King Code's CSI Compliance and ESG Performance: Evidence from the JSE in South Africa

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Declaration

I, Amanda Sosola, at this moment, declare that the work on which this dissertation is my original work (except for acknowledgements as indicated) and that neither the whole work, nor any part of it, has been, is being, or is to be submitted for another degree in this or any other university. I authorise the university to reproduce for research either the whole or any portion of the contents in any manner whatsoever.

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Abstract

This research investigates the relationship between corporate social investment (CSI) compliance under the King Code IV and Environmental, Social and Governance (ESG) performance among companies listed on the Johannesburg Stock Exchange (JSE) in South Africa. As an emerging economy with a history of socio-economic disparities, South Africa's business landscape has been transformed through governance codes such as the King Code. This study employs a comprehensive data set comprising CSI values and ESG performance scores to analyse the extent to which companies aligning with King Code guidelines demonstrate enhanced ESG outcomes. The MSCI ESG Leaders Index South Africa constituents between 2016 and 2021 are used for this analysis.

The descriptive statistics highlight substantial differences between financial and non-financial companies in terms of their ESG score (ESGSCORE), average corporate Social Investment (CSI), return on assets (ROA), and firm size (FSIZE). Financial firms exhibit lower ESGSCORE variability, higher average CSI and ROA, and slightly lower FSIZE variability, indicating potential variations in ESG performance, corporate sustainability practices, and financial performance. Correlation analysis shows connections between ESGSCORE and CSI, ROA, and FSIZE. The regression findings show an inverse relationship between ESG and CSI and a negative and significant impact of profitability on ESG performance among non-financial firms, with no significant effect observed for financial firms. Additionally, FSIZE has a positive and statistically significant impact on ESGSCORE for financial and non-financial firms.

This study's findings hold implications for corporate governance and sustainability practices in South Africa, shedding light on the effectiveness of the King Code IV in fostering socially responsible business behaviour. By examining the correlation between CSI compliance and ESG performance, the research contributes valuable insights to stakeholders, policymakers, and investors who seek to understand the interplay between governance frameworks and sustainable business practices in the South African context. Thus, this research aims to inform discussions on the role of regulatory frameworks in promoting corporate responsibility and driving positive environmental, social, and governance outcomes in emerging market economies like South Africa.

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Glossary of Terms

CSI	Corporate Social Investment
CSR	Corporate Social Responsibility
DFI	Development Finance Institution
ESG	Environmental, Social and Governance
FEM	Fixed Effects Model
REM	Random Effects Model
IRP	Integrated Resource Plan
JSE	Johannesburg Stock Exchange
King IV	King Report on Governance in South Africa
RI	Responsible Investment
ROI	Return on Investment
SDGs	Sustainable Development Goals
SRI Index	Sustainable Responsible Investment Index
SSE	Shanghai Stock Exchange
SZSE	Shenzhen Stock Exchange

Chapter 1

1. Introduction

1.1 Background of Study

In recent years, there has been a surge in the social purpose movement known as Environmental, Social and Governance (ESG) in the private sector to address issues that governments need to sufficiently address. As elaborated by (Matos, 2020), ESG factors are considered when deciding which investments to include in an investor's portfolio. Investors often evaluate ESG factors using non-financial data on governance and social and environmental impacts. This has resulted in ESG forming a large proportion of capital market investments. This study aims to establish the validity of the relationship between the King Code on Governance's CSI compliance and ESG performance in South Africa.

According to (Johannesburg Stock Exchange, n.d.), the Johannesburg Stock Exchange (JSE) was one of the first to establish a Socially Responsible Index aiming at sustainability practices. The JSE aimed to promote corporate sustainability practices over the past decade (Johannesburg Stock Exchange, n.d.) This was influenced by the emergence of the King Code and other international sustainability initiatives, which saw the SRI Index later evolving and being replaced with the FTSE/JSE Responsible Investment Index. Fast forward, there are now various ESG/Responsible Investment Indices in South Africa and the world, such as the MSCI, Bloomberg and Thompson Reuters ESG data. According to (Mokabane & Du toit, 2022); in March 2010, South Africa became the first country worldwide to acknowledge integrated reporting formally by incorporating the King III report into the JSE listing requirements.

In September 2015, (UN, 2015) introduced the 2030 Agenda and the Sustainable Development Goals (SDGs), consisting of 17 objectives and 169 specific targets encompassing various economic, social and environmental development, as illustrated in Figure 1.

Figure 1: Sustainable Development Goals

While the SDGs have pushed both developed and developing countries to adopt implementation plans on sustainability, South Africa already had other measures to ensure good governance and encourage responsible investment (RI) covering all entities in the Companies Act.

ESG investment aligns closely with the United Nations' SDGs, mainly focusing on SDG 13: Climate Action and SDG 17: Partnerships for the Goals:

- SDG 13: Climate Action focuses on urgently combating climate change and its impacts. ESG factors in investment decisions help promote climate action by considering the environmental impact of investments, such as carbon emissions, renewable energy use, and resource efficiency (UN, 2015).
- SDG 17: Partnerships for the Goals emphasises the importance of collaboration and partnerships to achieve the SDGs. ESG investing encourages collaboration between investors, companies, and other stakeholders to address sustainability challenges and work towards achieving the SDGs collectively (UN, 2015).

The Regulatory Environment pushing the ESG agenda in South Africa consists of the King Code, the Companies Act, and the Global Reporting Initiative (GRI) ESG standards. The primary driver in promoting governance adoption in South Africa is the King Code, which establishes the country's philosophy, principles, practices, and outcomes as the standard for corporate governance. It plays a crucial role in fostering good corporate citizenship. It has significantly spurred the integration of Environmental, Social and Governance (ESG) considerations in companies listed on the JSE through its corporate governance principles and

requirements for Corporate Social Responsibility (CSR). As stipulated (PWC, 2016), King IV reinforces that an organisation must understand that it is a part of society and accountable to both present and future stakeholders. The code encourages organisations to move towards an integrated approach to ESG practices, including adopting industry-specific standards, monitoring performance, and disclosing ESG issues and their impact on the organisation, its stakeholders and the environment.

1.2 Definition of Research Problem and Research Questions

This research aims to tackle issues related to poverty, inequality, and environmental concerns. Despite growing interest in sustainable corporate practices, limited research exists on ESG in South Africa. Previous research has mainly focused on corporate governance and does not encompass all three ESG aspects: environmental, social, and governance. It is possible that the consideration of a composite ESG measure can conceal varying levels of consistency in the individual elements (Johnson, Mans-Kemp, & Erasmus, 2019)The growing attention towards companies' ESG factors is primarily driven by institutional investors (Johnson, Mans-Kemp, & Erasmus, 2019).

The following studies have examined the impact of the King Code on ESG practices and investing decisions and collectively contribute insights that are highly relevant to the investigation of corporate social investment (CSI) compliance and its implications on ESG performance.

(Ackers and Eccles,2015) found that the King III Code institutionalised CSR assurance techniques in South Africa. While mandatory CSR assurance could address inconsistencies in voluntary practices, a longitudinal study suggested other factors like company size and industry may also influence independent CSR assurance. This suggests that regulatory frameworks, such as the King Code, are pivotal in shaping CSR practices within the South African business landscape.

(Khumalo and Pitt, 2015) linked CSR disclosure among JSE-listed firms to industry environmental effects and media attention, supporting legitimacy theory. This underscores the importance of external influences in shaping corporate behaviour, which may be crucial in understanding the broader context within which companies operate and engage in CSI activities. (Zhang, 2016) compared South African and Chinese firms, highlighting the role of South African institutional investors in governance disclosure and Chinese investors in

financial performance, providing a comparative perspective that could inform discussions on the influence of different investor landscapes.

(Eccles, 2019) found a correlation between corporate accountability, firm size, and industry but not executive compensation. (Maubane, Prinsloo, & Van Rooyen, 2014) analysed sustainability reporting on the JSE, finding compliance with guidelines and reporting variations across sectors. This study may offer valuable benchmarks for assessing how companies conform to guidelines and how such adherence translates into sustainability reporting.

Collectively, these studies lay a robust foundation for investigating the interplay between regulatory frameworks, industry dynamics, and external influences on corporate behaviour, providing a comprehensive backdrop for examining King Code's CSI compliance and its impact on ESG performance among JSE-listed companies.

Key drivers of ESG adoption in South Africa include the King Code, institutional investors, industry factors, media attention, and reporting guidelines. Further research is needed to fully understand these drivers' implications for ESG investment practices in the country.

1.2.1 Poverty

The statistics according to (Sulla, 2020) show that approximately 55.5 per cent of the population in South Africa is living in poverty while a total of 13.8 million people are experiencing food poverty. (Meyer, 2021) highlighted that the government administered the following social grants to the underprivileged namely The Old Age Pension Grant, Disability Grant, Child Support Grant, Foster Child Grant, and Care Dependency Grant and approximately 3.9 million individuals, equivalent to 9 per cent of the population, received one of these grants in 2000. Between 2000 and 2019, the annual growth rate of beneficiaries witnessed a 19 per cent increase. The social grant system is facing significant challenges attributed to rapidly escalating unemployment rates. The impact of COVID-19 is anticipated to push an additional one million individuals into poverty (Meyer, 2021). While the government plays a vital role in addressing poverty, it is still insufficient to meet society's needs. Thus, corporations that benefit from the communities must play a role by making socially impactful investments.

With the share of the private sector in GDP above 70 per cent in most countries, regional integration is only sustainable with active private participation (AfDB, 2019). Thus, companies in the private sector that control a large portion of the economy need to do more to improve ESG investment in South Africa. In the words of Nelson Mandela, overcoming poverty is not

a gesture of charity. It is an act of justice. It protects a fundamental human right, the right to dignity and a decent life. (UN, 2018) All sectors must fight against poverty and bring down the poverty line, beginning with incorporating ESG in business activities.

1.2.2 Inequality

South Africa is one of the most unequal countries in the world, with a Gini at 63 in 2014/15 (Sulla, 2020). The Gini Index is a metric used to evaluate how income is spread among people. When the Gini Index is higher, it signifies increased inequality, meaning that individuals with higher incomes receive a more significant proportion of the overall income belonging to the population. According to the 11th edition of the South Africa Economic Update, for South Africa to considerably increase its economic potential, it must escape the equilibrium of slow growth and high inequality, which has been mired for many years (The World Bank, 2018). The income gap between the rich and poor remains high in South Africa, resulting in economic inequalities.

While the government is trying to bridge this gap, the private sector has a significant role in engaging in ESG and impact investment. If all sectors play a role in poverty alleviation, the number of poor people could be reduced to 4 million by 2030 through selected policy interventions (The World Bank, 2018). These measures involve tackling corruption, ensuring access to free higher education, reinstating policy stability in the mining sector, enhancing the competitiveness of key state-owned enterprises, opening South Africa's significant conglomerates to increased foreign competition and facilitating skilled immigration (The World Bank, 2018). The private sector could play its role by engaging in impact investment in the education sector, improving social aspects in their human resources policies, and creating jobs.

1.2.3 The Environment

South Africa faces three primary environmental challenges: pollution, energy shortages, and deforestation. Pollution contributes to ecological issues like climate change and air pollution. Energy deficits have led to prolonged blackouts, with 77 per cent of the country's energy coming from coal. Deforestation exacerbates pollution and energy shortages, as the current rate of deforestation hinders the production of sufficient power for the entire population in South Africa (Woo, 2022).

Businesses in the private sector must ensure that their activities do not harm the environment further. Wherever possible, they can implement measures and actions to fix the problem. One

example is businesses getting involved in reforestation to ensure that the country remains green and that all forests can be replaced. This research, therefore, aims to address the following question:

- Has the King Code positively impacted ESG adoption in South Africa?

1.3 Research Objectives

This research aims to examine the effect of the King Code's CSI compliance on ESG performance in South Africa.

1.4 Scope and Justification of the Study

The relationship between King IV and ESG adoption can be seen in several key areas. King IV encourages organisations to create an ESG framework and set goals and objectives that address specific ESG issues. This provides a degree of accountability and brings transparency to the company's ESG policies and performance.

King IV has been identified as the driving factor contributing to ESG in South Africa. It is relevant because of the legislative requirements for all JSE-listed companies to comply with the King Code. The JSE amended the JSE listing requirements in May 2017 after the Institute of Directors in Southern Africa (IoDSA) released the final version of King IV™. Under the amendments, listed companies do not have the choice that non-listed companies have to apply only some of the King Code principles and explain the ones they have not used. Listed companies must apply all the latest King Code principles, including IT governance – called IT Governance, Risk and Compliance (Giles, 2017). For this reason, this study will focus primarily on companies listed on the Johannesburg Stock Exchange, as the JSE requirement by the King Code makes it a relevant player in influencing the application of corporate social responsibility and governance in JSE-listed companies. In my view, if the King Code weren't a mandatory part of the reporting requirements of JSE-listed companies, most companies would not care as much about CSR and governance compliance.

The topic of ESG is essential to numerous stakeholders as it addresses some severely problematic areas of poverty, inequality, and environmental concerns in South Africa. The research will be helpful to the following stakeholders:

- Government

The government is considered a stakeholder in this research as it controls, among other things, the regulatory framework that defines how enterprises can operate, which is critical to the long-term success of companies and the ESG environment. (CFI, 2023). In addition, governments benefit from tax income derived from these companies and the people they employ (Swift Digital, 2021). The government will benefit from this research as it will highlight areas where they can assist the private sector in developing ESG by redirecting their procurement to the right companies, offering tax incentives, and adjusting the necessary regulations to promote ESG in South Africa.

- Investors

Investors consist of shareholders and debtholders who invest in the business and expect a return on investment (ROI) (CFI, 2023). Investors (individual and institutional investors) concerned with the concept of responsible investment can utilise this research to make the right investment decisions by understanding the driving factors of ESG in companies in which they choose to invest.

- Managers of firms

Managers of firms in this study can utilise the analysis in this research to understand their position compared to other firms and to gain a bigger picture and understanding of areas that require improvement.

- Development finance institutions

The primary responsibility of the development finance institutions (DFIs) involves offering financial support and aiding initiatives and enterprises that enhance the economic and environmental aspects of the nation. On the other hand, public and private entities play a part in identifying these projects and presenting them to the development finance agency (USB, 2022). DFIs can utilise the information in this study to understand areas where they need to assist start-ups, individual groups, and governments in ESG adoption and the SDGs. They can also identify companies that would benefit from their funding projects.

- Researchers

Research and academic participants come in diverse forms, including the following:

- Institutions involved in research activities, such as universities, non-university research institutions, and significant research facilities.
- Entities providing financial support for research, such as national research councils and agencies that fund specific projects.
- Academies, professional societies, and similar associations formed by researchers.
- Independent researchers themselves. (S4D4C, n.d.)

Researchers can use the information in this study to contribute to the research on ESG, fill in the research gaps, and explore other areas that need further study and research in the coming years. They can also use the research to provide their clients with information for decision-making.

1.5 Organisation of the Study

This study has five chapters, as follows:

- *Chapter 1: Introduction and Background of Study*

This chapter postulates a general overview of the importance of ESG and provides a summary of the King Code.

- *Chapter 2: Literature Review*

This chapter examines the relevant literature on ESG in South Africa, the driving factors, and how they have addressed the poverty, inequality, and environmental challenges in South Africa. It also highlights the gaps in the literature that we seek to address with this study.

- *Chapter 3: Methodology*

This chapter outlines the research methodology to be applied and the sample size and research parameters.

- *Chapter 4: Discussion of Findings*

This chapter outlines a discussion of the research results and findings of the data collected to reach the relevant conclusions relating to the research questions.

- *Chapter 5: Conclusion and Recommendations*

This chapter outlines the conclusion and recommendations of the research in line with the original objectives.

Chapter 2

2. Literature Review

2.1 Introduction

This chapter will begin by defining the key terms and concepts in the research, followed by an overview of the corporate governance framework in South Africa, the Broad-Based Black Economic Empowerment Act 53 of 2003 and the Global Reporting Initiative (GRI) standards. Furthermore, a review of the theoretical framework and empirical literature will be done, followed by a summary of the literature to identify the gaps and areas that need further research.

2.2 Definition of Key Terms and Concepts

2.2.1 Environmental, Social and Governance Standards

ESG is a set of standards for a company's operations that socially conscious investors use to screen potential investments. Environmental criteria consider how a company performs as a steward of nature. The social criteria examine how it manages relationships with employees, suppliers, customers, and the communities it operates. Governance involves a company's leadership, executive pay, audits, internal controls, and shareholder rights (Investopedia, 2022).

2.2.2 Responsible investment

RI is an investment product that requires that – in addition to financial factors – investors acquire, hold, or dispose of companies' shares based on environmental, social, and governance (ESG) factors and ethical factors. RI identifies companies with vital sustainability records and engages with companies to encourage improved ESG performance (Louche & Lydenberg, 2011).

2.3 Overview of Corporate Governance Practices in South Africa

This sub-section aims to give an overview of the corporate governance practises in South Africa. The King Code of Governance Principles (the code) and the King Report on Governance for South Africa (King III) were released on 1 September 2009 and came into effect on 1 March 2010. The initial and second reports (King I and King II) were focused on corporate entities. (IOD, 2016)

Simultaneously, King III made a bold proclamation that was applicable to all entities, irrespective of their method or form of incorporation or establishment, and across all sectors (public, private, and non-profit). In 2016, King IV was adopted, incorporating the concept of "three shifts" in global economic governance: a transition from financial capitalism to inclusive capitalism, a shift from short-term capital markets to long-term sustainable capital markets, and a move from silo reporting to integrated reporting (Hendricks & Wyngaard, 2010).

The King IV Code also replaced the 'applying or explain' principle with an 'apply and explain' principle, which requires institutional investors to substantiate their claim that they are practising and achieving good governance outcomes (IoDSA, 2016). While King IV adoption is voluntary for non-listed organisations, organisations listed on the JSE must comply with King IV and thus have an obligation to comply. Based on King IV (IoDSA, 2016), the recommendations for enhancing CSR adoption should be implemented according to an "apply and explain" approach. According to (IoDSA, 2016), the following principles outline these recommendations:

- Principle 1: The organisation's leadership is required to exhibit ethical and practical conduct.
- Principle 2: The governing body must oversee ethical practices within the organisation to cultivate an ethical culture.
- Principle 3: The governing body must ensure that the organisation behaves responsibly as a corporate citizen and is perceived as such.
- Principle 4: The governing body is tasked with recognising that the organisation's core purpose, risks, opportunities, strategy, business model, performance, and sustainable development are interconnected aspects of the value creation process.
- Principle 5: The governing body should guarantee that the organisation's reports furnish stakeholders with comprehensive information for making informed assessments of its performance and prospects in the short, medium, and long term.
- Principle 6: The governing body serves as the organisation's central entity and guardian of corporate governance.
- Principle 7: The governing body should have an appropriate balance of knowledge, skills, experience, diversity, and independence to effectively fulfil its governance role and responsibilities.

2.4 Overview of ESG Practices in South Africa

This section aims to overview ESG practices, drivers, and performance in South Africa. While there is no mandatory reporting framework that applies to all companies in South Africa, several regulations encourage ESG reporting for specific industries—and, in some cases, for JSE-listed companies—such as the King IV Code, JSE Listing Requirements, The Global Reporting Initiative, and other sector-specific requirements.

According to research by Pfaff (2021), Chapters 2 and 13 of the South African Bill of Rights provide an abundant source of pragmatic goals that connect the attributes of ESG thinking and action in South Africa. As stated in Chapter 2, section 9(1), Everyone is equal before the law and has the right to equal protection and benefit of the law, and Section 24(b): Everyone has the right to have the environment protected, for the benefit of present and future generations, and as professed in Chapter 13, section 215 (1): National, provincial and municipal budgets and budgetary processes must promote transparency, accountability and the effective financial management of the economy, debt and the public sector. The overview of Environment, Social and Governance is further expanded as follows:

2.4.1 Environmental practices

Companies operating in South Africa are particularly concerned about environmental issues, such as climate change, water scarcity, the depletion of natural habitats, overfishing, and pollution (Johnson et al., 2019). Environmental-related acts, such as the National Environmental Management Act 107 of 1998 (NEMA), the Carbon Tax Act 15 of 2019, and the Integrated Resource Plan (IRP), mainly address these issues.

2.4.2 Social practices

A history of social injustices has hindered South Africa's socio-economic development. Regulatory initiatives like the Employment Equity Act 55 of 1998 and the Broad-Based Black Economic Empowerment (B-BBEE) Act 53 of 2003 have been implemented to redress the inequalities stemming from the apartheid system. Additionally, these measures align with the goals of the Reconstruction and Development Plan and the Growth, Employment, and Redistribution Policy (Johnson et al., 2019).

2.4.3 Governance practices

The King IV Report on Corporate Governance has emerged to promote integration and drive ESG and governance in ESG in South Africa. (Pfaff, 2021).

In conclusion, enough legislation currently encourages ESG, and it is only a matter of time before it is mandated in the Standards.

2.5 Theoretical Framework

The theories relating to the research problem are namely the stakeholder theory hypothesis, the institutional theory hypothesis and the legitimacy theory. These theories seek to emphasise the importance of considering the environment and the communities in which a business operates about the continuity of their organisation.

2.5.1 Stakeholder Theory Hypothesis

Stakeholder theory plays a pivotal role in the adoption of ESG practices. The primary focus of the stakeholder theory of corporate governance is on the influence of corporate activities on all identifiable firm stakeholders. According to this perspective, the governance of a company, as decided by corporate management (officers and directors), should consider each stakeholder's interests (Krenn, 2016). Every organisation's activity impacts the stakeholders associated with it and the environment in which it operates. This suggests that organisations can identify stakeholders affected by their decisions and activities and consider their stakes in the decision-making process. In this way, the company will be able to ensure that ESG adoption is beneficial to all stakeholders, building trust and long-term relationships.

2.5.2 Institutional theory hypothesis

The institutional theory hypothesis asserts that corporate governance involves institutional change and continuity. This perspective offers a comprehensive outlook, considering the impact of economic market forces, social embeddedness, and cultural forces in shaping corporate governance (Krenn, 2016). The essence of comprehending this conceptual framework lies in its intention to depict relationships in a bi-directional and multi-directional manner. In simpler terms, individual, cultural/social, organisational, and institutional/regulatory factors are mutually shaped by and contribute to each other. Individual attitudes impact and are shaped by the social and organisational environment in which the individual operates (Greve & Argote, 2015). This suggests that ESG adoption will likely occur in companies operating within high-level institutional frameworks. Therefore, at a micro level, companies are more likely to adopt similar practices within the same norm. More robust institutional guidance, which provides a foundation for building standards and practices, is also beneficial.

2.5.3 Legitimacy theory

The fundamental acts an organisation does to fulfil societal duties are described by legitimacy theory (Deegan, 2002). Legitimacy theory, as opposed to agency theory, considers the interests of society (Ullah, Muttakin, & Khan , 2019). Legitimacy theory supports the same mandate and goals of ESG. The theory suggests that for an organisation to be considered legitimate from the external environment, it must be perceived as being socially responsible to gain the trust of stakeholders.

2.6 Review of Empirical Literature

This section provides an overview of the existing literature in line with ESG investment and its driving factors in South Africa. It will then highlight the gaps in the literature and thus motivate the purpose of this study.

2.6.1 Impact of the King Code on ESG and impact on investing

(Ackers and Eccles, 2015) did a study that evidenced that the institutionalisation of CSR assurance techniques in South Africa is driven by King III, as indicated by the expansion of CSR assurance since King III's adoption. Additionally, the study stated that voluntary CSR assurance practices led to inconsistent CSR assurance practice implementation, making it more difficult for stakeholders to comprehend the nature and breadth of CSR assurance engagements. Therefore, this could be overcome through mandatory CSR assurance regimes. The adoption of the King Code became a requirement for all JSE-listed companies. This is aligned with growth in ESG factors and impact investment.

A longitudinal investigation was conducted by (Ackers & Eccles, 2015), involving a content analysis of the Annual and CSR Reports of the leading 100 JSE-listed companies over the span of eight years, from 2007 to 2014, to help one understand how mandatory adoption of King III and integrated reporting affect ESG. This study aimed to identify companies offering independent CSR assurance, covering the period before and after the implementation of King III. This study also looked at other variables affecting CSR choices, including company size and industry sector. The data indicated that, despite being a nominal requirement for JSE-listed businesses, King III may not be the predominant factor influencing independent CSR assurance. However, it still plays a significant role. The study also suggested a potential influence of company size and industry sector.

(Khumalo and Pitt, 2015) A similar study was conducted on the determinants of CSR disclosure of firms listed on the JSE in 2015. The study discovered statistically significant links between CSR declarations, industry environmental effects, and media attention. It was found that the legitimacy theory best explains the motivations behind CSR disclosure among South African listed corporations. The conclusion relating to the legitimacy theory shows that beyond the legislative requirements, there are specific responsibilities that companies need to take to sustain the environment in which they operate.

2.6.2 Other drivers of ESG adoption in South Africa

A case study was done (Zhang, 2016) on South Africa and China's two major rising economies. The study focused on Chinese companies listed on the Shanghai Stock Exchange (SSE) or the Shenzhen Stock Exchange (SZSE) from 2008 to 2013 and South African firms listed on the Johannesburg Stock Exchange (JSE) from 2010 to 2013. The findings suggest that institutional investors prioritise traditional factors over social considerations and are hesitant to sacrifice financial performance for ESG goals. Notably, this trend needed to be evident in China, while in South Africa, institutional investors demonstrated success in enhancing corporate governance disclosure. The study underscores the influential role of institutional investors as leaders directing capital allocation in the private sector.

Another study by (Eccles, 2019) investigated the connections between several business characteristics and corporate accountability. A substantial correlation between accountability and firm size, as well as between accountability and the institutional proxies of industrial sectors and numerous securities exchange listings, was shown to exist at the level of pure statistics. On the other hand, there was no proof that executive compensation and corporate accountability are related.

(Maubane, Prinsloo, & Van Rooyen, 2014) conducted a study to examine reporting trends within specific market sectors of companies listed on the JSE, aiming to assess the effectiveness of the JSE SRI Index guidelines on reporting. Findings revealed that all chosen market sectors complied with the JSE SRI Index requirements by reporting on environmental, social, and governance (ESG) categories. The mining and materials sector exhibited more extensive reporting in the environmental and social aspects compared to other industries, while all sectors showed less emphasis on reporting indirect impacts in the governance category. Overall, the results suggest that companies generally find it easy to adhere to the reporting guidelines outlined by the JSE SRI Index.

2.7 Conclusion and Gaps in Empirical Literature

In conclusion, this literature review has provided an overview of the existing research on ESG investment and its driving factors in South Africa. The reviewed studies have shed light on the impact of the King Code on ESG practices and its influence on investing decisions.

The studies focus on corporate social responsibility (CSR), environmental, social, and governance (ESG) practices, and corporate accountability within the South African context. However, they approach these topics from different perspectives and methodologies, resulting in varying conclusions and insights.

Regulatory Influence on CSR Assurance (Ackers and Eccles vs. Khumalo and Pitt) emphasise the impact of regulatory frameworks, particularly King III, on CSR assurance practices among JSE-listed companies. They suggest that while King III plays a significant role, other factors such as company size and industry sector influence CSR choices. In contrast, (Khumalo & Pitt, 2015) focus on CSR disclosure determinants and highlight the role of industry environmental effects and media attention. While they acknowledge the influence of regulations, they emphasise broader motivations for CSR disclosure, such as the legitimacy theory.

Institutional Investor Influence on ESG Factors (Zhang and Eccles):

Zhang (2016) and Eccles (2019) both contribute to understanding the complexities of institutional investors' priorities and corporate accountability. Zhang's examination of South African and Chinese institutional investors reveals distinct preferences, with South Africans prioritizing corporate governance disclosure and Chinese investors focusing on traditional financial factors. This suggests differing views on ESG considerations, potentially influencing investment decisions and corporate behaviour. Meanwhile, Eccles' research highlights the relationship between business characteristics and accountability, indicating correlations between firm size, industry sectors, and accountability mechanisms. Although Eccles does not directly address institutional investors' preferences, his findings imply that these factors may influence accountability practices within companies. Together, these studies underscore the importance of considering institutional investors' perspectives and business characteristics in understanding and promoting corporate accountability within diverse contexts.

Adherence to Reporting Guidelines (Maubane and Ackers and Eccles):

Maubane, Prinsloo, & Van Rooyen (2014) scrutinize reporting trends among specific market sectors of JSE-listed companies and their compliance with the JSE SRI Index guidelines, revealing generally high adherence but noting sectoral disparities. In a similar vein, Ackers & Eccles (2015) delve into CSR assurance practices, focusing primarily on the impact of regulatory frameworks such as King III in South Africa. While acknowledging King III's substantial contribution to CSR assurance, they also highlight the potential influence of other factors. These studies collectively enrich our understanding of CSR, ESG practices, and corporate accountability in the South African context, offering nuanced insights with variations in emphasis, methodology, and findings.

Chapter 3

3. Research Methodology

3.1 Introduction

This section outlines the research methodology for addressing the research questions, including the data collection methods, sample period and size, and empirical model. The section will further illustrate the independent and dependent variables for the quantitative research methodology.

3.2 Research Approach

Quantitative research is an approach used to test objective theories by exploring the connections among variables (Creswell, 2017). These variables can be measured using instruments that allow for the analysis of numerical data through statistical procedures. This research adopts the quantitative research approach to address the following research question:

Is compliance with the King IV CSI requirements a driving factor of ESG adoption in South Africa? The answer enabled the research to predict whether better adoption and enforcement of the King Code's CSI will improve ESG in South Africa.

3.3 Research Design

To address the research questions above, a cross-country correlational study was conducted to investigate the relationship between ESG (dependent variable) and the independent variable, namely the King IV report. The study analysed numerical data of the MSCI South Africa ESG Leaders Index companies using regression analysis. Quantitative research will be used to obtain secondary data for this study.

3.3.1 Data, sample size and period size

The research sample size comprised of the entities included in ESG in South Africa, as per the MSCI South Africa ESG Leaders Index, spanning six years, from 2016 to 2021. The number of constituents varies yearly, between 27 to 38 for this time frame. The MSCI South Africa ESG Leaders Index comprises large and mid-cap companies in South Africa. This capitalisation-weighted index is designed to expose investors to companies exhibiting superior

ESG performance compared to their counterparts in the same sector (MSCI South Africa, 2022). The selection of the companies on the Leaders Index ensures that the study streamlines companies that the MSCI has already qualified. The selection of the time frame is to consider the period from when King IV was introduced up to 2021, with the most recent available data. According to (MSCI, 2022), the MSCI ESG Leaders Index is a market capitalisation-weighted index adjusted for float. Its purpose is to mirror the performance of companies that boast high ESG scores compared to others in the same industry. To elaborate, the percentiles signify the effectiveness of a company in managing crucial issues relative to its industry peers. Moreover, companies engaged in alcohol, gambling, tobacco, nuclear power, civilian firearms, fossil fuels extraction, thermal coal power, and weapons are omitted from the Indexes.

The selected time frame was based on data relevance and data availability. The years before 2016 are excluded as they are not relevant to the publishing date of King IV. While the additional factors, such as the GRI and SDG, are perceived to contribute towards ESG in South Africa, they will not be included in the data analysis due to the limitations of the measuring methods in South Africa. The data used in this study was secondary data collected from the published Integrated Reports of the sample companies, including financial statements, sustainability reports, and corporate social responsibility reporting. ESG data was obtained from the MSCI rating agency. The constituents of the MSCI ESG Leaders Index South Africa between 2016 and 2021 are presented in Tables 4,5,6 and 7 in the Appendix, with the average ESG Index, Corporate Social Investment, Profitability and company size over the six years.

Limitations

Several inherent limitations relate to the research method and sample used in this study of ESG (Environmental, Social, and Governance) performance among companies in South Africa as per the MSCI South Africa ESG Leaders Index from 2016 to 2021. Understanding these limitations is crucial for interpreting the study's findings accurately. Here are some of the fundamental limitations:

a) Sample Size and Composition

Fluctuating Constituents: The number of entities in the sample varies annually between 27 to 38. This fluctuation could impact year-on-year comparability and the consistency of the analysis.

Representation: Focusing on companies included in the MSCI South Africa ESG Leaders Index may limit the study to a subset of companies with already superior ESG performance, potentially overlooking the broader market and smaller companies making significant ESG strides.

Exclusion Criteria: The Index's exclusion of companies involved in specific industries (e.g., alcohol, gambling) may omit sectors where significant ESG progress or challenges exist, potentially skewing the understanding of ESG trends in South Africa.

b) Time Frame

Six-Year Duration: While six years is a substantial period to observe trends, it may only partially capture the long-term impact of ESG policies or practices, especially considering the delayed effects some ESG initiatives might have.

Post-King IV Regulation: By focusing on the period following the introduction of King IV, the study inherently assumes that prior years offer less relevant data for current ESG practices, which may miss foundational shifts or trends initiated before 2016.

c) Data Sources and Reliability

Secondary Data: The reliance on published Integrated Reports, financial statements, and sustainability reports introduces the limitation of reporting bias, where companies may present themselves in a favourable light, affecting the objectivity of ESG data.

MSCI ESG Ratings: While MSCI ratings are a recognised benchmark for ESG performance, they are based on available information and proprietary methodologies, which might need to fully capture a company's on-the-ground ESG impact or practices.

d) Methodological Constraints

Exclusion of Other ESG Influences: Due to measurement limitations, the study may not capture the full spectrum of ESG influences in South Africa by not incorporating additional factors like the Global Reporting Initiative (GRI) and Sustainable Development Goals (SDG).

Sector Comparisons: The ESG performance is compared within sectors, which is valuable for like-for-like analysis but may not adequately highlight cross-sectoral ESG innovation or challenges.

3.3.2 Model specification

The selected variables for analysis were informed by the literature review outlined in Chapter 2, examining the impact of the King Code (KI) on ESG investment in South Africa. Regression analysis will be used to predict the driving factor, namely the KI (independent variable) of ESG (dependent variable) investment. Regression analysis is used to indicate the value of one

variable based on other variables. The technique involves developing a mathematical equation or model that describes the relationship between the variable to be forecast, the dependent variable, and variables that the statistics practitioner believes are related to the dependent variable, known as the independent variables (Keller, 2018).

The regression model can be written as:

$$\boldsymbol{ESG_{it} = \beta_0 + \beta_1 CSI_{it} + \beta_2 ROA_{i,t} + \beta_3 firmsize_{i,t} + \mu_{it}}$$

Where,

- ESG_{it} denotes ESG score for each company,
- *i* at time, *t*,
- CSI is the CSR investment as a proxy for the King Code
- *ROA* denotes the return on assets and firm size denotes the size of each company based on its market value.
- μ_{it} represents an error term that follows a normal distribution, characterised by a standard deviation of one unit and a mean or median of zero.

3.3.3 Description of variables

The following variables were selected in assessing the impact of the King Code's CSI on ESG performance:

- ***Dependent variables*: *ESGSCORE***

ESG can be simplified as a numerical gauge of a company's perceived performance across various environmental, social, and governance aspects. The ESG score is determined by assessing the organisation's reported behaviour concerning ESG issues, reflecting how it performs in these areas (Alva Group, 2021). According to (Gregory, 2022), the MSCI ESG Ratings aim to evaluate a company's capacity to endure financially significant, long-term ESG risks. These ratings address two primary questions: Firstly, what issues among the industry's negative externalities could lead to unforeseen business costs in the medium to long term? Conversely, which ESG issues impacting an industry might offer businesses opportunities over the medium to long term? Employing a quantitative model that assesses the ranges and average values of externalised impacts in each sector, the ratings pinpoint material risks and opportunities. The final ESG Rating is derived by normalising the weighted average of individual Key Issue Scores.

- Independent variables

Corporate Social Investment (CSI): South Africa is one of the first countries mandating companies listed on the JSE to demonstrate their adherence to King III as a prerequisite for retaining their listing (Kloppers, 2017). The adoption of the King Code will be measured by assessing the CSI component of the company, that is, evaluate the rand amount invested in CSI per company. This will be calculated as a percentage based on the amount of money spent on CSI about the company's earnings before interest, taxes, depreciation, and amortisation (EBITDA).

Control variables

FIRM SIZE: can strongly influence the results of this study as accessibility to assets, economies of scale, and overall firm exposure can enable a company to achieve better ESG scores. According to (Gregory, 2022), one explanation for the correlation between size and ESG ratings is that larger companies can leverage economies of scale in their environmental, social, and governance initiatives. Additionally, research by (Drempetic, Klein, & Zwergel, 2019) suggests that ESG scores are influenced by organisational legitimacy. Larger firms tend to receive higher ESG scores because their size allows them to allocate more resources to collecting and reporting ESG data, thereby gaining greater legitimacy from rating firms, even if their actual performance is not inherently superior. Nevertheless, the observed relationship between firm size and ESG score is evident and may impact this research to some extent. In this study, firm size is gauged by market capitalisation, defined as the value of a company as determined by the stock market, specifically, the total market value of all outstanding shares (Boyte-White, 2022).

Return on Assets (ROA): Return on Assets may influence the results of this study as the company's ability to invest in ESG could be directly correlated with their profitability. It can be assumed that the more money a company has, the more they can invest in ESG activities. Profitability is measured using EBITDA. It is an alternate measure of profitability to net income (Hayes, 2022).

3.4 Estimation Approach

Random effects and fixed effects estimation techniques are commonly used in panel data analysis. The models embody fundamentally distinct underlying beliefs regarding the data. Choosing the suitable model is crucial to accurately estimate various statistical measures

(Borenstein, Hedges, Higgins, & Rothstein, 2010). The advantages of fixed effects models will be discussed, followed by the random effects model, a common alternative to the fixed effects approach.

3.4.1 Fixed effects (FE) estimation

In the fixed effect model (FEM), it is assumed that the genuine effect size remains uniform across all studies, and any discrepancies in effect size between studies stem solely from errors in estimating the effect size within each study. Consequently, when assigning weights to different studies, we can largely discount the information from smaller studies since we have more dependable information about the same effect size in larger (Borenstein, Hedges, Higgins, & Rothstein, 2010). Fixed effects estimation controls unobserved time-invariant individual-specific factors in panel data analysis. This will help determine the influence of time differences between independent variables on an interdependent variable. A fixed effect model contains all intercepts specific to the regression equation, defined as dummy variables. These dummies reflect unobserved and temporal variations in the diversity of individuals. The fixed effects model can be written as:

$$yit=\alpha i+Xit\beta+uit$$

Where:

- *it is the dependent variable for individual I* at time *t*.
- αi represents individual-specific fixed effects.
- *Xit* is a vector of time-varying independent variables.
- β is a vector of coefficients.
- *uit* is the error term.

Applying FEM to these studies involved creating regression models where the dependent variable (e.g., the level of CSR assurance or the extent of CSR disclosure) was regressed on independent variables that vary over time (e.g., changes in regulatory requirements, media attention, etc.) for each company. By including dummy variables for each company (but not for time), FEM effectively nets out the influence of all time-invariant characteristics of each company, focusing solely on the impact of the time-varying independent variables.

3.4.2 Random effects (RE) estimation

In the random effects model (REM), the objective is not to calculate a single, definitive effect size but to estimate the average within a range of effect sizes. Given that each study offers

insights into a distinct effect size, we aim to ensure that all these effect sizes contribute to the overall summary estimate (Borenstein, Hedges, Higgins, & Rothstein, 2010). Random effects estimation accommodates unobserved, time-invariant, individual-specific factors that correlate with the observed independent variables. It presupposes these unobserved factors are random and unrelated to the independent variables. The random effects model includes a random error term in the regression equation, representing the unobserved individual-specific effects. The random effects model can be written as:

$$yit = Xit\beta + ci + uit$$

Where:

- *yit* is the dependent variable for individual *i* at time *t*.
- *Xit* is a vector of time-varying independent variables.
- β is a vector of coefficients.
- *ci* represents the unobserved individual-specific random effects.
- *uit* is the error term.

The choice between fixed effects and random effects estimation depends on the nature of the data and the underlying assumptions. Fixed effects are typically preferred when there is reason to believe that unobserved individual-specific effects are correlated with the independent variables. At the same time, random effects may be more suitable when such correlations are not expected or when dealing with many individual-specific effects. Researchers often perform tests like the Hausman test to decide between these two approaches.

The practical application of the REM in such studies involves acknowledging that each company or sector can have unique factors influencing its CSR and ESG practices and outcomes. By treating these unique influences as random effects (ci), the REM allows for the estimation of the average impact of certain policies, practices, or characteristics on CSR and ESG outcomes across a population of companies while accounting for the variability between them.

In the context of the studies on South African companies listed on the Johannesburg Stock Exchange (JSE), using REM would allow researchers to estimate the average impact of variables like corporate governance (influenced by the King III report), industry sector, and company size on CSR and ESG reporting and practices. This model acknowledges the diversity and complexity of the factors at play, offering a nuanced understanding that can inform more effective and inclusive policy and strategy development.

Chapter 4

4. Research Findings

4.1 Introduction

This chapter presents the findings of the hypotheses proposed in Section 1.3. It then proceeds to examine the descriptive statistics of the variables used in the regression model and analyse the regression output. Finally, the validity of the estimated regression models is discussed before concluding the chapter.

4.2 Descriptive Statistics

The descriptive statistics of the regression variables presented in Table 1 serve as a tool for delivering a concise and lucid overview of the data. This includes fundamental metrics of data centralisation (mean, median, and mode), indicators of data spread (range, variance, and standard deviation), and characteristics of data distribution (skewness and kurtosis). These summarising figures facilitate the detection of data patterns, trends, and relationships, shedding light on the data's inherent organisation. Additionally, this section delves into the visual representation of data using diverse charts, tables, and graphs.

The average ESGSCORE is the same for financial and non-financial companies (0.0300 in both cases). However, financial companies have a more minor standard deviation (0.0210) than non-financial companies (0.0623), suggesting that ESGSCORE is less volatile among financial companies. This is less than 1 per cent, in comparison with the ESGSCORE standard deviation of the FTSE/JSE Index by (Chininga, Alhassan, & Bomikazi, 2023)

Financial companies have a higher CSI (18.1100) than non-financial companies (17.7196), suggesting potentially stronger corporate sustainability practices among financial companies. The standard deviation of CSI is also lower in financial firms (1.0684) than in non-financial firms (1.7962), suggesting less variation in CSI across financial firms. This demonstrates that companies in the financial sector may have stronger sustainability practices. The crucial aspects of corporate social investment and responsibility become significant in the context of non-financial reporting initiatives, especially when investors assess companies as suitable for socially responsible investment, sometimes as part of stock exchange indices (Heese, 2007). This is why CSI can be seen to have higher CSI than non-financial companies.

Financial companies have a higher average ROA (0.0913) than non-financial companies (0.0702), suggesting better potential financial performance among financial companies. The standard deviation of ROA is lower in financial companies (0.0689) than in non-financial companies (0.0900). This is less than 1 per cent when compared to the ROA standard deviation (8.268) of the FTSE/JSE Index by (Chininga, Alhassan, & Bomikazi, 2023).

Financial and non-financial firms have similar averages for FSIZE, but the standard deviation of FSIZE is slightly smaller in financial firms (0.7871) than in non-financial firms (0 ,8748). This is less than 1 per cent when compared to the FSIZE standard deviation (1.472) of the FTSE/JSE Index by (Chininga, Alhassan, & Bomikazi, 2023).

Financial companies in this analysis appear to have lower ESGSCORE variability, higher average CSI and ROA, and slightly lower FSIZE variability than non-financial companies. These differences reveal potential differences in ESG performance, corporate sustainability practices, and financial performance between the two types of companies in the data set. However, further analysis and context are needed to understand the underlying factors causing these differences fully.

When considering the descriptive statistics for the total sample, the ESG Score Index has a mean of 2.99 per cent, which indicates the sum of all the values divided by the total number of observations. The mean can be affected by outliers. The standard deviation of 5.38 per cent for the ESG Score Index measures the average distance between each data point and the mean. The skewness of 5.14 for the ESG Score Index measures the asymmetry of the data distribution. It determines whether the data is symmetric (skewness close to zero), positively skewed (longer right tail), or negatively skewed (longer left tail). In this case, the ESG Score Index is positively skewed. The kurtosis of 30.94 indicates leptokurtic distribution, meaning the distribution has heavier tails and a sharper peak compared to the normal distribution. The distribution has more extreme outliers or values in the tails.

Table 1: Descriptive Statistics

	ESGSCORE	CSI	ROA	FSIZE
Non-Financial Sample				
Mean	0.0300	17.7196	0.0702	25.0643
Median	0.0140	17.3921	0.0641	24.8637
Std dev	0.0623	1.7962	0.0900	0.8748
Min	0.0042	14.0779	-0.3147	23.6439
Max	0.3880	23.8760	0.4706	28.0448
N	143	100	143	143
Financial Sample				
Mean	0.0300	18.1100	0.0913	25.3894
Median	0.0265	18.3767	0.0974	25.4943
Std dev	0.0210	1.0684	0.0689	0.7871
Min	0.0038	15.4037	-0.0584	23.9283
Max	0.0941	19.7557	0.2738	26.6561
N	57	43	57	57
All Sample				
Mean	0.0300	17.8370	0.0762	25.1569
Median	0.0166	17.6020	0.0733	24.9796
Std dev	0.0538	1.6184	0.0849	0.8614
Min	0.0038	14.0779	-0.3147	23.6439
Max	0.3880	23.8760	0.4706	28.0448
N	200	143	200	200

Note: CSI=Corporate social investments; ROA=Return on assets; FISZE=Firm size

4.3 Correlation Matrix

The correlation matrix in Table 2 measures the correlations between variables. The closer the correlation coefficient is to +1, the stronger the positive relationship. In the data set, ESGSCORE is perfectly correlated with itself, which is expected (the correlation coefficient is 1.0000). There is a moderate positive correlation between ESGSCORE and LCSI, with a correlation coefficient of 0.4209. This shows that as the log of CSI increases, ESGSCORE also tends to increase, indicating a positive relationship between the two variables. There is a weak

negative correlation between ESGSCORE and ROA, with a correlation coefficient of -0.0934. This implies a small negative relationship between ESGSCORE and ROA, suggesting that companies with higher ESG scores may have slightly lower returns on assets.

There is a strong positive correlation between ESGSCORE and FSIZE, with a correlation coefficient of 0.7058. This shows a significant positive relationship between ESG scores and company size, implying that larger companies tend to have higher ESG scores. These correlations provide information about the relationships between the variables in your data set. However, correlation does not imply causation, and further analysis or regression will be done to understand further the underlying factors influencing these relationships and their practical significance.

Table 2: Correlation Matrix

	ESGSCORE	CSI	ROA	FSIZE
ESGSCORE	1.0000			
CSI	0.4209	1.0000		
	0.0000			
ROA	-0.0934	0.0557	1.0000	
	0.1883	0.5084		
FSIZE	0.7058	0.6130	0.0881	1.0000
	0.0000	0.0000	0.2150	

Note: CSI=Corporate social investments; ROA=Return on assets; FISZE=Firm size

4.4 Regression Results

The output in Table 3 is the summary of regression results on the effect of CSI on ESGSCORE. The regression models are estimated for different subsets of data: non-financial companies (A), financial companies (B), and all companies combined (C). The models for each sub-sample were estimated with and without year effects. The coefficients in a linear regression model represent the estimated effect of each independent variable on the dependent variable. The Wasquared F test statistic, which examines the overall significance of the independent variables in the regression equation, is significant at 1 per cent across all specifications. The R-squared values represent the proportion of the variance in the dependent variable (ESGSCORE) explained by the independent variables. From the model diagnostics in Table 3, higher R-squared values are observed in the models, including the year dummies, compared with the

models without the year dummies. This indicates a greater explanatory power when accounting for year effects. Hence, the discussion of the regression results will be limited to the models with the year dummies.

The coefficient for CSI is negative and statistically significant across both the non-financial and financial samples at a 5 per cent significance level in the preferred model (model with year dummies). This indicates that an increase in CSI activities is associated with a decrease in ESGSCORE. However, the estimated effect was observed to be greater among financial firms than non-financial firms, which suggests that the negative impact of CSI on ESG is more pronounced among financial firms. This difference is more noticeable in financial firms, possibly due to differences in business models. Financial firms, such as banks and investment companies, may focus more on short-term financial gains, which can lead to a more substantial negative impact of CSI activities on their ESG performance. On the other hand, non-financial firms may place a higher emphasis on long-term sustainability and corporate responsibility, potentially mitigating the negative effect of CSI. It is worth noting that previous studies have linked CSR activities with the ability to mitigate ESG risk but have not established a causal relationship between the two (Karwowski & Raulinajtys-Grzybek, 2021). The current research fills the gap by analysing the CSI initiatives as a driver of ESG scores and further concluding – based on the outcome – that an increased focus on CSI might redirect attention and resources away from comprehensive ESG practices.

The effect of profitability on ESG differs among financial and non-financial firms. Specifically, a negative and significant impact of profitability is observed among non-financial firms at 5 per cent, while a positive and insignificant effect is observed among financial firms. This indicates that increasing profitability of non-financial firms reduces their ESG performance while no effect is observed for financial firms. The observed difference suggests that the relationship between profitability and ESG performance varies across different sectors. Non-financial firms experience a negative impact on their ESG performance as profitability increases, possibly due to a focus on short-term financial gains. In contrast, financial firms exhibit a neutral effect, indicating that their profitability does not necessarily compromise their commitment to ESG factors, possibly due to industry regulations and a growing awareness of the interconnectedness between financial success and sustainable practices. This supports the study by (Yustin, 2003) which concluded that profitability has a negative and significant effect on ESG disclosure. According to (Yustin, 2003) the negative and significant effect observed between profitability and the proxy of return on equity and ESG disclosure can be understood

through legitimacy theory. The company engages in social contracts and consistently endeavors to meet its obligations to secure legitimacy from the community. Companies experiencing lower levels of profitability are more compelled to undertake initiatives that contribute to the welfare of the community

Firm size is observed to have a positive and statistically significant effect on ESGSCORE for both financial and non-financial firms. This indicates that the bigger the firm in terms of revenue, the higher their ESG score. The positive and statistically significant effect of firm size on ESGSCORE in both financial and non-financial firms suggests that larger companies are more likely to prioritise and invest in environmental, social, and governance practices. This relationship is influenced by factors such as resource availability, stakeholder pressure, risk management considerations, access to capital, and economies of scale. (Drempetic et al, 2020) conducted a study to examine the impact of company size, the resources at a company's disposal for supplying ESG data, and the accessibility of a company's ESG data on its sustainability performance. A notable positive correlation among these factors was observed.

Table 3: Regression Results on CSI and ESG

	A		B		C	
	Non-Financial Sample		**Financial Sample**		**All Sample**	
	FEM	**REM**	**REM**	**REM**	**FEM**	**FEM**
	Coefficient	Coefficient	Coefficient	Coefficient	Coefficient	Coefficient
Constant	-0.3065	-0.9417*	-0.5464***	-0.6050***	-0.2759	-0.3416*
	(0.2281)	(0.5126)	(0.0524)	(0.0687)	(0.1738)	(0.1817)
CSI	-0.0097***	-0.0043**	-0.0046**	-0.0076**	-0.0099***	-0.0103***
	(0.0030)	(0.0021)	(0.0020)	(0.0034)	(0.0025)	(0.0026)
ROA	-0.0077	-0.0386*	0.0301	0.0524	-0.0019	0.0146
	(0.0509)	(0.0204)	(0.0208)	(0.0414)	(0.0391)	(0.0423)
FSIZE	0.0203***	0.0420*	0.0259**	0.0302***	0.0192***	0.0220***
	(0.0086)	(0.0221)	(0.0025)	(0.0038)	(0.0065)	(0.0069)
Year Dummy	NO	YES	NO	YES	NO	YES
Wald χ^2/F	6.16	49.37	139.06	95.96	9.28	3.77
Prob > χ^2/F	0.0009	0.0000	0.00000	0.0000	0.0000	0.0007
R-squared	0.2161	0.5444	0.8291	0.8491	0.2194	0.2429
Hausman χ^2	14.48	12.01	7.39	0.11	19.48	17.43
Prob > χ^2	0.0023	0.1509	0.0605	1	0.0002	0.026
Firms	30	30	11	11	41	41
Observations	100	100	43	43	143	143

Note: CSI=Corporate social investments; ROA=Return on assets; FISZE=Firm size. ***, ** and * denote significance at 1%, 5% and 10% respectively.

Chapter 5

5. Conclusion and Recommendations

5.1 Introduction

This chapter provides the study's findings and recommendations for future research. The research addresses a significant gap in existing knowledge by examining the effects of implementing the King IV guidelines on ESG investment in the country.

5.2 Summary of Findings

In the study of the King Code's CSI Compliance and ESG Performance based on evidence from the JSE in South Africa, an ESG score was measured in comparison to corporate social investment (King IV Recommendation), as well as other control variables, namely company size and profitability.

In summary, the descriptive statistics suggest notable differences between financial and non-financial companies regarding ESGSCORE variability, average CSI, ROA, and FSIZE. Financial firms show lower ESGSCORE variability, higher average CSI and ROA, and slightly lower FSIZE variability. These distinctions suggest potential variations in ESG performance, corporate sustainability practices, and financial performance.

Correlation analysis reveals a moderate positive correlation between ESGSCORE and CSI, a weak negative correlation between ESGSCORE and ROA, and a strong positive correlation between ESGSCORE and FSIZE. This confirms the research by (Drempetic, Klein, & Zwergel, 2019) which suggests that “ESG scores are influenced by organisational legitimacy.

In regression analysis, the coefficient for CSI is negative and statistically significant for both non-financial and financial samples. This implies that increasing profitability negatively impacts ESG performance among non-financial firms, while no significant effect has been observed for financial firms. The regression findings also reveal an inverse relationship between ESG and CSI and a negative and significant impact of profitability on ESG performance among non-financial firms, with no significant effect observed for financial firms. Additionally, firm size is found to have a positive and statistically significant effect on ESGSCORE for both financial and non-financial firms.

The findings of this study, particularly the effects of implementing the King IV guidelines on ESG investment in South Africa, can be explained through the lenses of institutional theory, legitimacy theory, and stakeholder theory. These theoretical frameworks offer insights into the motivations behind corporate behaviour, especially about ESG practices and compliance with guidelines such as King IV.

The adoption of King IV guidelines and the observed variations in ESG performance among financial and non-financial firms can be understood as responses to institutional pressures. Companies align with these guidelines to signal their commitment to sustainable and ethical practices, responding to normative pressures from regulators, cognitive pressures from industry norms, and coercive pressures from legal and professional standards. This alignment can also be a strategic response to the institutional environment, indicating that firms are not just passive adopters of practices but actively engage with these norms to maintain their legitimacy and competitive advantage.

The positive correlation between ESG scores and corporate social investment (CSI) suggests that firms invest in ESG initiatives to bolster their legitimacy. By adhering to the King IV recommendations, companies aim to demonstrate their commitment to societal values and expectations, enhancing their legitimacy in the eyes of investors, customers, and the broader public. The observed negative impact of profitability on ESG performance among non-financial firms could indicate a trade-off that these firms face, where pursuing short-term profitability might come at the expense of investments in long-term ESG initiatives, potentially jeopardising their legitimacy.

The findings of the study, especially the significant positive effect of firm size on ESG scores for both financial and non-financial firms, could indicate larger firms having more resources and capacities to engage with a broader range of stakeholders and invest in ESG practices. These firms might be more visible and thus more pressured by stakeholders to adopt sustainable practices. The moderate positive correlation between ESG scores and CSI further reflects that firms are responding to stakeholder expectations around corporate social responsibility, a key component of broader ESG criteria.

In summary, the study's findings can be plausibly explained through institutional, legitimacy, and stakeholder theories, each offering insights into why firms adopt certain ESG practices and how they might navigate the challenges of aligning profitability with sustainability and ethical considerations. These theoretical frameworks also support the study's recommendations for targeted policy measures to encourage more responsible and sustainable business practices.

5.3 Policy Implications of the Findings

The study's exploration into how companies in South Africa align with the King Code's CSI compliance and their ESG performance has unveiled several insights with significant implications for policy development. Here's a narrative interpretation of the potential steps that could be taken by policymakers based on these findings:

One key recommendation is for policymakers to consider crafting sector-specific regulations and guidelines in light of the observed disparities in ESG performance and financial metrics between sectors. Recognising the unique challenges and opportunities inherent to each industry could lead to more effective and targeted policies that better support the distinct needs of financial and non-financial companies.

Another critical area for policy intervention is the enhancement of corporate sustainability reporting. Non-financial firms are particularly encouraged to adopt standardized and comprehensive reporting practices. By mandating more detailed disclosure, policymakers can empower investors and stakeholders to make more informed assessments of a company's ESG performance. This step towards greater transparency and accountability is pivotal in driving the corporate world towards more sustainable practices.

Furthermore, the study suggests a substantial opportunity for policymakers to incentivise the integration of ESG factors into the core business strategies of companies, especially those outside the financial sector. Through mechanisms such as tax benefits, preferential treatment in government procurement processes, or other financial incentives, companies could be motivated to adopt sustainable practices that are beneficial for the environment and society and financially rewarding.

Lastly, an intriguing observation from the study is the negative impact that increased profitability can have on ESG performance, particularly within non-financial firms. This highlights a crucial area for policy intervention, where policymakers are encouraged to find innovative ways to ensure that financial success and ESG performance are not mutually exclusive. By promoting policies that encourage responsible profitability, there's an opportunity

to redefine the corporate pursuit of success to include sustainable and ethical considerations at its core.

In summary, the findings from this study underscore the need for nuanced and targeted policy measures that address the specificities of different sectors, enhance transparency and accountability through better reporting, incentivize the integration of sustainable practices, and reconcile the pursuit of profitability with the imperative of ESG performance.

5.4 Recommendations for Further Research

Based on the study's findings and conclusions regarding the impact of the King IV on ESG investment in South Africa, here are some recommendations for further study:

5.4.1 Small and medium enterprise

As noted in the literature review, previous studies may have primarily focused on large corporations, disregarding the King Code's CSI compliance on ESG performance in small and medium-sized enterprises. Exploring the obstacles, opportunities, and effective approaches for implementing ESG practices in smaller businesses could help address this gap.

Policy makers focus on small and medium enterprises (SMEs) due to economic and regulatory considerations. As per World Bank statistics, SMEs constitute approximately 90 per cent of businesses and contribute to over 50 per cent of global employment (World Bank, 2022). While playing a crucial role in local livelihoods and a dynamic economy, SMEs have the potential to cause disproportionately significant harm to nearby residents, generating pollution or carbon emissions that cannot be overlooked (Chen, 2022).

5.4.2 Comparative analysis

Conduct a comparative study between South Africa and other jurisdictions that have implemented similar corporate governance frameworks. Compare the influence of different frameworks on ESG investment and identify transferable best practices.

5.4.3 Sector-specific studies

Conduct in-depth research that focuses on specific sectors or industries within South Africa to comprehend how the implementation of King IV’s CSI guidelines affects ESG investment in different sectors. This analysis could provide insights into sector-specific challenges and opportunities.

5.4.4 Performance and financial implications

Examine the financial performance of companies that have embraced ESG principles following King IV implementation. Assess the relationship between ESG practices, financial performance, and investment returns to ascertain the potential benefits of integrating ESG considerations.

Appendix

Table 4: Average ESG Score by Company Name

Average 'ESG Score (ESG)' by 'Company Name '

Company Name	Average of ESG Score (ESG)
LIBERTY HOLDINGS	0.41%
MASSMART HOLDINGS	0.47%
CORONATION FUND MANAGERS	0.48%
FORTRESS INCOME FUND A	0.55%
MOMENTUM METROPOL HLDGS	0.56%
PIONEER FOODS	0.56%
FORTRESS REIT	0.57%
TELKOM SA SOC	0.65%
INVESTEC LTD (ZA)	0.67%
PICK N PAY STORES	0.69%
HYPROP INVESTMENTS LTD	0.76%
EXXARO RESOURCES	0.80%
NETCARE	0.83%
KUMBA IRON ORE	0.84%
FORTRESS INCOME FUND B	0.85%
RESILIENT REIT	0.89%
LIFE HEALTHCARE GROUP	0.94%
IMPERIAL HOLDINGS	0.98%
PSG GROUP	0.99%
MONDI (ZA)	1.02%
THE FOSCHINI GROUP	1.05%
SPAR GROUP (THE)	1.08%
NEW EUROPE PROPERTY INV	1.29%
SAPPI	1.35%
NEPI ROCKCASTLE	1.40%
REDEFINE PROPERTIES LTD	1.41%
PRICE GROUP (MR)	1.43%
ANGLO AMERICAN PLATINUM	1.49%
MULTICHOICE GROUP	1.53%
RMB HOLDINGS	1.55%
WOOLWORTHS HOLDINGS	1.59%
GROWTHPOINT PROP LTD	1.64%
NORTHAM PLATINUM	1.67%
BIDVEST GROUP	1.72%
CLICKS GROUP	1.87%
DISCOVERY HOLDINGS	1.91%
NEDBANK GROUP	2.02%
TIGER BRANDS	2.04%
OLD MUTUAL (NEW)	2.07%
ASPEN PHARMACARE HLDGS	2.17%
VODACOM GROUP	2.21%
NORTHAM HOLDINGS	2.30%
SHOPRITE HOLDINGS	2.37%
REMGRO	2.74%
BARCLAYS AFRICA GROUP	2.75%
BID CORPORATION	2.88%
ABSA GROUP	3.02%
SANLAM	3.44%
GOLD FIELDS	3.50%
SASOL	4.48%
CAPITEC BANK HOLDINGS	5.03%
IMPALA PLATINUM HOLDINGS	5.10%
MTN GROUP	5.49%
STANDARD BANK GROUP	5.98%
FIRSTRAND	6.73%
NASPERS N	31.02%

Table 5: Average Company Size by Company Name

Average 'Company Size (SZ)' by 'Company Name'	
Company Name	**Average of Company Size (SZ)**
NASPERS N	1,176,645,612,769
FIRSTRAND	337,148,927,153
STANDARD BANK GROUP	259,453,774,808
ANGLO AMERICAN PLATINUM	255,904,646,456
CAPITEC BANK HOLDINGS	235,855,936,242
VODACOM GROUP	231,991,496,977
MTN GROUP	208,044,371,401
SASOL	179,427,513,146
IMPALA PLATINUM HOLDINGS	172,605,163,790
SANLAM	158,542,139,419
BARCLAYS AFRICA GROUP	148,644,604,056
KUMBA IRON ORE	143,569,822,911
ABSA GROUP	123,671,988,429
GOLD FIELDS	118,516,102,891
RMB HOLDINGS	107,610,607,050
NEDBANK GROUP	107,276,512,218
NORTHAM HOLDINGS	106,799,163,914
SHOPRITE HOLDINGS	104,070,854,137
BID CORPORATION	99,335,826,958
DISCOVERY HOLDINGS	95,584,398,046
REMGRO	94,918,598,319
ASPEN PHARMACARE HLDGS	88,619,336,977
NORTHAM PLATINUM	84,916,805,389
TIGER BRANDS	82,381,647,433
NEPI ROCKCASTLE	76,877,581,936
OLD MUTUAL (NEW)	70,883,140,867
BIDVEST GROUP	65,178,756,181
CLICKS GROUP	64,044,153,414
GROWTHPOINT PROP LTD	63,694,553,212
WOOLWORTHS HOLDINGS	57,892,265,793
MULTICHOICE GROUP	54,807,028,657
PSG GROUP	54,363,347,557
REDEFINE PROPERTIES LTD	54,163,632,911
PRICE GROUP (MR)	51,531,653,803
NEW EUROPE PROPERTY INV	50,696,066,574
SAPPI	48,022,769,376
IMPERIAL HOLDINGS	45,352,955,451
EXXARO RESOURCES	44,899,988,188
RESILIENT REIT	44,416,189,686
NETCARE	40,734,308,588
FORTRESS INCOME FUND B	39,116,136,141
THE FOSCHINI GROUP	39,100,485,501
TELKOM SA SOC	38,988,934,165
LIFE HEALTHCARE GROUP	37,454,087,360
SPAR GROUP (THE)	37,350,814,908
MONDI (ZA)	35,842,127,023
PIONEER FOODS	33,889,646,655
MOMENTUM METROPOL HLDGS	32,704,861,775
LIBERTY HOLDINGS	32,632,794,569
PICK N PAY STORES	32,517,082,011
MASSMART HOLDINGS	27,393,905,641
INVESTEC LTD (ZA)	26,589,571,552
HYPROP INVESTMENTS LTD	26,380,737,095
CORONATION FUND MANAGER	25,253,746,169
FORTRESS REIT	22,364,876,448
FORTRESS INCOME FUND A	18,553,567,094
Grand Total	**135,484,876,139**

Table 6: Average Profitability by Company Name

Average 'Company Profitability (PF) ' by 'Company Name '	
Company Name	**Average of Company Profitability (PF)**
STANDARD BANK GROUP	33,396,833,333.33
ANGLO AMERICAN PLATINUM	31,508,833,333.33
FIRSTRAND	24,433,166,666.67
VODACOM GROUP	18,318,204,666.67
MTN GROUP	16,677,500,000.00
NEDBANK GROUP	15,504,500,000.00
SANLAM	14,400,666,666.67
SHOPRITE HOLDINGS	6,722,666,666.67
GROWTHPOINT PROP LTD	5,577,666,666.67
NASPERS N	5,203,166,666.67
WOOLWORTHS HOLDINGS	4,768,166,666.67
REDEFINE PROPERTIES LTD	4,758,580,500.00
BIDVEST GROUP	4,580,800,500.00
LIBERTY HOLDINGS	4,240,500,000.00
PRICE GROUP (MR)	3,726,000,000.00
IMPERIAL HOLDINGS	3,555,500,000.00
THE FOSCHINI GROUP	3,295,727,400.00
ASPEN PHARMACARE HLDGS	3,282,666,666.67
TELKOM SA SOC	2,900,000,000.00
HYPROP INVESTMENTS LTD	2,709,924,666.67
SPAR GROUP (THE)	2,643,866,666.67
CLICKS GROUP	2,408,706,250.00
TIGER BRANDS	2,257,500,000.00
PICK N PAY STORES	1,789,150,000.00
REMGRO	1,276,000,000.00
NETCARE	1,270,666,666.67
INVESTEC LTD (ZA)	459,784,950.00
SAPPI	430,000,000.00
BARCLAYS AFRICA GROUP	3,385,500.00
KUMBA IRON ORE	-
MULTICHOICE GROUP	-
PSG GROUP	-
CORONATION FUND MANAGERS	-
RMB HOLDINGS	-
CAPITEC BANK HOLDINGS	-
GOLD FIELDS	-
NEPI ROCKCASTLE	-
MOMENTUM METROPOL HLDGS	-
IMPALA PLATINUM HOLDINGS	-
DISCOVERY HOLDINGS	-
BID CORPORATION	-
RESILIENT REIT	-
FORTRESS INCOME FUND B	-
EXXARO RESOURCES	-
NORTHAM PLATINUM	-
SASOL	-
OLD MUTUAL (NEW)	-
LIFE HEALTHCARE GROUP	-
FORTRESS REIT	-
MASSMART HOLDINGS	-
PIONEER FOODS	-
ABSA GROUP	-
MONDI (ZA)	-
FORTRESS INCOME FUND A	-
NEW EUROPE PROPERTY INV	-
NORTHAM HOLDINGS	-
Grand Total	**6,219,862,862.00**

Table 7: Average Corporate Social Investment by Company Name

Average 'Corporare Social Investment (KI)' by 'Company Name '	
Company Name	**Average of Corporare Social Investment (KI)**
ANGLO AMERICAN PLATINUM	445,126,666.67
FIRSTRAND	212,166,666.67
NEDBANK GROUP	131,166,666.67
STANDARD BANK GROUP	129,316,666.67
MTN GROUP	124,006,666.67
VODACOM GROUP	96,757,000.00
BIDVEST GROUP	94,333,333.33
SANLAM	68,266,666.67
TELKOM SA SOC	47,000,000.00
GROWTHPOINT PROP LTD	35,700,000.00
SHOPRITE HOLDINGS	32,433,333.33
LIBERTY HOLDINGS	30,775,000.00
PRICE GROUP (MR)	29,320,000.00
NETCARE	28,000,000.00
REMGRO	24,166,666.67
CLICKS GROUP	20,125,000.00
PICK N PAY STORES	20,050,000.00
SPAR GROUP (THE)	16,350,000.00
THE FOSCHINI GROUP	15,925,000.00
TIGER BRANDS	11,500,000.00
NASPERS N	10,000,000.00
ASPEN PHARMACARE HLDGS	7,700,000.00
SAPPI	4,966,666.67
INVESTEC LTD (ZA)	4,778,929.75
REDEFINE PROPERTIES LTD	4,400,000.00
HYPROP INVESTMENTS LTD	1,600,000.00
RESILIENT REIT	-
SASOL	-
MONDI (ZA)	-
MOMENTUM METROPOL HLDGS	-
FORTRESS INCOME FUND A	-
ABSA GROUP	-
FORTRESS REIT	-
MULTICHOICE GROUP	-
CAPITEC BANK HOLDINGS	-
WOOLWORTHS HOLDINGS	-
MASSMART HOLDINGS	-
DISCOVERY HOLDINGS	-
PSG GROUP	-
NEPI ROCKCASTLE	-
FORTRESS INCOME FUND B	-
EXXARO RESOURCES	-
RMB HOLDINGS	-
NEW EUROPE PROPERTY INV	-
LIFE HEALTHCARE GROUP	-
NORTHAM HOLDINGS	-
GOLD FIELDS	-
NORTHAM PLATINUM	-
BID CORPORATION	-
OLD MUTUAL (NEW)	-
IMPALA PLATINUM HOLDINGS	-
IMPERIAL HOLDINGS	-
CORONATION FUND MANAGERS	-
KUMBA IRON ORE	-
PIONEER FOODS	-
BARCLAYS AFRICA GROUP	-
Grand Total	**46,347,288.60**

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