zéghal, 2010). Al-Absy (2020) studied the relationship between board chairman tenure and likelihood of financial distress in Malaysian companies and found that long board chairman tenure reduces the likelihood of financial distress and improves financial sustainability.

Contrary to the above findings, (Munene et al., 2020) found that board tenure has a detrimental effect on financial distress. The study was based on Kenyan Savings and Credit Cooperatives and found that there is a statistically significant and positive relationship between board tenure and the likelihood of financial distress.

However, Salloum et al. (2013) found no conclusive evidence on the relationship between board tenure and financial distress. The study results were statistically insignificant.

Accordingly, the hypotheses of this study, as it relates to board tenure are asserted as follows:

H3a: There is a negative significant relationship between board tenure and the likelihood of financial distress in South African SOEs.

H3b: There is a negative significant relationship between board tenure and the incurrence of fruitless and wasteful expenditure in South African SOEs.

3.8.4 Board Gender Diversity

Board diversity can be defined as the representation of various attributes, such as, age, gender, ethnicity, culture, religion, constituency representation, independence, knowledge, technical skills, educational background, and commercial experience in the board (Khatib et al., 2021). Tshipa (2017) states that whilst board diversity is a topical issue it is however the most under-researched board governance variable. According to Ntim (2013) South Africa's apartheid history

provides an interesting context for studying board diversity in the country. The extended policy of racial, social, economic, and political segregation resulted in largely homogenous boards in favour of males and persons of white ethnicity. This present study focusses on board gender diversity.

Agency theorists contend that diversity enhances independence and reduces the possibility of collusion amongst members of the board (Gordini & Rancati, 2017). This means that diversity leads to improved supervisory, better control and monitoring (Musa et al., 2020). Furthermore, a diverse board is argued to be more probing of management which results in better decision making (Gordini & Rancati, 2017). Alqatan (2019) submits that boards with a mix of males and females can better fulfil their fiduciary duty to all shareholders as a diverse board achieves better representation of shareholders who are a mix of males and females.

Resource dependence views board diversity as an enhancement to the quality of board advice and decision making through the contribution of diverse perspectives (Alqatan, 2019; Gordini & Rancati, 2017; Kwame et al., 2017). There is, therefore, an increased ability to solve problems due to an increase in creativity and innovation (Gordini & Rancati, 2017). Furthermore, a diverse board helps better link the company to its external environment and secure various critical scarce resources such as skills, business contracts, societal recognition, and legitimacy (Tshipa, 2017). The company also gains a competitive advantage through better understanding of its marketplace including consumer groups and labour (Gordini & Rancati, 2017).

Board diversity is not immune to criticism. Opponents argue that homogenous groups are more cooperative (Gordini & Rancati, 2017). Diverse boards often face challenges of poor communication and misunderstandings (Santen & Donker, 2009). Therefore, board diversity inhibits cohesion and performance as there is greater potential for conflict and factionist behaviour (Tshipa, 2017). Furthermore, the diversity in opinions leads to delays in decision-making and failure to implement decisive strategies timely (Gordini & Rancati, 2017). Some opponents dismiss the notion that diversity leads to improved monitoring, arguing that the appointment of diverse directors may be perceived as a tokenism gesture and mere compliance leading to the marginalisation of these directors (Gordini & Rancati, 2017; Tshipa, 2017).

The importance of board diversity in South Africa is cemented in the King IV Report on Corporate Governance which requires that boards promote diversity in their membership and that they should set targets for race and gender representation.

The survey of the literature on board gender diversity and financial distress shows mixed results. However, as it relates to board gender diversity and fruitless and wasteful expenditure, we are not aware of any prior study that has examined this relationship.

Guizani and Abdalkrim (2022) found empirical evidence in support of the position held by agency and resource dependence theorist on board gender diversity. They found that female representation on the board, in Malaysian companies, strengthens board efficacy and reduces the likelihood of financial distress. Their findings were in accordance with other earlier studies, conducted in different countries, which also found that board gender diversity has a statistically significant but negative relationship with financial distress (Ali et al., 2021; Darrat et al., 2016; Kristanti et al., 2015; Mittal & Lavina, 2018; Yousaf et al., 2020).

However, Al-Absy et al. (2020) had earlier found results contrary to those later found by Guizani and Abdalkrim (2022) in Malaysian companies. The former found empirical evidence that contradicts the position held by agency and resource dependence theorists' regarding board gender diversity. Their results show that female representation on the board has a direct and significant relationship with financial instability and increases the risk of financial distress.

There are also studies that yielded statistically insignificant results suggesting that there is no relationship between board gender diversity and likelihood of financial distress (Salloum et al., 2013; Santen & Donker, 2009).

Accordingly, the hypotheses of this study, as it relates to board gender diversity are asserted as follows:

H4a: There is a negative significant relationship between board gender diversity and the likelihood of financial distress in South African SOEs.

H4b: There is a negative significant relationship between board gender diversity and the incurrence of fruitless and wasteful expenditure in South African SOEs.

3.8.5 Board Education

The importance of board education can be explained from a resource dependence theory perspective. According to Hambrick and Mason (1984) a higher education level is a good signal of a higher level of knowledge and intellectual competence. It is submitted that directors with good qualifications and skills bring value-adding resources in the form of proficiencies, technical competencies, knowledge, information, and external relationships at their disposal (Yousaf et al., 2020) This means that education enhances board capital and strengthens the boards' ability to co-opt resources for the company.

Whilst resource dependence theory advocates for board education, empirical literature shows mixed results on the relationship between board education and the likelihood of financial distress. Kristanti et al. (2015) and Yousaf et al. (2020) found a negative relationship between board education and probability of financial distress. In a South African study of 116 listed companies, Sewpersadh (2022) found empirical support for the resource dependence theory position on board education. They found that a higher percentage of directors with postgraduate qualifications lowers the probability of financial distress.

However, Kanakriyah (2021) found results contrary to the resource dependence theory and found that board education has a negative effect on company financial performance which suggests that it may increase the likelihood of financial distress.

There are also studies that have shown no conclusive evidence on board education and likelihood of financial distress. Li et al. (2021) and Noor and Iskandar (2012) found statistically insignificant results on the relationship between board education and likelihood of financial distress in China and Malaysia, respectively.

Whilst empirical studies on board education and likelihood of financial distress show mixed results, we did not find any prior study that has tested the relationship between board education and the incurrence of fruitless and wasteful expenditure.

Accordingly, the hypotheses of this study, as it relates to board education are asserted as follows:

H5a: There is a negative significant relationship between board education and the likelihood of financial distress in South African SOEs.

H5b: There is a negative significant relationship between board education and the incurrence of fruitless and wasteful expenditure in South African SOEs.

TABLE 3.1 – Summary of Prior Empirical Studies on Board Attributes and Financial Distress

Author(s)	Data	Board Size	Board Activity	Board Tenure	Board Gender Diversity	Board Education
Chen et al. (2020)	Taiwan Stock Exchange listed companies covering the period 1995 - 2016	Negative	Not applicable	Not applicable	Not applicable	Not applicable
Manzaneque et al. (2016)	Spanish listed companies covering the period 2007 - 2012.	Negative	Not applicable	Not applicable	Not applicable	Not applicable
Darrat et al. (2016)	Compustat listed companies covering a 10-year period from 1996 to 2006	Negative (for complex companies)	Not applicable	Not applicable	Negative relationship	Not applicable
Mariano et al. (2020)	270 UK listed companies. The study period was 9 years from 2010 to 2018	Negative Relationship	Not applicable	Not applicable	Not applicable	Negative relationship
Ud-Din et al. (2020)	146 companies listed on the Pakistan Stock Exchange, over a period of 15 years from 2005 to 2019	Negative	Not applicable	Not applicable	Not applicable	Not applicable
Salloum et al. (2013)	178 Lebanese non-listed and family-owned companies. The study period was from 2004 to 2008.	Positive	Not applicable	Insignificant	Insignificant	Not applicable
Handriani et al (2021)	94 manufacturing companies listed on the Indonesia Stock Exchange. The study period was from 2010 to 2018.	Insignificant	Not applicable	Not applicable	Not applicable	Not applicable
Mokarami and Motefares (2013)	76 companies listed in the Tehran Stock Exchange	Insignificant	Not applicable	Not applicable	Not applicable	Not applicable
Bravo-Urquiza & Moreno-Ureba (2021)	36 Spanish companies listed in the IBEX-35 for the period 2013 - 2016	Negative	Negative	Not applicable	Not applicable	Not applicable
Ali & Nasir (2018)	Bursa Malaysia listed companies for the years 2010 until 2016	Insignificant	Positive Relationship	Not applicable	Not applicable	Not applicable
Khurshid et al. (2018)	164 Pakistan Stock Exchange Listed companies over an 8-year period from 2009 to 2016	Negative Relationship	Positive Relationship	Not applicable	Not applicable	Not applicable
Bredart (2014)	312 US companies listed on the Amex, Nasdaq, and the NYSE over the period 2007 to 2009	Negative Relationship	Insignificant	Not applicable	Not applicable	Not applicable
Ningrum et al (2017)	59 companies in the sector of consumer goods and trade listed in Indonesian Stock Exchange in the period of 2010-2015	Negative relationship	Insignificant	Not applicable	Negative relationship	Not applicable
de Maere et al. (2014)	232 unlisted Belgium companies over a five-year period	Insignificant	Not applicable	Negative Relationship	Not applicable	Not applicable

Lajili & Zéghal, 2010	118 US publicly traded companies. The study period was from 2001 to 2003	Not applicable	Not applicable	Negative Relationship	Not applicable	Not applicable
Al-absy (2020)	282 Malaysian companies over a three-year period from 2013 to 2015	Insignificant	Insignificant	Negative Relationship	Not applicable	Not applicable
Munene et al. (2020)	174 Kenyan companies over the period 2012 to 2018	Positive Relationship	Not applicable	Positive relationship	Negative relationship	Negative relationship
Guizani & Abdalkrim (2022)	367 non-financial companies listed on Bursa Malaysia over the period from 2011 to 2019	Not applicable	Not applicable	Not applicable	Negative relationship	Not applicable
Mittal & Lavina (2018)	50 family-controlled companies listed in the Bombay Stock Exchange of India from 2013 to 2016	Not applicable	Not applicable	Not applicable	Negative relationship	Not applicable
Kristanti et al. (2015)	7 family companies during the 2010 to 2014 period listed in Indonesia Stock Exchange	Not applicable	Not applicable	Not applicable	Negative relationship	Negative relationship
Yousaf et al. (2020)	295 Chinese listed at the Shanghai Stock Exchange for the study period 2007 to 2016	Not applicable	Not applicable	Not applicable	Negative relationship	Negative relationship
Ali et al. (2021)	1374 non-financial Chinese companies for the study period 2009 to 2018	Not applicable	Not applicable	Not applicable	Negative relationship	Not applicable
Al-absy et al. (2020)	282 Malaysian companies over a three-year period from 2013 to 2015	Not applicable	Not applicable	Not applicable	Positive relationship	Not applicable
Sewpersadh (2022)	116 South African listed companies for the period 2011 to 2016	Not applicable	Not applicable	Not applicable	Not applicable	Negative relationship
Li et al. (2021)	2824 Chinese companies over a 17-year study period from 2003 to 2019	Insignificant	Not applicable	Not applicable	Not applicable	Insignificant
Noor & Iskandar (2012)	56 Malaysian companies for the study period 2005 to 2011	Not applicable	Not applicable	Not applicable	Not applicable	Insignificant
Hazami-Ammar & Gafsi (2021)	67 French companies over the study period 2015 to 2017	Negative Relationship	Not applicable	Not applicable	Not applicable	Not applicable
Santen & Donker (2009)	All companies listed on the Amsterdam Stock Exchange over the period 1993 - 2003	Not applicable	Not applicable	Not applicable	Insignificant	Not applicable
Kanakriyah (2021)	85 Jordanian industrial and service companies listed on the Amman Stock Exchange during the period 2015 - 2019	Negative relationship	Negative relationship	Not applicable	Not applicable	Positive relationship

Source: Author's summary of literature survey

3.9 GAPS IDENTIFIED IN THE LITERATURE

Despite the plethora of studies on board governance and the development of corporate governance as a subject area, our search of the literature highlighted five notable gaps evident in the prior literature that motivate and justify for the relevance of this study.

Firstly, most of the studies in this subject have been conducted in developed and advanced nations. Therefore, there are limited empirical findings from a developing nation perspective (Dzingai & Fakoya, 2017; Kwame et al., 2017; Puni & Anlesinya, 2020; Srivastava et al., 2019).

Secondly, apart from the geographic confinement of previous studies, they also suffer from a public sector deficiency. Historically, corporate governance has been associated with the private sector and consequently, there is limited research from a public sector and SOE perspective (Mbo & Adjasi, 2017; Simpson, 2014; Wong, 2004). Simpson (2014) argues that corporate governance in the public sector deserves more attention because whilst unethical behaviour in the private sector impacts the shareholders of a company, unethical behaviours in the public sector affects all taxpayers and citizens and undermines the quality of government.

Thirdly, corporate governance is a wide and growing subject area. Some corporate governance variables are under-researched in the literature. There is relatively limited research on board gender diversity, board qualifications, and board tenure (Tshipa, 2017).

Fourthly, despite the PFMA placing a burden on the board of a SOE to take effective and appropriate steps to prevent fruitless and wasteful expenditure, we did not identify any prior study in the literature that has empirically tested the relationship between board attributes in SOEs and the level of fruitless and wasteful expenditure incurred.

Finally, there is a lack of conclusive evidence on the relationship between board attributes and likelihood of financial distress as prior studies have yielded mixed and inconsistent results (Afrifa & Tauringana, 2015; Rebeiz, 2015; Shank et al., 2013). Some studies show that the study board attributes have a positive relationship with financial distress, whilst some show a negative relationship. There are also studies that show no relationship.

In light of the above gaps identified in the literature, this study seeks to contribute and add to the existing body of literature on board attributes in South African SOEs.

3.10 SUMMARY

This study seeks to establish whether there is a relationship between board attributes and financial distress and fruitless and wasteful expenditure in South African SOEs. In this chapter of the study, we discussed the theoretical and legislative frameworks underpinning board governance in South African SOEs. Moreover, prior empirical studies were also surveyed to develop a knowledge of the extant literature and to identify any gaps emerging in the literature. From a theoretical perspective, the agency theory posits that the board's monitoring and control activities over management can improve the financial viability of SOEs and deter the incurrence of fruitless and wasteful expenditure. Stewardship theory, on the other hand, argues that managers are intrinsically motivated to work towards ensuring the best outcome for shareholders and the company. Lastly, resource dependence theory, submits that the board can enhance the financial sustainability and improve resource optimisation as the board plays a critical role in securing resources that are pivotal to the success of the company. However, these theories presented conflicting views on the different board attributes constituting this study. From an empirical perspective, the survey of prior empirical studies showed a lack of conclusive evidence on the relationship between board attributes and financial distress. Furthermore, no prior study was found to have tested the relationship between board attributes and fruitless and wasteful expenditure. Therefore, the question still remains, whether board attributes have an impact on financial distress and fruitless and wasteful expenditure in South African SOEs. The discussion in this chapter will form a critical foundation for the methodology that will be followed to address the research problem of this study.

CHAPTER FOUR RESEARCH METHODOLOGY

4.1 INTRODUCTION

This chapter endeavours to provide a precise plan of action that accurately depicts the techniques and research strategies that were employed in addressing the research questions of this study. This entails setting out the systematic steps that were followed in gathering, analysing, and presenting the data that was utilised in executing the research.

The previous chapter concluded with a discussion on the limitations of previous studies on board attributes. This chapter will first build on this discussion and the gaps identified in the survey of prior literature by presenting a summary of the study hypotheses. Secondly, the research paradigm and approach that was followed in carrying out the research is discussed. Thirdly, the study sample and study variables are defined, and the data collection process is explained. Fourthly, the techniques employed to analyse the data are explained. Fifthly, the controls implemented to ensure the validity and reliability of the study are highlighted. Finally, before the chapter is concluded with a summary; the ethical considerations of the study are set forward.

4.2 STUDY HYPOTHESES

The objective of this study is to investigate the relationship between board attributes and the likelihood of financial distress, and the level of fruitless and wasteful expenditure incurred in South African State-Owned Enterprises (SOEs). The study hypotheses of this study are formulated based on this objective and the discussion in Chapter 3 of this study on the extant literature on board attributes.

Table 4.1 presents a summary of the study hypotheses based on the five board attributes explored in the literature review.

Table 4.1: Summary of Study Hypotheses

Hypothesis	Statement
H1.a	There is a negative relationship between board size and the likelihood of financial distress.
H1. b	There is a negative relationship between board size and the incurrence of fruitless and wasteful expenditure incurred.
H2.a	There is a negative relationship between board activity and the likelihood of financial distress.
H2. b	There is a negative relationship between board activity and the incurrence of fruitless and wasteful expenditure.
H3.a	There is a negative relationship between board tenure and the likelihood of financial distress.
H3. b	There is a negative relationship between board tenure and the incurrence of fruitless and wasteful expenditure.
H4.a	There is a negative relationship between board gender diversity and the likelihood of financial distress.
H4. b	There is a negative relationship between board gender diversity and the incurrence of fruitless and wasteful expenditure.
H5.a	There is a negative relationship between board education and the likelihood of financial distress.
H5. b	There is a negative relationship between board education and the incurrence of fruitless and wasteful expenditure.

Source: Author

4.3 RESEARCH PARADIGM AND APPROACH

Research paradigm refers to the fundamental beliefs and assumptions that provide a system and framework of thinking that will guide a researcher's behaviour and the research technique and process to be followed in solving a research problem (Ardalan, 2003; Morgan, 2007).

According to Sultana et al. (2020) there are four basic paradigms in finance related research:

- **Positivism** relies on objective experimentation and hypothesis testing to study the causal relation between phenomena (Rehman & Alharthi, 2016). The positivism paradigm adopts a quantitative approach as empirical data is collected, analysed, and tested to form a knowledge base (Rehman & Alharthi, 2016; Sultan a et al., 2020). The positivist paradigm

requires an objective approach to the data collection and data analysis process and therefore the researcher's involvement in these processes is reduced to a minimal (Khan & Kong, 2022).

- **Interpretivism** seeks to understand social phenomena at the level of subject experience (Ardalan, 2019). Interpretivists collect qualitative data from participants and then employ an inductive approach in analysing the data to discover patterns in the data which are organised in broad themes and used to formulate a knowledge base and to generate a theory (Sultana et al., 2020).
- **Pragmatism** follows characteristics of both characteristics of positivism and interpretivism (Sultana et al., 2020). Pragmatists holds the view that a complete understanding of the research problem, data, and study phenomena requires a mixed method of research comprising of both quantitative and qualitative research approaches.
- **Post Positivism/Critical Realism** adopts the same view as positivism in that observable phenomena can be tested independently of the researcher; however, it contends that interpretation is subject to human social conditioning (Maarouf, 2019).

According to Saunders et al., (2009) the research paradigm and approach adopted in a study are a function of the nature of the research question. The research questions of this study demand a highly objective evaluation with deductive reasoning. This study adopts the positivist paradigm and a quantitative approach to addressing the research questions of the study. The positivist paradigm will provide an outcome that explains the relationship between the study phenomena being board attributes, likelihood of financial distress and fruitless and wasteful expenditure. Furthermore, the quantitative research approach is appropriate for this study as the quantitative approach follows the confirmatory scientific method for hypothesis testing. In addressing the research questions, empirical data will be collected and statistically analysed to deduce on the relationship between board attributes and the likelihood of financial distress and the relationship board attributes, and fruitless and wasteful expenditure incurred in South African SOEs. Therefore, this study's contribution to the literature will be based on the generalised empirical findings from the testing of the study hypotheses.

4.4 THE STUDY POPULATION AND SAMPLE

The focal point of this study is on board attributes in South African SOEs. Consequently, the target population of this study can be defined as the SOEs listed under the schedules of the Public Finance Management Act (PFMA). The inherent nature of the two research questions that give rise to this study, direct the focus of this study towards commercial SOEs only. Therefore, the study applied a non-probability sampling method whereby all commercial SOEs were selected for the study and all non-commercial SOEs were excluded. The selection of commercial SOEs is consistent with previous similar studies on South African SOEs (Bezuidenhout & Bussin, 2020; Marimuthu, 2020, 2021; Marimuthu & Kwenda, 2019). Table 4.2 shows the number of commercial SOEs listed in the schedules of the PFMA:

Table 4.2: Commercial SOEs listed in the PFMA.

Schedule in PFMA	SOE Category	Number of SOEs
Schedule 2	Major Public Entities	21
Schedule 3B	National Business Enterprises	21
Schedule 3D	Provincial Business Enterprises	17

Source: Author

As per Table 4.2 the initial sample of this study targeted the 59 commercial SOEs listed in the respective schedules of the PFMA. However, the study had to exclude some commercial SOEs for the following reasons:

- Incomplete data set published in the annual reports and annual financial statements of the sample SOEs during the study period.
- Unpublished annual reports and/or annual financial statements for any of the financial year during the study period.
- Privatised SOEs.
- Liquidated SOEs during the study period.

The final sample of the study consisted of 27 commercial SOEs (see Appendix B).

4.5 DATA COLLECTION

Data collected for research purposes can be classified as either primary or secondary data (Hox & Boeije, 2005; Rabiński, 2003). Primary data refers to data the researcher collects specifically for the research problem (Hox & Boeije, 2005). Secondary data, on the other hand, refers to data from secondary sources, collected by others not specifically for the research problem (Cowton, 1998). Irrespective of whether the data collected is primary or secondary, the data must be current, relevant, reliable, and accurate (Rabiński, 2003).

This study, in line with the quantitative approach adopted, used numerical secondary data relating to the board attributes, financial distress, and fruitless and wasteful expenditure of the sample SOEs. The secondary data was collected from the annual reports and audited annual financial statements for the five-year study period from 2016 to 2020. The annual reports and audited annual financial statements were obtained from the websites of the respective sample SOEs.

4.6 STUDY VARIABLES

4.6.1 Independent Variables: Board Attributes

The discussion in Chapter 3 of this study, on the King IV recommendations, the requirements of the PFMA and the Companies Act relating to the composition of the board as well as the approach adopted in similar prior empirical studies, was used in this study to inform the selection and operationalisation of the independent variables of the study. The following board attributes constitute the exploratory variables of this study:

Board Size (BSize)

Board size refers to the number of directors sitting on the board. This measure of board size is consistent with previous studies (Handriani et al., 2021; Javed et al., 2013; Manzaneque et al., 2016; Mariano et al., 2020; Meyer & de Wet, 2013; Salloum et al., 2013a).

Board Activity (BActivity)

This study measured board activity as the number of times the board meets in a financial year. The use of board meetings as a measure of board activity is consistent with the prior literature (Brick & Chidambaran, 2010; Fallatah, 2012; C. Ntim & Osei, 2011; Paul, 2017; Vafeas, 1999).

Board Tenure (BTenure)

Board tenure is defined as the average number of years the directors have served on the board (Ombaba & Kosgey, 2018). This study, therefore, measured board tenure by dividing the total number of years the directors have served on the board by the total number of directors on the board. This is consistent with earlier literature (Arosa et al., 2013; Ng et al., 2016; Ombaba & Kosgey, 2018; Salloum et al., 2013b; van Ness et al., 2010).

Board Gender Diversity (BGenDiv)

Board gender diversity is associated with female representation in the board of directors. Prior studies have used different measures for board gender diversity. Some studies have used the percentage of female directors on the board, some have used the total number of female directors, and some have used dummy variables to measure board gender diversity. This study measured board gender diversity as the percentage of women on the board of directors (Adams & Ferreira, 2009; Marquez-Cardenas et al., 2021; C. G. Ntim, 2013; Simionescu et al., 2021; Taljaard et al., 2015). The percentage of women on the board of directors was calculated by dividing the number of female directors on the board by the total number of board directors. The measurement of board gender diversity using the proportion of female directors to the total number of board directors ensures that the measurement is not affected by the size of the board, as larger boards have a higher probability of female board directors due to a greater availability of board positions (Marquez-Cardenas et al., 2021).

Board Education (BEdu)

The educational qualifications held by board members is used as a proxy to measure the intelligence and skills of the board. Studies in the prior literature surveyed have measured board education with reference to the proportion of directors with advanced educational qualifications

(Amran et al., 2014; Darmadi, 2013; Ghardallou et al., 2020; Johl et al., 2015; Kanakriyah, 2021; Sewpersadh, 2019; Ujunwa, 2012; Yousaf et al., 2020). In line with these previous studies, this study measures board education as the percentage of directors who hold postgraduate degrees.

4.6.2 Dependent Variable: Financial Distress

The first dependent variable of this study measures the likelihood of financial distress in the sample SOEs. Prior studies have used various failure prediction models and financial ratios to measure financial distress. This study uses the Zmijewski financial distress score (ZFC) to measure the likelihood of financial distress. The ZFC model has also been used in other board governance studies to measure the level of financial distress (Bravo-Urquiza & Moreno-Ureba, 2021; Carcello & Neal, 2003; Hay et al., 2007; Iqman et al., 2018; Miglani et al., 2015; Richardson et al., 2015; Tykvoová & Borell, 2012). The ZFC is one of the most widely used financial distress prediction model (Miglani et al., 2015). It is also more prevalent in recent studies on corporate failure due to its higher capacity to predict financial distress (Bravo-Urquiza & Moreno-Ureba, 2021). The calculation of the ZFC is detailed below:

Zmijewski Financial Score (ZFC)

The ZFC model was developed by Mark Zmijewski in 1984 using a sample of 840 companies (Zmijewski, 1984). The ZFC measures likelihood of financial distress using financial ratios relating to liquidity, profitability, and leverage. The ZFC is calculated as follows:

$$ZFC = -4.336 - 4.513X1 + 5.679X2 - 0.004X3$$

Where:

$$X1 = (\text{Net Profit})/(\text{Total Assets})$$

$$X2 = (\text{Total Liabilities})/(\text{Total Assets})$$

$$X3 = (\text{Current Assets})/(\text{Current Liabilities})$$

X1 is a profitability ratio known as return on assets (ROA). ROA is calculated as the proportion of profit to total assets. ROA measures how efficiently assets are being used to generate profits.

X2 is a leverage ratio known as the debt ratio. The debt ratio shows the extent of debt financing used in a company. The measure shows the proportion of the company's total assets financed using debt. A high debt ratio indicates a higher degree of financial leverage and an increased risk of financial distress.

X3 is a liquidity ratio known as the current ratio. The current ratio assesses a company's ability to meet its short-term financial obligations by comparing the company's short-term assets with its short-term liabilities.

The outcome of the ZFC model is a financial distress probability. This means that a higher ZFC indicates a greater probability of financial distress (Miglani et al., 2015). Therefore, the ZFC can be interpreted as follows:

$ZFC > 0$; the company is financially distressed.

$ZFC < 0$; the company is not financially distressed.

4.6.3 Dependent Variable: Fruitless and Wasteful Expenditure (FW_{exp})

The second dependent variable of this study measures the level of fruitless and wasteful expenditure incurred in the sample SOEs. Fruitless and wasteful expenditure is defined in Section 1 of the Public Finance Management Act, Act No. 1 of 1999, (PFMA) as expenditure which was made in vain and would have been avoided had reasonable care been exercised. Furthermore, Section 55(2)(b)(i) & (ii) of the PFMA, requires that the annual report and annual financial statements of an SOE disclose the fruitless and wasteful expenditure incurred during the financial year. This study, therefore, used the fruitless and wasteful expenditure amount disclosed as incurred during the respective financial year in the notes to the financial statements of the sample SOEs. To ensure comparability amongst the different SOEs in the sample, the fruitless and wasteful expenditure incurred was calculated as a percentage of the total revenue of the SOE.

The second dependent variable of this study is therefore expressed as follows:

$$FW_{exp} = \frac{\text{Fruitless \& Wasteful Expenditure Incurred}}{\text{Revenue}}$$

4.6.4 Control Variables

This study draws on the prior literature to identify the control variables. The control variables are defined as the SOE-specific variables that have an effect on the dependent variables being financial distress and fruitless and wasteful expenditure. This study adopted SOE size and audit opinion as the control determinants of financial distress and fruitless and wasteful expenditure.

SOE Size (SOESize)

Efficiency, effectiveness, and economies of scale are a by-product of company size. Larger companies therefore have an advantage over smaller companies in this regard (Miglani et al., 2015). Consequently, it is submitted that SOE size is inversely related to financial distress and fruitless and wasteful expenditure. In line with previous literature, SOE size was measured as the natural logarithm of the total assets (Alqatan, 2019; Harvey Pamburai et al., 2015; luqman et al., 2018; Manzaneque et al., 2015; Ombaba & Kosgey, 2018; Sewpersadh, 2019, 2020; Shahwan, 2015). The use of log transformation is to control for the effects of skewedness.

Audit Opinion (AudOPN)

The literature argues that an unsatisfactory financial audit opinion is a negative signal regarding a company's financial status, risk, and management of resources (Miglani et al., 2015). Therefore, it is submitted that an unsatisfactory audit opinion is indicative of higher probability of the likelihood of financial distress and higher propensity to incur fruitless and wasteful expenditure. Audit opinion is measured using a dummy variable, where 1 is for an unsatisfactory audit opinion, otherwise 0. The use of audit opinion as a control variable for this study is consistent with prior studies (luqman et al., 2018; Miglani et al., 2015; Murhadi et al., 2018). For purposes of this study, an unsatisfactory audit opinion refers to a financially qualified, disclaimer, or an adverse audit opinion.

Table 4.3 provides a summary of the independent, dependent and control variables of this study and how they are operationalised.

Table 4.3 Operationalisation of the Study Variables

Variable	Abbreviation	Operationalisation	Predicted Relationship with Dependent Variables
<i>Independent Variables</i>			
Board Size	BSize	Number of board directors	Negative
Board Activity	BActivity	Number of board meetings held in a financial year	Negative
Board Tenure	BTenure	Average number of years the directors have been serving on the board	Negative
Board Gender Diversity	BGendiv	Percentage of female directors from the total number of board directors	Negative
Board Education	BEdu	Percentage of board directors with postgraduate degrees from the total number of board directors	Negative
<i>Control Variables</i>			
Company Size	SOESize	Natural logarithm of total assets	Negative
Audit Opinion	AudOPN	Dummy variable which takes the value of 1 if the audit opinion is unsatisfactory and 0, otherwise	Positive
<i>Dependent Variables</i>			
Financial Distress	ZFC	Zmijewski financial distress prediction model	
Fruitless and Wasteful Expenditure	FW _{exp}	Fruitless and wasteful expenditure as a percentage of total revenue	

Source: Author

4.7 DATA ANALYSIS

This study used descriptive and inferential statistics to analyse the data collected.

4.7.1 Descriptive Statistics

Descriptive statistics are used to describe, summarise, and organise the basic characteristics of the data collected (Kaur et al., 2018). Descriptive statistics include measures of central tendency (mean, mode, and median), measures of frequency (frequency and percent), and measures of dispersion/variation (range, variance, and standard deviation, quantiles) (Kaur et al., 2018; Mishra et al., 2019). Descriptive statistics serve a crucial purpose in formulating a knowledge base as it gives a broader perspective and understanding of the study phenomena (Mishra et al., 2019).

4.7.2 Empirical Model

The objective of this study is to investigate the relationship between board attributes and financial distress and the relationship between board attributes and fruitless and wasteful expenditure in South African SOEs. This study used regression analysis to address this objective. Pooled ordinary least-square (OLS) regression was used to test the relationship between the dependent and the independent variables of the study. Pooled OLS regression was selected as the statistical technique for this study due to its prediction and explanation ability (Hutcheson, 1999). This means that the pooled OLS regression model was used to provide empirical evidence on the existence of the relationship between the independent and the dependent variables of this study. Furthermore, it was also used to provide an explanation on the strength of the relationship between the study variables.

Pooled OLS regression requires a continuous dependent variable (Hutcheson, 1999). Consequently, in the prior literature surveyed, pooled OLS regression model is prevalent in studies that use a continuous dependent variable. Therefore, this regression model is appropriate for this study, as the two dependent variables of this study, being the ZFC and FW_{exp} are continuous variables.

The pooled OLS regression model is characterised by constant coefficients, ignoring specific effects of variables tested and assuming a zero mean (Hiestand, 2005). According to Al-Absy (2020) pooled OLS has the robust functionality to solve the problem of heteroscedasticity.

The use of pooled OLS regression as the statistical technique for empirical testing is also consistent with other similar prior empirical studies on board attributes (Al-Absy, 2020; Khan & Kong, 2022; Iqman et al., 2018; Sewpersadh, 2019, 2020).

This study also considered whether the fixed effects or random effects model is more appropriate. The fixed effects model assumes constant intercept coefficients and considers the heterogeneity of the variables. On the other hand, the random effects model assumes different intercepts for each variable in the model (Wooldridge, 2013). The Hausman test was used to test whether the fixed effects or random effects model is a more appropriate estimator model for this study. The null hypothesis in the Hausman test is that the random effects model is the appropriate estimator model, whilst the alternative hypothesis is that the fixed effects model is more appropriate. An insignificant p-value suggests that the null hypothesis be accepted and therefore the random effects model should be applied (Jingura, 2019; Wooldridge, 2013).

Based on the two research questions that give rise to this study, the study regression models can be expressed as follows:

$$ZFCit = \beta_0 + \beta_1 BSizeit + \beta_2 BActivityit + \beta_3 BTenureit + \beta_4 BGenDivit + \beta_5 BEducit + SOESizeit + AudOPNit + \mu it + \epsilon_{it}$$

$$FWexpit = \beta_0 + \beta_1 BSizeit + \beta_2 BActivityit + \beta_3 BTenureit + \beta_4 BGeDivit + \beta_5 BEducit + SOESizeit + AudOPNit + \mu it + \epsilon_{it}$$

4.8 VALIDITY AND RELIABILITY

According to Saunders et al., (2009) validity and reliability are crucial aspects of any research project that are needed ensure that the research is credible. Validity refers to obtaining data that is meaningful and appropriate for the intended use (Surucu & Maslakci, 2020). Reliability, on the other hand, encompasses the dependability, stability, and consistency of the research instruments (Saunders et al., 2009; Surucu & Maslakci, 2020). Therefore, a reliable study, can be replicated at a different time by a different researcher but still obtain the same findings (Surucu & Maslakci, 2020).

In Chapter 1 of this study, the research problem and objectives of this study were clearly defined. In Chapter 2 and 3, the literature was then reviewed to ensure that there is a sound theoretical

framework and prior empirical research underpinning this study. The selection and formulation of the study variables was consistent with the prior literature surveyed.

South African SOEs are the central focus of this study. Therefore, the study sample was obtained from the listing of SOEs in the Schedules of the PFMA. The secondary data was obtained from the annual reports and audited annual financial statements of the sample SOEs, which were downloaded from their respective websites. Therefore, the source of the data is verifiable to ensure its integrity. Furthermore, the study can be replicated as the information is publicly available.

Pooled OLS regression was then employed to analyse the data collected. This statistical technique was considered appropriate for this study and is also used in similar previous studies. The findings of this study were also compared to the findings of the prior empirical studies.

The validity and reliability of this study can, therefore, be confirmed.

4.9 ETHICAL CONSIDERATIONS

This study adopts a quantitative approach to answering the research questions. Secondary data was collected from the individual annual reports and audited annual financial statements of the sample SOEs. The data used in this study is therefore publicly accessible and no consent was required to obtain the data. Furthermore, the use of secondary data in a quantitative study reduces the risk of researcher bias. The data was collected and recorded objectively and accurately. Objectivity was also maintained in the treatment of the research findings and results.

Ethical clearance to conduct the study was also obtained from the Commerce Research Ethics Committee of the University of Cape Town (see Appendix C).

4.10 SUMMARY

This chapter endeavoured to provide a depiction of the research methodology and techniques adopted in this study. This study followed the confirmatory scientific method and hence the positivist paradigm and quantitative approach were adopted to answer the research questions. A non-probability sampling method was applied whereby all commercial SOEs listed in the schedules of the PFMA were selected. The study variables consisted of five board attributes, as the independent variables, whilst SOE size and audit opinion were identified as the control variables. Given the two research questions of this study, the ZFC and FWexp were identified as the dependent variables. The OLS regression model was adopted as the regression model to test the relationship between the study variables.

The next chapter of this study will then present the results of the empirical testing performed as described in this chapter.

CHAPTER FIVE RESEARCH FINDINGS AND DISCUSSION OF RESULTS

5.1 INTRODUCTION

The previous chapter of this study detailed the quantitative research methodology and techniques adopted to answer the study's research questions. The purpose of this chapter is to present the research findings and outcomes from the empirical testing performed to determine the relationship between board attributes and financial distress and the relationship between board attributes and fruitless and wasteful expenditure in South African SOEs. Furthermore, the research findings will be interpreted and analysed based on the theoretical underpinning and prior literature surveyed.

This chapter will first begin with a presentation of the descriptive statistics of the study variables. Then collinearity issues between the study variables are considered. Following this, the results of the diagnostic tests performed to determine the most appropriate model to test the relationship between the independent and dependent variables are presented and interpreted. Then the regression results from the preferred estimation model are presented and interpreted. Finally, before the chapter concludes with a chapter summary, the study results are discussed and analysed.

5.2 DESCRIPTIVE STATISTICS

Descriptive statistical analysis plays an important role in enhancing understanding of the study variables and identifying any variables that are outliers (Mishra et al., 2019).

Table 5.1 presents the descriptive statistics observed from the sample of 27 SOEs over the five-year study period, resulting in 135 total observations.

Table 5.1: Variables' Descriptive Statistics

Variable	Symbol	Mean	Std.dev	Min.	Max.	Median	Obs.
Independent Variables							
Board Size	BSize	9,815	2,528	1,000	16,000	10,000	135
Board Activity	BActivity	9,644	4,939	2,000	28,000	9,000	135
Board Tenure	BTenure	2,755	1,754	0,000	8,508	2,326	135
Board Gender Diversity	BGenDiv	0,376	0,116	0,000	0,615	0,400	135
Board Education	BEdu	0,831	0,157	0,364	1,000	0,867	135
Dependent Variables							
Zmijewski Financial Distress Score	ZFC	-1,455	2,316	-4,276	7,611	-2,056	135
Fruitless and Wasteful Expenditure	FWexp	0,005	0,020	0,000	0,176	0,000	135
Control Variables							
SOE Size	SOESize	16,477	3,604	7,889	21,976	15,679	135
Audit Opinion	AudOPN	0,289	0,455	0,000	1,000	0,000	135

Source: Author

As per Table 5.1 the average board size of the study, SOEs was 9,82 board members. This average falls within the acceptable range of seven to ten board members as proposed by Yeung (2018). The average board size of this study is marginally lower than the average board size of 10,05 and 10.28 observed in studies of JSE listed companies by Sewpersadh (2022) and Tshipa (2015), respectively. The smallest board observed in this study had only one board member, whilst the largest board had sixteen board members.

The average number of board meetings held by SOEs is 9,64, with the lowest and highest number of meetings observed being 2 and 28, respectively. A prior study by Pamburai et al. (2015) noted that the boards of JSE listed companies had on average 5,33 meetings. A later study on JSE listed companies by Tshipa et al. (2018) found that the average number of board meetings is 5,06. This suggests that South African SOE boards meet more regularly relative to their private sector counterparts.

In terms of board tenure, the average tenure of board directors in the study SOEs is 2,75 years. The longest length of time served by a board director is 8,51 years.

The average proportion of female directors on the board of the study SOEs is 37,56%. There were some boards with no female representation. The highest percentage of female directors observed from the sample data was 61,54%.

In terms of board education, on average, 83,06% of board members held postgraduate qualifications, with the lowest and highest proportion of directors with postgraduate qualifications being 36,36% and 100%, respectively. The average observed in this study is higher than the average of 72,57% observed by Sewpersadh (2022) in JSE listed companies.

With respect to financial distress, the Zimjewski Financial Distress Score (ZFC) varied from -4,28 to 7,61. The sample had an average ZFC of -1,45. 23% of the study SOEs were classified as financially distressed, whilst 77% were classified as healthy. As discussed in the previous chapter, the ZFC incorporates three financial ratios to measure financial distress; namely return on asset (ROA) ratio, debt ratio, and the current ratio. Table 5.2 summarises the descriptive statistics of the three ratios that constitute the ZFC.

Table 5.2: Descriptive Statistics of the ZFC Financial Ratios

	Mean	Std.dev	Min.	Max.	Median	Obs.
ROA	0,003	0,085	-0,314	0,204	0,009	135
Debt ratio	0,503	0,372	0,074	2,022	0,385	135
Current ratio	2,345	2,093	0,130	10,984	1,677	135

Source: Author

As per table 5.2 above, the average ROA from the study SOEs was below 0% with a range from -31,41% to 20,42%. In contrast, Sewpersadh (2019) found that the ROA was on average 13.3% in JSE listed companies. The average debt ratio was 50,40% in this study. Similarly, Sewpersadh (2019) found that the leverage in the JSE listed companies were on average 51.27%. The average current ratio in this study was 2,35.

As it relates to the second dependent variable of this study, fruitless and wasteful expenditure, on average the fruitless and wasteful expenditure incurred by the study SOEs amounted to 0,5% of their revenue, with the highest fruitless and wasteful expenditure as a percentage of revenue being 17,61%.

5.3 CORRELATION ANALYSIS

Multi-collinearity issues exist when the independent variables are highly correlated with each other. The existence of collinearity between independent variables reduces the reliability of the estimation model. This study utilised the Pearson's correlation test to identify any multi-collinearity issues. According to Gujarati and Porter (2009) multi-collinearity problems exist when the correlation coefficient between two independent variables exceeds 0,80. Table 5.3 below shows the strength of the relationship between all the study variables as measured by Pearson's correlation test.

The correlation matrix presented in Table 5.3 does not evidence any high correlation between the independent variables. The correlation coefficients are relatively low, since they range from - 0,3933 to 0,3085. None of the correlation coefficients exceed 0,80 and therefore no collinearity concerns are noted.

As per Table 5.3, board size has a positive significant correlation with board activity and board gender diversity. This means that as boards become larger, more board meetings are held and female representation on the board increases. Board gender diversity is also positively and significantly associated with board education, implying that with increases in female representation on the board there will be an increase in the proportion of directors with postgraduate qualifications.

Board tenure, however, has an inverse and statistically significant relationship with board activity. This suggests that as average board tenure increases, less board meetings are held.

There is a 10% significantly positive relationship between board education and ZFC. This implies that as board education increases the risk of financial distress increases.

SOE size has a negative and significant relationship with board gender diversity and ZFC. This firstly, suggests that as SOEs become larger, female representation on the board decreases. Secondly, this indicates that as SOE size increases, the risk of financial distress decreases.

Audit opinion has a negative significant relationship with board tenure. However, audit opinion is positively associated with FWexp.

Table 5.3: Correlation Matrix of All Variables

	BSize	BActivity	BTenure	BGenDiv	BEdu	ZFC	FWExp	SOESize	AudOPN
BSize	1								
BActivity	0.3085*** 0.0003	1							
BTenure	-0.0542 0.5322	-0.3131*** 0.0002	1						
BGenDiv	0.3129*** 0.0002	0.0848 0.328	0.1964 0.0224	1					
BEdu	0.0652 0.4523	-0.0767 0.3763	0.1057 0.2226	0.2506* 0.0034	1				
ZFC	-0.132 0.1269	-0.0027 0.9748	-0.0665 0.4432	-0.018 0.8357	0.2253* 0.0086	1			
FWExp	-0.1559 0.071	-0.0715 0.41	-0.0942 0.2773	-0.0301 0.7288	-0.1891 0.028	0.1252 0.148	1		
SOESize	-0.1277 0.1401	-0.1452 0.0928	-0.0274 0.7524	-0.2283* 0.0077	-0.2048 0.0172	-0.3933*** 0	0.1535 0.0756	1	
AudOPN	0.0858 0.3225	0.2022 0.0187	-0.3823*** 0	-0.1031 0.2342	0.044 0.6122	0.18 0.0367	0.2243* 0.0089	-0.0244 0.7792	1

***, **, * denote significance at 1%, 5% and 10% respectively

Source: Author

5.4 SELECTION OF APPROPRIATE ESTIMATION MODEL FOR THE STUDY

Pooled OLS regression was adopted in this study to estimate the relationship between the independent and dependent variables. Furthermore, consideration was made on whether the fixed effect or random effects model is preferred.

The fixed effects model assumes homogeneity amongst the sample SOEs and therefore allows each variable to have its own intercept value. On the other hand, the random effects model assumes heterogeneity amongst the sample SOEs and therefore permits the true effect sizes to differ (Borenstein et al., 2010).

The Hausman test was performed to identify the most appropriate model for this study between the fixed effects model and the random effects model.

Table 5.4 below shows the results of the Hausman test.

Table 5.4: Hausman Test

	Model 1: ZFC	Model 2: FWexp
Chi.sq	2,8501	9,6886
df	10	10
P-value	0,9847	0,4682

Source: Author

The chi-squared p-value for both models is greater than 5% and therefore considered insignificant. This suggests that for both models the random effects model is preferred, as the null hypothesis was not rejected.

5.5 REGRESSION ANALYSIS

5.5.1 Financial Distress (ZFC Model)

Table 5.5 presents the results of the tested relationship between the board attributes, which constitute the independent variables of this study and the ZFC as the dependent variable. The table shows the results of both the pooled OLS and random effects regression model.

Table 5.5: Pooled OLS and Random Effects Model on ZFC

Variables	Pooled OLS	Random Effects
BSize	-0.165**	-0.0513*
	-0,0733	-0,0309
BActivity	-0,0189	0,0151
	-0,031	-0,0237
BTenure	-0,0579	-0,0354
	-0,0937	-0,0622
BGenDiv	-1,487	-1.340**
	-1,667	-0,625
BEdu	2.425**	1.776**
	-1,189	-0,736
SOESize	-0.253***	-0,14
	-0,0506	-0,121
AudOPN	0.926***	0.585*
	-0,339	-0,306
Constant	2,043	-1,204
	-1,679	-2,201
Observations	135	135
R-squared	0,26	0,24

Note: Robust standard errors in parentheses

***, **, * denote significance at the 1%, 5%, and 10% level of confidence, respectively.

Source: Author

Table 5.5 shows that the coefficient of multiple determination (R-squared) for the pooled OLS and random effects regression models are 26% and 24%, respectively. The R-squared indicates the degree of variation in the ZFC that can be explained by variations in board attributes. The relatively low R-squared values suggest a weak relationship between the independent and dependent variables of this study.

In terms of the pooled OLS regression model, board size, board activity, board tenure, and board gender diversity all have a negative relationship with financial distress as measured by the ZFC. However, only the relationship between board size and the ZFC is statistically significant at the 5% confidence level.

Board education, on the other hand, has a positive and statistically significant relationship with the ZFC. This means that as board education increases the likelihood of financial distress increases.

Both control variables, being SOE size and audit opinion, have a statistically significant relationship with the ZFC. However, the direction of the relationships differs. SOE size has an inverse relationship with the ZFC, whilst audit opinion has a positive relationship with the ZFC.

In terms of the random effects regression model, board size and board gender diversity both have a negative and statistically significant relationship with the ZFC. This means that as the total number of directors and as the proportion of female directors serving on the board increase, the likelihood of financial distress as measured by the ZFC decreases. Conversely, board education and audit opinion, have a positive and statistically significant relationship with the ZFC. However, board activity, board tenure and SOE size have probability figures that are above 10% which means that they are all insignificant in explaining variations in the ZFC under the random effects regression model.

5.5.2 Fruitless and Wasteful Expenditure (FWexp Model)

Table 5.6 presents the results of the tested relationship between the board attributes, which constitute the independent variables of this study and FWexp as the dependent variable. The table shows the results of both the pooled OLS and random effects regression model.

Table 5.6: Pooled OLS and Random Effects Model on FWexp

Variables	Pooled OLS	Random Effects
BSize	-0.00137*	-0,00086
	-0,000816	-0,000746
BActivity	-0,000482	-0,000347
	-0,000413	-0,000375
BTenure	-0,000513	-0,000832
	-0,000641	-0,000685
BGenDiv	0,0214	0,00976
	-0,0167	-0,0111
BEdu	-0.0276*	-0,0155
	-0,0155	-0,0161
SOESize	0,000731	0,000777
	-0,000495	-0,000752
AudOPN	0.0144**	0,0134
	-0,00717	-0,0109
Constant	0,00166	-0,00354
	-0,00763	-0,00901
Observations	135	135
R-squared	0,212	0,18

Note: Robust standard errors in parentheses

***, **, * denote significance at the 1%, 5%, and 10% level of confidence, respectively.

Source: Author

Similarly, to the ZFC model, the R-squared of the FWexp model is relatively low, under both the pooled OLS ($R^2 = 21\%$) and random effects ($R^2 = 18\%$) regression models.

In terms of the pooled OLS regression model, board size has a negative and statistically significant relationship with FWexp. This means that as the number of directors serving on the board increases the incurrence of FWexp decreases. Board education also has a negative and statistically significant relation with FWexp.

Audit opinion has a positive and statistically significant relationship with FWexp. This indicates that SOEs with unsatisfactory audit opinions are more likely to incur FWexp.

Board activity, board tenure, board gender diversity and SOE size all have a statistically insignificant relationship with FWexp.

From a random effects regression model perspective, all the independent variables, except for board gender diversity, have a negative but statistically insignificant relationship with FWexp. Whilst the relationship between board gender diversity and FWexp is also statistically insignificant, the direction of the relationship, is however positive. Both control variables have a positive but statistically insignificant relationship with FWexp.

5.6 DISCUSSION OF RESULTS: BOARD ATTRIBUTES AND FINANCIAL DISTRESS

This section of the study discusses the results of the empirical testing of the relationship between board attributes and financial distress. This discussion is based on the empirical results from the preferred estimation model which were presented in section 5.5.1.

5.6.1 Board Size

The results of the empirical testing show that there is an inverse and statistically significant relationship between board size and financial distress as proxied by the ZFC. This suggests that as the number of directors serving on the board increases the likelihood of financial distress decreases. The finding of this study concurs with the prior findings by Bravo-Urquiza & Moreno-

Ureba (2021), Chen et al. (2020), Darrat et al. (2016), Manzanque et al. (2016), Mariano et al. (2020) and Ud-Din et al. (2020).

This finding endorses the agency theory and resource dependence view on board size. Firstly, from an agency theory perspective, the finding supports the notion that a high number of board members increases the capacity and effectiveness of the board's monitoring and control of management (Mariano et al., 2020). Secondly, from a resource dependence perspective, the finding indicates that larger boards are better able to secure necessary resources, have additional access to information, lead to more shared knowledge and support a diversity of interests and viewpoints which strengthens the financial performance of the SOEs and thereby reducing the likelihood of financial distress (Manzanque et al., 2016; Mariano et al., 2020).

The argument put forward by stewardship theorist is not supported by the empirical findings of this study. Stewardship theorists posit that smaller boards are more cohesive and are better able to discharge their responsibilities. The findings of this study are therefore contrary to the findings of previous studies that supported the stewardship theory position on board size (Munene et al., 2020; Salloum et al., 2013).

5.6.2 Board Activity

The study results show a positive but statistically insignificant relationship between board activity and financial distress. The positive direction of the relationship may indicate that the boards of SOEs are reactive rather than proactive and hence meet more regularly during periods of financial distress. However, as the results are statistically insignificant no conclusive evidence can be drawn on the relationship between board activity and financial distress. The finding of this study concurs with the prior empirical findings by Brédart (2014) and Ningrum et al. (2017).

This means that this study does not find empirical evidence to support the agency theory proposition on board meetings. According to agency theorists board meetings are an important tool through which board directors fulfil their supervisory and control role over management. The finding of this study, therefore, differs to the finding by Bravo-Urquiza and Moreno-Ureba (2021) who found empirical evidence in support of the agency theory position. They concluded that the heightened monitoring by the board through an increase in the frequency of board meetings, improves financial performance and reduces financial distress.

The literature presents some possible explanations for lack of conclusive evidence on the relationship between board activity and financial distress. Prior studies have criticised the effectiveness of board meetings. Board meetings are criticised for the following reasons: a lack of focus on strategic issues; poor probing of managers by independent directors; incurrence of costly travel and administrative expenses and exorbitant meeting fees; and reactive rather than proactive discussions (Johl et al., 2015; Mohd Ali & Mohd Nasir, 2018; Puni & Anlesinya, 2020).

5.6.3 Board Tenure

Board tenure has a negative relationship with financial distress. However, the relationship is statistically insignificant and thus there is no evidence to suggest that board tenure has an impact on the likelihood of financial distress. Salloum et al. (2013) also found a statistically insignificant relationship between board tenure and financial distress. They submit that this means that it is equally probable (or improbable) that a short tenured director may not have sufficient firm-specific knowledge and in some cases a long tenured director may be sufficiently probing of management due to familiarity.

The results of this study are not consistent with prior studies that found empirical evidence in favour of the agency theory and the resource dependence theory position on board tenure. Those studies found that long board tenure strengthens the board's ability to effectively monitor managers and improves board capital which results in improved financial sustainability (Al-Absy, 2020; de Maere et al., 2014; Lajili & Zéghal, 2010).

5.6.4 Board Gender Diversity

The King IV Report on Corporate Governance emphasises the importance of board gender diversity. Moreover, resource dependence theorists argue in favour of board gender diversity by submitting that board gender diversity enhances decision making, improves problem solving and helps the company secure additional external resources (Alqatan, 2019; Gordini & Rancati, 2017). Agency theorists also present a viewpoint in favour of board gender diversity. They argue that diversity strengthens independence and minimises the risk of collusion amongst board members (Gordini & Rancati, 2017).

The empirical results of this study show that board gender diversity has a negative and statistically significant relationship with financial distress. This study, therefore, finds empirical evidence to support both the agency and resource dependence position on board gender diversity. Furthermore, this finding also aligns with other previous studies who also found that an increase in female representation reduces the likelihood of financial distress (Darrat et al., 2016; Foster, 2020; Guizani & Abdalkrim, 2022; Kristanti et al., 2015; Mittal & Lavina, 2018; Munene et al., 2020; Ningrum et al., 2017; Yousaf et al., 2020).

5.6.5 Board Education

Contrary, to the resource dependency view on board education, this study finds that board education has a positive and statistically significant relationship with financial distress as measured by the ZFC. These results differ from prior studies by Kristanti et al. (2015), Sewpersadh (2022), and Yousaf et al. (2020) who found that an improvement in board education reduces the probability of financial distress. Their findings support the notion that board education enhances board capital and strengthens the board's ability to co-opt resources for the company.

The results of this study suggest that SOEs with a higher proportion of board members that hold post-graduate qualifications are more likely to experience financial distress. Similarly, Kanakriyah (2021) found a statistically significant positive relationship between board education and financial distress. They attributed this relationship to the issue of family appointments and nepotism resulting in the appointment of board members who hold high academic qualifications but lack business skills and experience. In the context of SOEs this may extend to the issue of political appointments.

5.7 DISCUSSION OF RESULTS: BOARD ATTRIBUTES AND FRUITLESS AND WASTEFUL EXPENDITURE

This section of the study discusses the results of the empirical testing of the relationship between board attributes and fruitless and wasteful expenditure. This discussion is based on the empirical results from the preferred estimation model which were presented in section 5.5.2.

5.7.1 Board Size

According to the PFMA the board of an SOE is responsible for taking effective and appropriate steps to prevent fruitless and wasteful expenditure. Moreover, agency theorists argue that a larger board is more vigilant and has greater capacity to effectively monitor and control the actions of managers (Kalsie & Shrivastav, 2016; Pucheta-Martínez & Gallego-Álvarez, 2020).

Resource dependence theorists also favour larger boards based on the premise that larger boards result in an increase in board capital and board quality which leads to an improvement in the quality of advice given to management and decisions made (Arora & Sharma, 2016; Wang et al., 2020).

Contrary, to the above theoretical positions, this study finds inconclusive evidence on the relationship between board size and fruitless and wasteful expenditure. Whilst a negative relationship was observed, the results were statistically insignificant and therefore the hypothesis is not supported.

5.7.2 Board Activity

The results of the empirical testing show that the direction of the relationship between board activity and fruitless and wasteful expenditure is inverse. However, the results are not statistically significant which suggests that there is no relationship between board activity and fruitless and wasteful expenditure in the true population.

This study, therefore, does not provide empirical evidence in support of the agency and resource dependence propositions as it relates to board meetings and fruitless and wasteful expenditure. The theory suggested that an increase in board meetings will reduce the incurrence of fruitless and wasteful expenditure as board meetings are assumed to be an important and effective tool for monitoring managers and providing insightful and strategic advice.

5.7.3 Board Tenure

Board tenure has a negative but statistically insignificant relationship with fruitless and wasteful expenditure. Thus, this study does not provide empirical evidence to suggest that the average

number of years the directors have been serving on the board of an SOE has an impact on the level of fruitless and wasteful expenditure incurred.

5.7.4 Board Gender Diversity

Whilst agency theorists argue that board gender diversity strengthens board independence which improves the board's monitoring and control of managers. This study finds no conclusive empirical evidence that board gender diversity reduces the incurrence of fruitless and wasteful expenditure.

The results also do not support the notion stemming from the resource dependence theory, that board gender diversity leads to a reduction in wastage and mismanagement of resources as it strengthens board quality and board capital.

The study results showed a positive but statistically insignificant relationship between board gender diversity and fruitless and wasteful expenditure. Therefore, the hypothesis is not supported as no relationship was established.

5.7.5 Board Education

The results of this study show no evidence of a relationship between board education, as proxied by the proportion of board members holding post-graduate qualifications, and the incurrence of fruitless and wasteful expenditure. The study hypothesis is not supported, as a negative but statistically insignificant relationship was observed.

5.8 SUMMARY

The purpose of this chapter was to present and discuss the results of the empirical testing performed to address the research objectives of this study. The primary research objectives of this study were to examine, the relationship between board attributes and financial distress, and the relationship between board attributes and fruitless and wasteful expenditure. In this chapter, the research results were presented and interpreted. Firstly, the results showed that only board size, board gender diversity and board education have a significant relationship with financial distress. Board size and board gender diversity have an inverse relationship with financial distress. On the other hand, board education has a positive relationship with financial distress.

Secondly, the results showed that all the study board attributes have no relationship with fruitless and wasteful expenditure. Table 5.7 presents a summary of the empirical findings of this study. The next chapter of this study will provide a conclusion to this study based on the empirical findings discussed in this chapter and in light of the study's research objectives.

Table 5.7: Summary of Study Empirical Findings

Independent Variable	Hypothesis	Expected Sign	Financial Distress Actual Sign	Fruitless and Wasteful Expenditure Actual Sign
Board Size	H1a: There is a negative significant relationship between board size and the likelihood of financial distress in South African SOEs. H1b: There is a negative significant relationship between board size and the incurrence of fruitless and wasteful expenditure in South African SOEs.	(-)	(-) Significant Supported	(-) Insignificant Not supported
Board Activity	H2a: There is a negative significant relationship between board activity and the likelihood of financial distress in South African SOEs. H2b: There is a negative significant relationship between board activity and the incurrence of fruitless and wasteful expenditure in South African SOEs.	(-)	(+) Insignificant Not supported	(-) Insignificant Not supported
Board Tenure	H3a: There is a negative significant relationship between board tenure and the likelihood of financial distress in South African SOEs. H3b: There is a negative significant relationship between board tenure and the incurrence of fruitless and wasteful expenditure in South African SOEs.	(-)	(-) Insignificant Not supported	(-) Insignificant Not supported
Board Gender Diversity	H4a: There is a negative significant relationship between board gender diversity and the likelihood of financial distress in South African SOEs. H4b: There is a negative significant relationship between board gender diversity and the incurrence of fruitless and wasteful expenditure in South African SOEs.	(-)	(-) Significant Supported	(+) Insignificant Not supported
Board Education	H5a: There is a negative significant relationship between board education and the likelihood of financial distress in South African SOEs. H5b: There is a negative significant relationship between board education and the incurrence of fruitless and wasteful expenditure in South African SOEs.	(-)	(+) Significant Not supported	(-) Insignificant Not supported

CHAPTER SIX CONCLUSION

6.1 INTRODUCTION

The purpose of this chapter is to provide a conclusion to this study based on the discussions in the previous chapters. This concluding chapter of this study begins with a summary and overview of the entire study. Then the implications of the research findings are presented. Finally, this concluding chapter ends with the study limitations and recommendations for further research.

6.2 STUDY SUMMARY AND OVERVIEW

South African SOEs have been criticised for their poor financial performance, deteriorating financial viability and failure to deliver on their strategic and developmental mandates. There is a heightened interest in board governance matters in SOEs due to the public outcry and media scrutiny over the state of SOEs. Board governance issues have been placed at the root cause of the challenges faced by SOEs. It was against this backdrop, that this study sought to investigate the relationship between board attributes and financial distress and the relationship between board attributes and fruitless and wasteful expenditure in South African SOEs.

Chapter one of this study contextualised the research problem and provided a background to the study. The chapter highlighted the importance of SOEs in the South African economy and the need for reform to address the challenges that plague these entities. Following, the background to the study, the research questions and objectives were set out. Finally, chapter one as the introductory chapter of the study, depicted how the entire study is organised.

Chapter two of the study aimed to provide an overview of SOEs in South Africa. The chapter began with an exploration of the term SOE. Then the history and development of SOEs in South Africa was discussed. Following which, the socioeconomic role of SOEs and the legal framework that governs them were discussed. Then finally, the financial management, financial sustainability and governance issues facing SOEs were highlighted.

Chapter three played an important role in linking the board governance attributes with financial distress and fruitless and wasteful expenditure, from a theoretical and prior literature perspective.

Firstly, the chapter surveyed the literature to explore the definition of the term corporate governance. Then as a theoretical underpinning for the hypothesised relationship between board attributes and financial distress and fruitless and wasteful expenditure, the main corporate governance theories were discoursed. Then the global and local history and development of corporate governance was highlighted. Following which the corporate governance legislative and regulatory landscape and the important role of the board of directors were discussed. The chapter then presented a survey of prior studies on board attributes and financial distress and fruitless and wasteful expenditure. Notably, the prior studies showed mixed results in terms of the relationship between board attributes and financial distress. However, we did not identify any prior study on board attributes and fruitless and wasteful expenditure. Finally, the gaps identified in the survey of prior studies were presented.

Chapter four established the quantitative research methodology and design adopted to address the research objectives of this study. Five board attributes were selected as the independent variables of the study, based on a sample of 27 national and provincial SOEs over a five-year period from 2016 to 2020. The first dependent variable of this study being financial distress was proxied by the Zmijewski financial distress score. The second dependent variable of this study being fruitless and wasteful expenditure incurred was operationalised by measuring the fruitless and wasteful expenditure incurred in the financial year as a percentage of the total revenue of the respective SOE. Then the control variables of the study, being SOE size and audit opinion were introduced. Ordinary least square regression was adopted as the research technique for this study and the random effects model was selected as the preferred regression model for this study.

The previous chapter of this study, chapter 5, presented the study empirical findings. No outliers and collinearity issues were identified in the descriptive statistics. The results of the regression analysis showed that board size and board gender diversity have an inverse and statistically significant relationship with financial distress. Board education, however, has a positive and significant relationship with financial distress. None of the study board attributes had a significant relationship with fruitless and wasteful expenditure.

6.3 IMPLICATIONS OF THE STUDY RESULTS

The aim of this study was to establish the relationship between board attributes and financial distress and the relationship between board attributes and fruitless and wasteful expenditure in South African SOEs.

In terms of the relationship between board attributes and financial distress, this study found that three of the five study board attributes have a significant relationship with financial distress. Firstly, the study found that increasing the total number of board members and increasing the proportion of female board members reduces the likelihood of financial distress. This means that financially stable SOEs tend to have larger boards and greater gender diversity. Hence, the implication for policymakers and shareholding ministries is that sufficiently larger boards with sufficient female representation should be appointed in South African SOEs. This finding supports the theoretical motion that large and diverse boards are better able to exercise their oversight and control responsibility over the financial performance and viability of the SOEs as they are more independent, less susceptible to external interference and are more robust in decision making through the inclusion of different viewpoints.

Secondly, the study however, found that there is a direct and positive relationship between board education and financial distress. Kanakriyah (2021) attributed a similar finding in their study to the issue of nepotism in the appointment of board members. In the context of SOEs, this may extend to the issue of political interference in board appointments where education is used as a “tick box exercise” to appoint political affiliates without considering the relevance of their qualification, business skills, experience, and industry knowledge.

As it relates to the relationship between board attributes and fruitless and wasteful expenditure, this study did not find any empirical evidence to support the hypothesised relationship. None of the study board attributes have a significant relationship with fruitless and wasteful expenditure. This suggests that the board attributes are not a strong estimator and do not have explanatory power over the incurrence of fruitless and wasteful expenditure in South African SOEs.

This finding implies that further research is needed to investigate the root causes and factors that inhibit SOE boards to effectively prevent fruitless and wasteful expenditure as required by the PFMA. The results also suggest that policymakers should place their attention on other

explanatory variables and factors that may better predict the incurrence of fruitless and wasteful expenditure in SOEs. These variables may include the quality of management and executives, supply chain management policies and processes, business practices and corporate culture.

6.4 LIMITATIONS OF THE STUDY

- This study was limited to only commercial SOEs in South Africa and therefore, the findings may not necessarily be generalised to all SOEs without additional research.
- The study sample consists of only 27 SOEs. This is a relatively small sample size as some commercial SOEs without the required data had to be excluded.
- Only five board attributes were selected for this study. There may be other board attributes and considerations that may affect financial distress and fruitless and wasteful expenditure.
- This study used the Zmijewski financial distress score as a proxy for financial distress. There are other financial distress prediction models that may be a better predictor of financial distress in SOEs.

6.5 RECOMMENDATIONS FOR FURTHER RESEARCH

This study has laid the foundation for further research on board attributes and financial distress and fruitless and wasteful expenditure in SOEs. Future research in this area could be enhanced by:

- Using qualitative methods or a mix of quantitative and qualitative methods could provide more comprehensive results.
- Using other financial distress measures such as the Altman Z score could provide more robust results.
- Including non-commercial SOEs can provide a different perspective.
- Expanding the study to include non-financial and service delivery-based performance measures as dependent variables.
- Expanded the study by analysing the relationship between the study board attributes and other non-compliance expenditure such as irregular expenditure.

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APPENDIX A: SUMMARY OF MEDIA ARTICLES

No.	Title	Summary	Source and Date
1	State-owned enterprises continue to drain the fiscus – and Scopa worries about lack of consequences	Media coverage of the Minister of Public Enterprises meeting with the Standing Committee on Public Accounts (SCOPA) to update them on the financial health status and audit outcomes of some of the major public entities. Concerns over the poor audit outcomes, dire financial status, and lack of consequence thereof of were expressed by SCOPA members.	Business Maverick (3 February 2021)
2	IMF once again raises the red flag on South Africa's public wage bill and state-owned enterprises	Media coverage of update meeting between National Treasury and the International Monetary Fund (IMF) on the fiscal support provided to South Africa. The IMF stressed that South Africa needs to contain the growing fiscal deficit and debt by avoiding transfers and subsidies to inefficient SOEs.	Business Maverick (27 January 2021)
3	Treasury in political spot over SOE spending - PwC	Economists have predicted that political pressures will prevent National Treasury from reducing expenditure allocated to assist struggling SOEs when the Minister of Finance tables his 2021 Budget Review.	IOL (18 February 2021)
4	Banks, investor push to solve Eskom's R464 million debt crises	Banks and investors met with Eskom to discuss the restructuring of Eskom's debt which it is struggling to service.	News24 (20 February 2021)
5	Lack of SOE governance is a drain on South Africa's economy, warns OECD	The OECD in its latest economic survey of South Africa noted that SOEs had become synonymous with the corrupt activities of state capture. The OECD further warned that the underperforming SOEs have a detrimental effect on the cost of doing business in South Africa. There is also a need to improve transparency and accountability in SOEs. The major governance concerns relate to the appointment of board members, the need for a clear distinction between the roles and powers of the board and the executive management, and for the state to be an informed and active owner.	The Africa Report (10 August 2020)
6	Audit outcomes of some SOEs paint a bleak picture.	The AGSA has reported a regress in the audit outcome of SOEs. Furthermore, there has also been an increase in irregular expenditure	SABC News (3 February 2021)
7	Greater oversight required to fix the Land Bank	The AG has called for greater oversight over the Land Bank following the bank receiving a disclaimer audit opinion due to the bank not submitting a management assessment of the going concern of the entity.	Moneyweb (11 February 2021)
8	South Africa's state-owned company losses piling up.	The Department of Public Enterprises reported that the seven public enterprises under its portfolio had reported net losses for the 2019/20 financial year. Furthermore, SAA and SA Express were placed under business rescue.	BusinessTech (20 August 2020)
9	SOEs to get R129 Billion in bailouts over 3 years.	Financially distressed SOEs will be allocated R129 billion in bailouts over 3 years. This includes SOEs such as ACSA, Denel, Eskom, SANRAL, and Transnet. 62% of SOE debt is government guaranteed.	Eyewitness News (26 February 2020)

APPENDIX B: STUDY SAMPLE

No.	Name of SOE	PFMA Schedule
1	Air Traffic and Navigation Services Company	Schedule 2
2	Airports Company	Schedule 2
3	Alexkor Limited	Schedule 2
4	Armaments Corporation of South Africa	Schedule 2
5	Broadband Infrastructure Company (Pty) Ltd	Schedule 2
6	DENEL	Schedule 2
7	ESKOM	Schedule 2
8	SA Broadcasting Corporation Limited	Schedule 2
9	SA Forestry Company Limited	Schedule 2
10	SA Nuclear Energy Corporation	Schedule 2
11	Trans-Caledon Tunnel Authority	Schedule 2
12	Transnet Limited	Schedule 2
13	Bloem Water	Schedule 3B
14	Council for Scientific and Industrial Research	Schedule 3B
15	Mintek	Schedule 3B
16	Public Investment Corporation Limited	Schedule 3B
17	Rand Water	Schedule 3B
18	SA Bureau of Standards	Schedule 3B
19	Sentech	Schedule 3B
20	Umgeni Water	Schedule 3B
21	East London Industrial Development Zone	Schedule 3D
22	Mayibuye Transport Corporation	Schedule 3D
23	Free State Development Corporation	Schedule 3D
24	Ithala Development Finance Corporation	Schedule 3D
25	Richards Bay Industrial Development Zone Company	Schedule 3D
26	Limpopo Economic Development Agency	Schedule 3D
27	Mpumalanga Economic Growth Agency	Schedule 3D

APPENDIX C: ETHICAL CLEARANCE



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26 10 2021

Philani Thusini
College of Accounting
University of Cape Town
REF: REC 2021/10/009

THE IMPACT OF BOARD ATTRIBUTES ON FINANCIAL DISTRESS, AND FRUITLESS AND WASTEFUL EXPENDITURE IN SOUTH AFRICAN STATE-OWNED ENTERPRISES

We are pleased to inform you that your ethics application has been approved. Unless otherwise specified this ethical clearance is valid until 31-Dec-2022 .

Your clearance may be renewed upon application.

Please be aware that you need to notify the Ethics Committee immediately should any aspect of your study regarding the engagement with participants as approved in this application, change. This may include aspects such as changes to the research design, questionnaires, or choice of participants.

The ongoing ethical conduct throughout the duration of the study remains the responsibility of the principal investigator.

We wish you well for your research.

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13:18:24 +02'00'

Jacques Rousseau
Commerce Research Ethics Chair
University of Cape Town
Commerce Faculty Office
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