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Corporate Governance and Financial Performance of Asset Managers in South Africa

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Dedication

I dedicate this dissertation to my God-given parents, Mrs. Fredah Mpai and the Late Abiot Mpai. Thank you for instilling hard work and discipline in me. I am eternally grateful for your sacrifices and the opportunities you provided me with - your daughter is a Master. I honour you with this body of work.

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Abstract

Corporate governance plays an important role in the creation of long-term value and the protection of shareholders and other stakeholders' interests. This research study examines the influence of corporate governance characteristics (board size, board independence, board chairman independence, audit committee independence, and audit committee financial expertise) on the financial performance of asset management firms in South Africa. The proxy for financial performance is Return on Assets. The study employed the fixed and random effects panel regression techniques to estimate a panel data of 11 asset management firms in South Africa from 2012 to 2023.

The results of the analysis show a positive and significant relationship between Return on Assets, board chairman independence, and audit committee financial expertise. While the relationship between board independence and Return on Assets is observed to be positive, it is not statistically significant. By contrast, board size and audit committee independence ratio showed no significant relationship with Return on Assets. Therefore, this study recommends the appointment of an independent non-executive chairman on the board of directors to achieve enhanced directorship independence and improved monitoring and supervisory responsibilities within the organisation. Furthermore, South African asset management firms should consider drafting more members with financial expertise into the audit committee and, in particular, directors with a background in accounting, audit, regulation, compliance, internal controls, and enterprise risk management.

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List of Acronyms and Abbreviations

ASISA	Association for Savings and Investment South Africa
AUM	Assets under Management
CAGR	Compounded Annual Growth Rate
CA (SA)	Chartered Accountant South Africa
CEO	Chief Executive Officer
CFA	Chartered Financial Analyst
CGI	Corporate Governance Index
CIPC	Companies and Intellectual Property Commission
CIS	Collective Investment Schemes
CPC	Code of Professional Conduct
ETN	Exchange-Traded Notes
ETF	Exchange-Traded Funds
FAIS	Financial Advisory and Intermediary Services
FICA	Financial Intelligence Centre Act
FIS	Financial Intelligence Centre
FSP	Financial Services Provider
FSR	Financial Sector Regulation
FSCA	Financial Sector Conduct Authority
GDP	Gross Domestic Product
IFRS	International Financial Reporting Standards
IoDSA	Institute of Directors South Africa
IRR	Internal Rate of Return
JSE	Johannesburg Stock Exchange.
King IV	King Report on Corporate Governance
OECD	Organisation for Economic Co-Operation and Development
PA	Prudential Authority
PIC	Public Investment Corporation
REIT	Real Estate Investment Trusts

ROA	Return on Assets
ROE	Return on Equity
ROIC	Return on Invested Capital
SADC	Southern African Development Community
SAICA	South African Institute of Chartered Accountants
SARB	South African Reserve Bank
SDG	Sustainable Development Goals
SME	Small and Medium Enterprises
TCFF	Treating Customers Fairly Framework
TRP	Takeover Regulation Panel
UN	United Nations
WEF	World Economic Forum

CHAPTER 1: INTRODUCTION

1.1 Background of the Study

The financial system is a set of complex and closely related institutions, intermediaries, and services that enable the mobilisation of money and financial instruments between investors and borrowers. In accordance with International Financial Reporting Standard (IFRS) 9, a financial instrument is a contract that simultaneously gives rise to a financial asset, financial liability, or equity instrument between two entities (EFRA, 2015) and can be traded and settled in financial markets. The economic function of financial markets is to provide market participants with a marketplace that accommodates the corporate finance needs of deficit units, and the investment needs of surplus units. Accordingly, financial institutions play an important intermediary role in facilitating the transfer of financial resources from savers to borrowers.

Financial intermediaries are principally responsible for determining the optimal balance between savers' preferred liquidity and borrowers' long-term financing requirements. Consequently, one of the primary fiduciary duties of financial institutions is identifying productive investment opportunities that are aligned with and in the best interests of savers while providing access to finance (Hawkins, 2004). In addition, financial intermediaries address information asymmetry between lenders and borrowers by pursuing mandated and regulated investment opportunities that are indicative of complete and accurate information that would otherwise not be easily accessible to individual savers. Access thereof allows financial intermediaries to perform a fair and critical analysis of investment risks and returns, which in turn results in the effective allocation of financial resources (Hawkins, 2004). Moreover, financial intermediaries execute stewardship responsibilities through risk management and, importantly, by exercising oversight responsibilities over corporate fund managers, thus ensuring the efficient use of financial resources (Hawkins, 2004).

The apparent significance and functionality of the financial system stimulates a recurring interest in the relationship between financial development and economic growth to be studied extensively within the sphere of development economics. Historically, studies have examined this phenomenon to particularly determine whether the relationship between financial development and economic growth is causal or correlated. A notable contributor to this literature is Schumpeter (Croitoru, 2012), who suggested that financial systems enable

economic growth through the effective allocation of funds to efficient investors who, in turn, trigger corporate productivity through investment and as a result stimulate economic growth (Croitoru, 2012).

King and Levine (1993b) reinforced this observation by Schumpeter (Croitoru, 2012) by performing an analysis that considered 77 countries between 1960 and 1989 and inferred that financial development in 1960 served as a conduit towards economic growth 30 years later. Rajan and Zingales (1998) analysed this phenomenon a step further and found that successful industries predominantly operated within financially developed countries and, in addition, made use of leverage to finance innovation and productivity. Moreover, Rajan and Zingales (1998) found that industries that similarly operated within financially developed countries but reinvested retained income, as opposed to raising capital to finance innovation and productivity, were less likely to be successful. Therefore, the analysis of 36 industries across 42 countries by Rajan and Zingales (1998) supports the inference of a causal relationship between financial development and economic growth.

Previous theoretical and empirical studies have identified economic growth as a determinant of economic development. While this may be the case, economic growth encompasses the following limitations:

i) the unequal distribution of income (Price, 2006);
ii) negative externalities and sustainability concerns (Xiong & Xu, 2021); and
iii) dominance in one sector of the economy (Wu *et al.,* 2018b).

These limitations make it apparent that while economic growth is necessary, it is indeed not a sufficient condition for development, and that policymakers have shifted their mindset towards prioritising sustainable development as a result (Dutta & Saha, 2023) (Pelsa & Balina, 2022). To better understand how to stimulate sustainable development, an analysis of the relationship between financial and sustainable development within the literature on development economics has gained traction (Dutta & Saha, 2023).

In the sphere of financial and sustainable development, and in particular social sustainability, studies have indicated that financial exclusion is a significant determinant of social exclusion (i.e., poverty) (Fernandez-Olit *et al*., 2016) and as Kirsten (2006) shows, South Africa faces a severe case of financial exclusion as a result of the apartheid government regime. Its history of

colonisation and apartheid built a financial system centred on the white minority and only stopped being economically reinforced in 1994. However, at the end of the institutionalised system of racial segregation, over half of the previously disadvantaged individuals, women, and children, who sit at the low end of income inequality, face deep financial exclusion (Wentzel *et al*., 2016).

The United Nations (UN) has identified financial inclusion as a catalyst for financial health and is considered a means to directly achieve eight of the 17 2030 Sustainable Development Goals (SDG's) (UNCDF, 2021). Financial inclusion is financial development that provides the access to – and usage of – affordable and quality financial services and products in a manner that is appropriate and convenient for previously disadvantaged individuals, but simple and dignified and well within the standards of client protection (FSCA, 2022). The eight Sustainable Development Goals that financial inclusion aims to address include: no poverty, zero hunger, good health and well-being, gender equality, decent work and economic growth, industry, innovation and infrastructure, reduced inequalities, and partnerships for the goals (UNCDF, 2021).

In the African context, South Africa is an emerging market and upper-middle-income economy and remains the largest and most financially advanced economy in the Southern African Development Community (SADC) and continent. According to the World Economic Forum (WEF) Global Competitiveness Report, South Africa ranked 7th out of 144 countries in the financial market development segment based on the availability and affordability of financial services and the standard of regulation of the securities exchange sector (WEF, 2013). In contrast to most emerging markets, the South African financial system boasts a wide variety of financial services including financial market infrastructures, commercial banking, insurance, retirement funds, payment providers, retail lending, financial advisory, investments, and asset management (FSCA, 2022).

In assessing the macroeconomic performance of South Africa's financial system, Hawkins (2004) observed growth, innovation, and financial stability to be key performance measurements. In terms of growth, South Africa's output strength has weakened, with real Gross Domestic Product (GDP) averaging a low growth rate ranging between 1.5 and 2 percent from 2015 to 2023 (FSCA, 2022). Moreover, South Africa entered a recession in 2019, which further extended to 2020 due to the impact of COVID-19, resulting in a distressing 6 percent contraction in real GDP in 2020 (FSCA, 2022). By contrast, the South African financial services

industry has experienced runaway growth, and from a financial depth perspective, the financial sector's importance is underscored by its contribution of over 20 percent of the South African economy (FSCA, 2022). In addition, domestic credit to the private sector is approximately 129 percent of GDP, which is significantly more than that of other emerging markets and African countries (FSCA, 2022). This is indicative of the sector's significant influence on the South African economy and further illustrates South Africa's deepened financial system. In this context, assets refer to the domestic credit advanced to the private sector.

In terms of innovation, because of the feedback relationship between innovation and growth, South Africa has seen new companies with unconventional business models enter the financial services sector and disrupt traditional distribution channels. In the banking sector, for example, innovation embodied in the form of digital financial services primarily materialises through the piggyback of legacy infrastructure (Jenik & Zetterli, 2020).

Finally, financial stability as a key performance macroeconomic indicator is concerned with the occurrence of bank failures and the public's perception of the banks within a country (Hawkins, 2004). The three primary factors that can increase a bank's risk of collapse are credit risk, interest rate risk, and liquidity risk. Recently, the African Bank and VBS mutual bank went into liquidation in 2014 and 2018, respectively, owing to poor governance and liquidity issues. While it is important to acknowledge this occurrence in the South African context, the Big Four banks (i.e. Standard Bank, Absa, Nedbank, and First Rand) do not show any indicators of possible bank failure (Mishi & Khumalo, 2019), which amongst other indicators is indicative of financial stability as per the responsibility of the South African Reserve Bank (SARB). Furthermore, South Africans still perceive banks as the safest institutions to place deposits (Hawkins, 2004), which upholds trust and credibility in the SARB and the rule of law regarding property rights. Therefore, all things considered it is reasonable to conclude that the South African financial services industry has exceeded expectations in terms of its macroeconomic performance.

The influence of the financial services sector on economic activity is measured based on two considerations: the ease with which corporations' access financial institutions and the ease with which investors obtain adequate returns (Hawkins, 2004). The Johannesburg Stock Exchange (JSE) is the largest exchange on the African continent and is currently ranked as the 17th largest stock exchange in the world by market capitalisation. The JSE has 276 listed companies with a market capitalisation of USD1.36 trillion (as of March 2022). As such, access to finance is not

a constraint for large corporations that are listed on the JSE and, in addition to this, big corporations ordinarily have treasury departments that manage the day-to-day capital requirements, obligations and financial risks of the company. Therefore, in this context, the evaluation of the ease with which companies access financial institutions focuses more on Small and Medium-sized Enterprises (SMEs) than on large and listed corporations on the JSE.

SMEs have been identified as drivers of poverty alleviation, job creation, innovation, and economic growth in Africa (IFC, 2019). The African business sector is dominated by SMEs, and from a South African perspective, SMEs contribute approximately 34 percent of the GDP to the economy and further reveal an approximate absorption rate of 61 percent of the labour force by the sector (IFC, 2020). Accordingly, SMEs play a significant role in achieving the 17 UN SDGs that promote sustainable, inclusive, and decent employment (Endris & Kassegn, 2022).

Notwithstanding the evidence of the impact of SMEs on economic growth, one of the main challenges that SMEs face is the lack of access to adequate financial resources (IFC, 2019). This is primarily due to the information asymmetry between the lender and borrower (Stiglitz, 1990), which has resulted in commercial financial institutions perceiving high risk to SMEs. Additionally, stringent financing conditions that require the provision of collateral from SMEs serve as bottlenecks for accessing finance (IFC, 2019). The majority of businesses in this sector are predominantly in the development phase of the business cycle and thus lack the ownership of tangible assets that have significant economic value for collateral purposes (IFC, 2019). In addition, the banking sector is not required to disclose rejection rates or reasons for the rejection of SME funding applications, which impedes the rate of financial inclusion within this sector by finding solutions that address the concerns of commercial banks. Consequently, credit cards, overdrafts, and bank loans are more likely to advance to SMEs in terms of funding as opposed to venture capital, which is why South Africa finds itself in a financing gap for both formal and informal SMEs of approximately USD30 billion and USD24 billion, respectively (IFC, 2019).

In terms of the ease with which investors may obtain adequate investment returns, it is important to note that South Africa is rich in natural resources, has first-world financial markets, and provides extensive opportunities for multinational organisations across industries and sectors. South Africa has a sophisticated legal system, and judicial authority is vested in the courts, which are independent and only subject to the constitution and law that is applied impartially, without favour or fear. In addition, South Africa has a residence-based tax system in which

residents are taxed on worldwide income, subject to the exclusions outlined in Section 9 of the Income Tax Act (South African Government, 2024). However, non-residents are taxed on income from a South African source. In terms of corporate tax, registered companies are taxed at a flat rate, and each company is taxed separately; therefore, there is no group of companies-based taxation (South African Government, 2024). While political instability, corruption, and maladministration have become embedded in South African culture, resulting in significant going-concern risks for key state-owned entities and jeopardising economic growth, the effective regulatory framework allows large companies with well-established administrative and compliance departments to successfully navigate bureaucracy. Therefore, it is reasonable to conclude that it is more probable for investors to obtain adequate returns than not.

Evidently, evaluating the financial services industry's influence on economic activity indicates that while there is still room for improvement, South Africa has made steady and sustainable progress towards a deepened, sophisticated, and first-world financial system that can significantly reinforce the economy of the country from a microeconomic performance perspective. This evaluation further supports the inference that the performance of the financial services sector is directly related to the economic well-being of the economy (Simbanegavi *et al*., 2014b).

In recent years, there has been a steep rise in corporate governance scandals, both globally and locally, and some of the challenges faced by South Africa particularly include corruption, negligence, mismanagement of public funds, and a lack of adequate resources to service the citizens of the country as a result of the leadership crisis that the country is currently facing. Therefore, given this context, it is appropriate to make a reasonable assumption that the financial services sector is not exempt from this culture and exposure to maladministration, which is accompanied by the risk of poor corporate governance.

Good corporate governance has been identified as one of the critical determinants of successful organisations and is further noted as a mechanism that has a positive impact on the financial and overall performance of organisations (Jonty *et al*., 2018). This is because governance ensures that agents who act on behalf of the principal fulfil their fiduciary duties in the best interest of the organisation and therefore create sustainable value for all stakeholders (Jensen & Meckling, 1976). Therefore, given the critical importance of the financial services sector for economic and sustainable development and in light of the exposure of the sector to poor corporate governance, it will be valuable to investigate the impact of corporate governance on

the financial performance of the financial services sector, with a particular focus on Asset Managers as critical financial intermediaries within the industry.

1.2 Research Problem and Questions

1.2.1 Research Problem

The purpose of a company is to create sustainable value for the relevant stakeholders of the organisation (IIR Framework, 2021). This purpose is achieved by the board of directors who are responsible for setting the organisation's strategic direction and objectives, in addition to monitoring the planning and implementation thereof, while simultaneously ensuring accountability within the management team (IoDSA, 2016).

The implementation of the strategic direction and objectives of the organisation encompasses a value-creation process that follows a business model approach (IIR Framework, 2021). The aforementioned process involves the transformation of resources, known as the Six Capitals, through the business activities of the organisation that result in the production of output that either stimulates or destroys value in the short, medium, and long term. Notably, value is maximised when those charged with governance create value in a manner that considers the legitimate needs of all relevant stakeholders (IIR Framework, 2021).

"Asset management is the process of investing money on behalf of retail and institutional investors for expected returns The investing activities include a balancing act between costs, opportunities, and risks against the desired performance of assets to maximize returns." (IAM, 2015, para.1). In the asset management industry, value is created at inception using financial capital, which among other capitals is a necessary input for the sector's business model. In the fund management context, financial capital comes in the form of Assets Under Management (AUM) and is derived from lenders, private investors, and institutional investors who comprise pension, mutual, and insurance funds, to name a few (Metrick & Yasuda, 2010). Accordingly, fund management business activities primarily encompass the use of financial capital to acquire various investments across four main asset classes: equity, bonds, commodities, and alternative investments. Furthermore, fund managers perform post-investment monitoring duties of the fund portfolio to generate sustainably high and risk-adjusted returns on behalf of investors, in addition to achieving the above fixed fee returns for the organisation as the output in the occurrence of good performance. The overall outcome of fund management business activities

stimulates economic activity through investments in the South African economy (Metrick & Yasuda, 2010).

Given the insights into the business model and the interests of the relevant stakeholders within the asset management industry, it is important to understand the role played by the board of directors in the creation of value. In addition, it is important to understand how the principal versus agent issue is addressed within this context, given the unique interests of all the relevant stakeholders. This required understanding is broad and aims to explore the corporate governance mechanisms employed within the industry that result in good performance. The understanding thereof will assist in providing more insight into the effective management or lack thereof of asset management firms within a South African context.

In addition to common law, corporate governance in South Africa is informed by the King IV Code of Good Corporate Governance, such that the recommendations of King IV have been part of the JSE mandatory listing requirements since 1994. Therefore, the significant application of King IV's corporate governance framework stimulates the need for a study from a South African perspective. However, it is important to note that unlisted companies in South Africa voluntarily apply King IV (van Zyl & Mans-Kemp, 2020).

Finally, this study makes several contributions to the literature. To date, few studies have evaluated the impact of corporate governance principles on the financial performance of the asset management industry. The existing literature on this phenomenon has been conducted on a generic basis, where the unit of analysis (i.e. organisations) varies across multiple industries (Paniagua *et al*., 2018) (Jensen & Meckling, 1976). As such, there is no particular focus on the subject matter within the asset management industry, more specifically, in the South African context. Thus, the study shows that asset management firms that appoint an independent non-executive chairman to the board of directors have improved financial performance. The study further provides evidence that supports the corporate governance principle that recommends audit committee members who are independent and possess financial expertise. These results support the view in the literature that qualifications and experience in finance, accounting, audit, and compliance result in better financial reporting and consequently increase financial performance. The study proposes to address the following question:

i) What is the impact of corporate governance principles on the performance of asset management firms in South Africa?

1.3 Research Objectives

This study aims to identify the relationship between corporate governance principles as per the King IV Code of Corporate Governance and the efficiency of the financial performance of asset managers in a South African context. The specific objective is to:

i) Examine the impact of the corporate governance principles on the financial performance of asset management firms in South Africa.

1.4 Scope and Justification of the Study

This study focuses on fund management firms in the asset management industry in South Africa. This study primarily focuses on the principles and recommendations of the King IV Code of Corporate Governance and the impact thereof, if at all, on the financial performance of fund managers.

As per the Companies Act, the corporate and governance structure of a fund manager includes both shareholders and executive management teams (South African Government, 2023). In this context, shareholders entrust management to act in the best interest of the organisation and relevant stakeholders in the effective management of the portfolio of funds. However, management's interests may, in certain instances, conflict with those of shareholders, which, in turn, leads to the principal versus agent issue (Jensen & Meckling, 1976). As such, the delegation of authority over the running of the fund management's business activities to the executive team places shareholders at an information disadvantage, given the lack of oversight over the day-to-day running of business operations.

AUM are a significant input in the calculation of the fixed fees generated by fund managers. As revenue is deemed a key audit matter in this industry, and because AUM serve as a key input in the calculation of revenue, there is a risk that the valuation of the AUM may be incorrect, incomplete, or subject to manipulation with the overstatement thereof having a direct impact on the profitability of the fund. Management may overstate AUM because of the opportunity to do so due to the lack of sufficient internal controls around the processing of the AUM, including controls covering the reconciliation of the AUM report from the administrators to the fund. In addition, there is a risk that performance fees may be overstated because of complex measurement principles, which are ordinarily based on funds meeting performance thresholds that consider the fair value of the investments held by the fund. If the investments held by the

fund are classified as level 2 financial instruments (according to the measurement principle under IFRS 13), there is a risk of overstatement because the valuation (i.e. fair value) of the investments is underpinned by assumptions that consider unobservable inputs which are subject to significant management judgement or bias. Moreover, the overstatement or manipulation of the inputs that drive management fees or performance fees may be rationalised by the executive management team or motivated by personal or organisational circumstances, such as personal financial issues faced by the directors of the company or the performance measurement system of the organisation, which may be significantly based on profitability.

The aforementioned indicates the importance of corporate governance mechanisms that aim to address the deviation in interests between managers and shareholders (Khan, 2011) to create value on a going-concern basis for all relevant stakeholders. As such, gaining an understanding of the relationship between corporate governance and fund manager performance is critical for the long-term survival of the asset management industry

While South Africa has presented opportunities for businesses to grow and yield high returns, some business opportunities have been irresistible, even for multinational companies that should know better. Today, corruption and state capture in South Africa have implicated law firms, software companies, banks, consulting companies, and major accounting practices that include auditors who have a statutory responsibility to maintain independent oversight of organisations within the country (Corruption Watch, 2019). As a result, the motivation of executive management teams to act with professional skills and due care within organisations is currently questionable in a South African context.

For the wider community, the deterioration in the financial performance of fund managers due to poor corporate governance may result in a decline in investments for economic stimuli and sustainable development. Additionally, the financial system's efficiency in mobilising financial resources between investors and borrowers is significantly affected by a potential going-concern risk that would impact fund managers because of poor corporate governance, as these institutions play a critical role as financial intermediaries. Therefore, the achievement of SDGs that address the furtherance of long-term economic growth, the promotion of employment and decent work, the creation of sustainable industrialisation, and the alleviation of poverty are compromised.

1.5 Organisation of the Study

The dissertation consists of five chapters. Chapter 1 introduces the background of the study and the research problem, along with the research questions and objectives. Chapter 2 presents an understanding of prior research in the study area, including the definition of relevant terms, followed by the context of the research area. Furthermore, this section provides corporate governance theories fundamental to King IV's conceptual framework and their relationship with South Africa's regulatory environment. Finally, a thorough review of the empirical literature is presented in this section. Chapter 3 presents the research methodology, which covers the research approach and design. Chapter 4 presents the results of the analysis of the study and the interpretation of the results. The analysis of the study considers descriptive statistics, correlations between the independent and dependent variables, and model diagnostics. Furthermore, this section delves into the results of the regression models. Chapter 5 provides the conclusions and recommendations of the study. This section further discusses how the findings of the study can be applied by companies and corporate governance regulators to improve corporate governance principles for asset managers in South Africa.

CHAPTER 2: LITERATURE REVIEW

2.1 Introduction

This Chapter defines the terms and concepts that underpin the impact of corporate governance on the financial performance of fund managers. This Chapter further presents an overview of the asset management sector, which is a part of the investment industry in South Africa. In addition, there is a thorough discussion of the corporate governance conceptual framework in the South African context, together with theories on which corporate governance principles are based. This Chapter also reviews the empirical literature on corporate governance and its impact on financial performance and presents a conclusion and summary of the empirical literature.

2.2 Definitions of Concepts and Terms

2.2.1 Corporate Governance

The concept of corporate governance was institutionalised in 1991 through the establishment of the Cadbury Committee in the United Kingdom. The Cadbury Committee was established to mitigate growing concerns around accounting irregularities within organisations. Corporate governance has since evolved into a multidimensional principle extending far beyond accounting irregularities. Consequently, there is no blanket definition of corporate governance (Khan, 2011).

Shleifer & Vishny (2007) defined corporate governance as a mechanism that provides a conducive business operating environment that yields a higher likelihood of maximised returns from investments made by capital providers within organisations. La Porta *et al*. (2000) expanded this definition by suggesting that corporate governance consists of policies and procedures aimed at protecting minority shareholder investments from a significant decline in returns.

La Porta *et al*. (2000) further argued that declining investment returns may arise primarily because of the undue influence of the majority shareholders. Conversely, as per the fraud triangle that originates from the Cressey Hypothesis, management may also be motivated by a lack of integrity and self-interest, in addition to two conditions that perpetuate fraud (i.e. an opportunity to carry out fraud and prevailing conditions that help justify unethical action).

The Organisation for Economic Co-operation and Development (OECD, 2004) provides a more comprehensive definition of corporate governance as the relationship between three significant parties: the board of directors, executive management team, shareholders, and other relevant stakeholders in the organisation. The definition is further expanded, stating that corporate governance provides an organisational structure that allows for firm-wide strategic objectives to be set, together with the development and execution of strategic plans that are intended to achieve set objectives. Moreover, the OECD (OECD,2004) states that corporate governance allows for monitoring activities that assess progress towards the achievement of strategic objectives set in line with the purpose of the company.

While it is evident that there are multiple definitions of corporate governance, it is important to note that they all maintain a consistent underlying principle, that is, to address the principal versus agent problem within organisations. The agency problem arises because of multiple factors; however, the genesis of this problem is the existence of information asymmetry between executive management, shareholders, and other relevant stakeholders of the company. Thus, the corporate governance framework aims to mitigate any conflicts of interest that may arise within this business relationship (Jensen & Meckling, 1976).

2.2.2 Financial Performance

An accurate measure of historical financial performance provides organisations with the ability to identify variances that negatively deviate from budgeted or projected financial performance.

Consequently, organisations can better understand the root cause of the variances identified and implement mitigating controls that improve future business performance. The firm-wide financial performance measurement indicators encompass profitability, capital structure, solvency, liquidity, Return on Invested Capital (ROIC), cash flow, and financial market/investor ratios. Notably, as per the Dupont Framework, the return on invested capital ratio includes the Return on Assets (ROA), which analyses the ability of an entity to effectively utilise its assets and resources to generate returns (ROA, n.d).

While the annualised internal rate of return (IRR) over time is the most widely accepted method for measuring fund management returns (Metrick & Yasuda, 2010), the ROA ratio specifically focuses on financial performance measurements from a firm-wide perspective, which allows for a more appropriate analysis of the relationship between corporate governance and financial

performance in the asset management industry. Therefore, IRR is not an adopted measure of financial performance in this study.

2.3 Overview of the Fund Management Industry in South Africa

Asset management is a process in which financial institutions manage client funds through the development and execution of investment strategies to create value and meet client goals. Value creation is achieved through portfolio management, which fundamentally entails the acquisition and risk management of financial assets such as stocks, bonds, and shares in private funds, among others. Asset management firms are granted full trading authority over their clients' invested funds, making asset managers fiduciaries with a legal obligation to act in the best interests of their clients.

As of 2023, there are over 500 asset management firms in South Africa that are independently owned or captives of banks and insurance companies. However, this figure is forecasted to decline by 3 percent over the next five years as a result of a number of rising challenges (RMB, 2023), such as stagnant economic growth, uncertainty related to economic policy due to political instability, and the increasingly negative outlook of the country. The assets managed by these firms represent 5 percent of the total AUM in South Africa, with the migration of these assets to other asset management firms expected to occur in the near term, as a holding of less than R10bn of listed AUM on the JSE by this segment of asset managers is no longer economically viable (RMB, 2023).

South African stocks have performed poorly in recent years, which has led many investors to increase their global equity holdings as opposed to investing in local stocks. This is evidenced by South Africa holding the title of the fifth most under owned market in the global equity market. As of July 2024, domestic multi-asset fund managers held 37.4% of the South African equity market (Momentum, 2024). As a result, larger asset management firms with the means and expertise to assist South Africans in investing offshore benefit from the outflow of funds from smaller asset management firms, further contributing to the reduction in asset manager numbers in the country. Furthermore, investors will now search for areas of the economy where there appears to be growth and expectations of good returns, such as alternative assets, namely, infrastructure-related assets. With South Africa focusing more on pressing economic and social infrastructure needs, infrastructure funds are expected to attract more investors and, as a result, will become a long-running subject in the country (RMB, 2023).

2.3.1 The Business Model

Asset managers pool the funds of their investors, including retail investors, institutional investors, government organisations, the private sector, and high-net-worth clients, and use them to fund different investments in several asset classes spanning individual stocks and bonds, commodities, and alternative investments. Alternative investments may take different forms and structures, such as hedge funds, mutual funds, index funds, exchange-traded, and private equity funds.

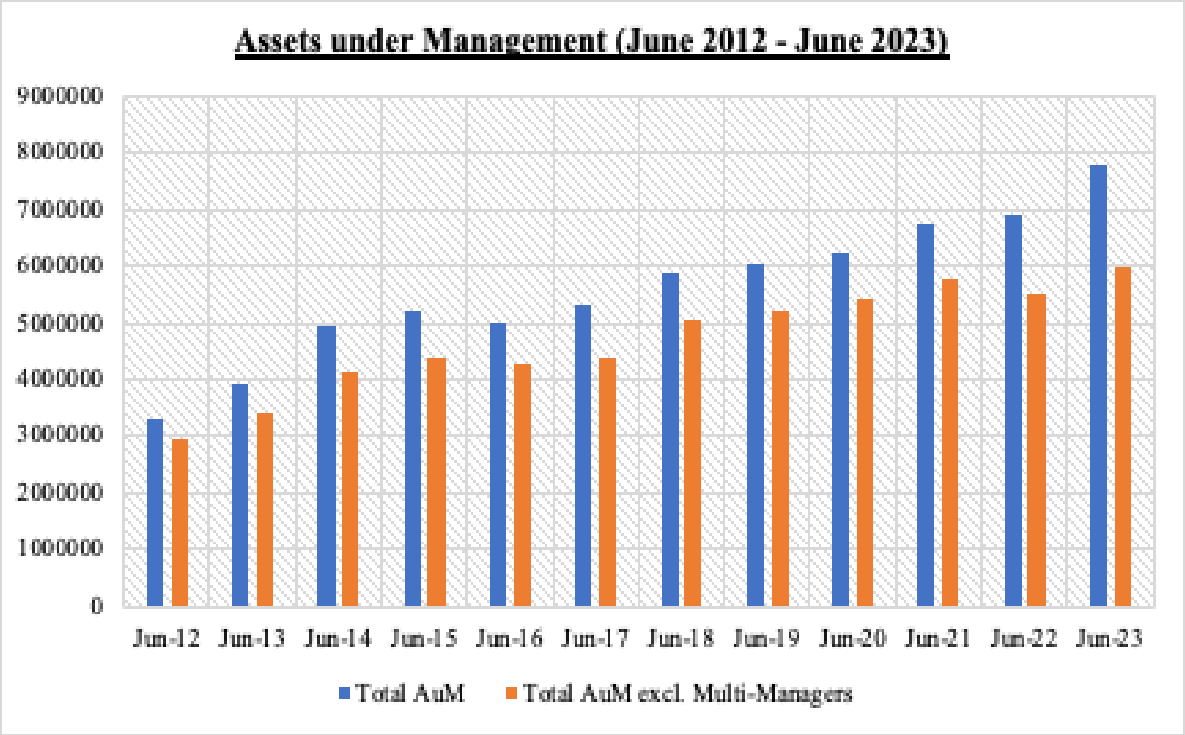
Asset management firms charge their clients a management fee: that is, a percentage of the total assets managed by the firm on the client's behalf. The disadvantage to investors is that fees are collected regardless of the asset manager's performance, which may lead to high exorbitant fees in the long term. However, management fees are fixed because of the high costs of resources and expertise required to run an asset management firm, in addition to the fixed overhead costs incurred in the day-to-day running of the operations.

2.3.2 The South African Asset Management Industry Landscape

In the past few years, the South African asset management industry has grown substantially, with a strong increase of over 100% from 2011 to 2022 in the assets under management. This observed growth is attributable to significant inflows among the ten largest asset managers in the country. The growth of South African multi-managers appears to be steadier than that of single managers, which is indicative of the growing confidence in multi-managers, as more investors diversify their portfolio allocations across various asset classes using varying investment methodologies. This is evidenced by the percentage increase in the total AUM by multi-managers from 14 to 23 percent between 2016 and 2023 (Alexander Forbes, 2023). Figure 1 illustrates the total AUM of single and multi-managers, in contrast to the total AUM, excluding multi-managers, over the past decade.

Figure 1

The total assets under management between 2012 and 2023 in South Africa



Source: Alexander Forbes, 2022, 2023.

According to The Manager Watch Survey (2022), released annually by Alexander Forbes, of the selected sample of 77 managers in the survey, the top 10 held over 60 percent of the total AUM. Ninety-One was noted as the largest asset manager in South Africa. It is noteworthy to mention that the Public Investment Corporation (PIC) was not considered because it is not a private asset manager. In solidifying its number one position in 2022, Ninety-One posted a 13 percent increase in AUM followed by STANLIB AM in second place, which saw a decline of 5 percent in AUM. Sanlam Investment Management outperformed Coronation and ranked third, with a 3 percent growth in AUM from June 2021 (Alexander Forbes, 2022).

While Alexander Forbes Investments occupied seventh position, the company remained the largest multi-asset manager in South Africa. Multi-asset management differs in the investment approach in that it permits the multi-manager to determine and blend multiple asset managers over the different asset classes into a single portfolio solution and seeks diversification across investment strategies, resulting in more stable performance over market cycles compared to single-manager funds (Alexander Forbes, 2022).

The 2023 survey showed no significant changes in the rankings of the various asset managers, with the exception of a notable change in the addition of Satrix to the top 20 asset managers. Ninety-One continued to hold the position of the largest asset manager in the country, followed by STANLIB AM, which maintained the second position from the prior year, with both asset managers experiencing a growth of 6 percent in AUM. Another notable change from 2022 is Coronation, which secured third place with a growth of 8 percent in AUM, which is marginally higher than the 6 percent achieved by both Ninety-One and STANLIB AM (Alexander Forbes, 2023).

Consequently, Sanlam Investment Managers fell to fifth place from third, due to the outperformance of both Coronation and Allan Gray, with the latter experiencing the highest growth in the top five, with an 11 percent increase in assets. Overall, the AUM of the survey participants averaged an increase of 12 percent from June 2022, with a large proportion concentrated in the top ten asset managers. Furthermore, of the total AUM held by the participating asset managers, 62 percent are held by the top ten asset managers. Table 1 illustrates the top 20 asset managers in South Africa as of 2023, and their previous positions between 2022 and 2021. Table 1 includes private asset managers with the exception of PIC (Alexander Forbes, 2023).

Table 1

Top 20 Asset Managers as of 30 June 2023

Rank 2021	Rank 2022	Rank 2023	Change from 2022	Asset Manager	Total Assets under management (R m)	South African Assets (R m)
1	1	1	-	Ninety-One	823367	491115
2	2	2	-	STANLIB AM	649148	564905
3	4	3	+1	Coronation	562831	397331
5	5	4	+1	Allan Gray	526030	326206
4	3	5	-2	Sanlam Investment Managers	494461	444229
6	6	6	-	Old Mutual Investment Group	390024	258545
7	7	7	-	Alexander Forbes Investments	389182	259571
8	8	8	-	Nedgroup Investments	379609	282957
10	9	9	-	Sanlam Multi Managers	343171	237483
9	10	10	-	Taquanta	255130	233215
14	12	11	+1	Momentum MoM	223827	178827
11	11	12	-1	MandG Investments	216291	191100
13	13	13	-	Future growth	194720	194720
12	14	14	-	Momentum AM	175152	170485
-	-	15	N/A	Satrix	161800	130834
15	15	16	-1	Old Mutual Multi-Managers	133639	114552
18	18	17	+1	Prescient	133449	126631
17	16	18	-2	Fairtree Asset Management	128029	122917
21	17	19	-2	Aluwani	122377	122115
20	19	20	-1	Ashburton	120221	114544

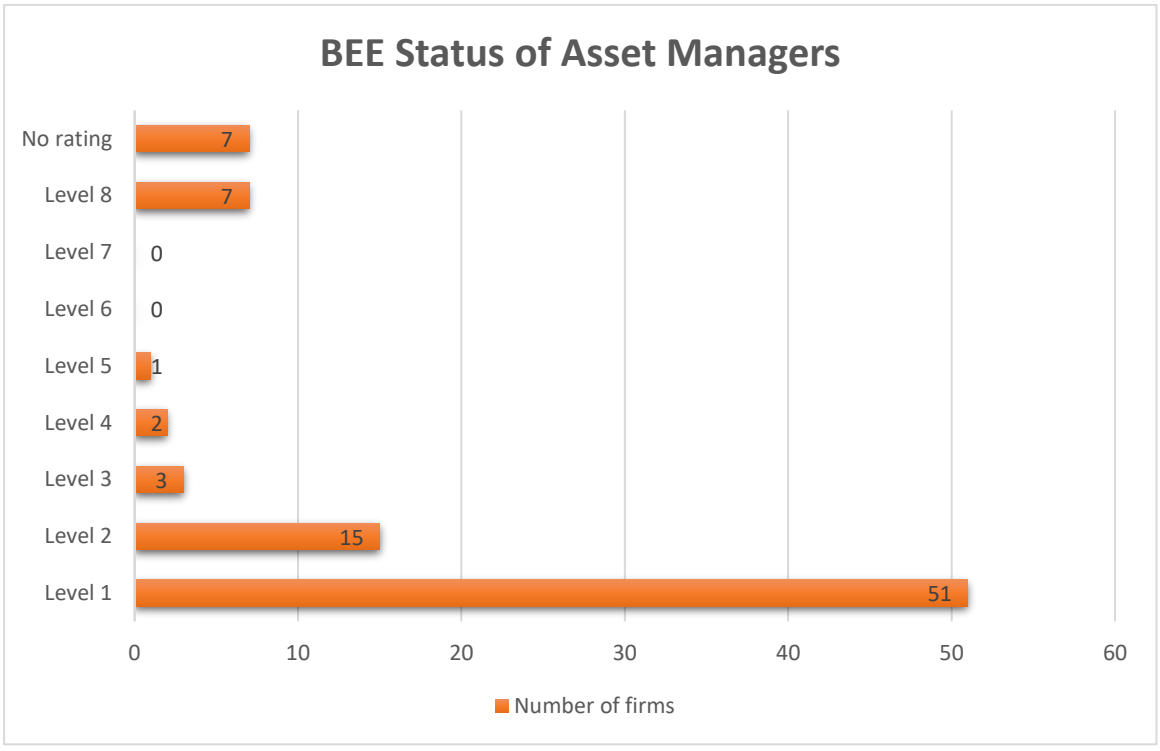
Source: Alexander Forbes, 2022, 2023.

A prominent trend observed in the South African asset management industry is the increase in the number of majority black-owned asset managers. This is evidenced by 19 of the top 20 asset managers with a Level 1 BEE status, with the exception of Fairtree, which held a Level 3 BEE status as of 2022. The trend is carried over in 2023, with 19 of the top 20 asset managers holding a Level 1 BEE status and Fairtree once again being the only exception; however, with a notable improvement to a Level 2 BEE status. The persistence in the distribution of AUM as of 2023, which indicates a high concentration among Level 1 and Level 2 contributors, was also observed in 2022, as indicated by a concentration of 65 percent for Level 1 and 29 percent for Level 2 BEE contributors in AUM (Alexander Forbes, 2022).

Additionally, the top five majority black-owned asset managers had a 2 percent increase in assets by 2022. Prior to this, significant growth in the AUM of the top five black-owned managers was observed from 2020 to 2021, with the growth attributable to Sanlam Investment Managers arrival in the asset management industry. Sanlam Investment Managers is the largest black-owned asset manager in South Africa, accounting for 52 percent of the country's top five black-owned managers' total assets by 2022 (Alexander Forbes, 2022).

Figure 2

The BEE status of the participating firms as of 2023



Source: Alexander Forbes, 2023

2.3.3 The Performance of the South African Asset Management Industry

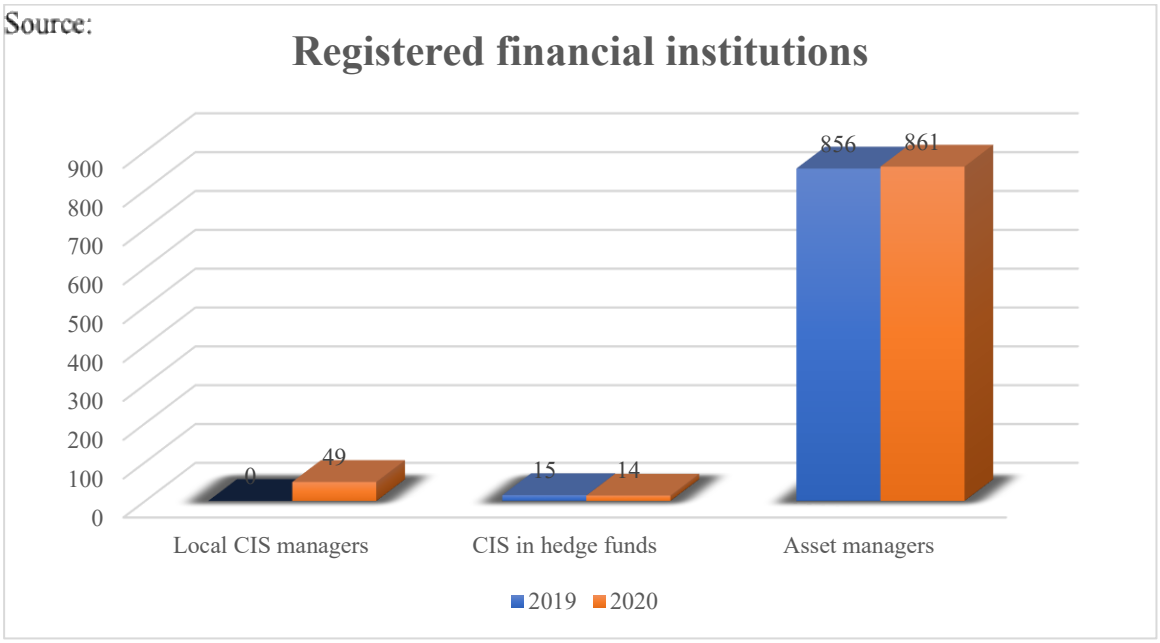
The South African asset management industry is comprised of Financial Advisory and Intermediary Services (FAIS) asset managers, investment administrators, and Collective Investment Schemes (CIS) (FSCA, 2022). The asset classes managed and administered by the asset management industry include equities, bonds, alternative investments, and hedge funds. The Financial Sector Conduct Authority (FSCA) regulates collective investment schemes under the Collective Investment Scheme Control Act 45 of 2002. Included under the supervision of the FSCA are the investment activities of 861 asset managers and 49 local CIS managers that manage a total of 1727 portfolios, one CIS in property approved, two in participating bonds, and 14 in hedge funds (FSCA, 2022).

In serving millions of South African consumers, the industry has simultaneously experienced continued growth in the number of consumers, investment activities, and total AUM. The growth in assets under management in CIS, which includes securities and hedge funds, equated to a 5 percent compounded annual growth rate (CAGR) for the period 2016 to September 2021, and private equity funds experienced a growth of 5 percent CAGR between 2015 and 2020 (FSCA, 2022). Furthermore, venture capital has also seen an increase over the past decade, and more notably, a R5.6 billion investment by fund managers in early-stage opportunities between 2016 and 2020 (FSCA, 2022).

Collective investment schemes are pools of funds that are managed on behalf of investors according to specific investment objectives that have been established for the scheme. CIS acquire a participatory interest in a portfolio of the scheme and in return investors share risk and receive shares, units, or any other form of participatory interest that represent their pro-rata share of the pool of funds (FSCA, 2022). In April 2015, the CIS held in hedge funds was subject to regulation, after it was determined to fall under collective investment schemes. These types of funds deploy a multitude of strategies, including leveraging or short investment positions, which could lead to a total loss larger than the total market value of the fund. Asset managers are granted FAIS licenses and manage assets on behalf of their clients for the sole purpose of making investment decisions that increase the value of their client portfolios (FSCA, 2022).

Figure 3

The number of registered financial institutions



Source: Financial Services Conduct Authority, 2022.

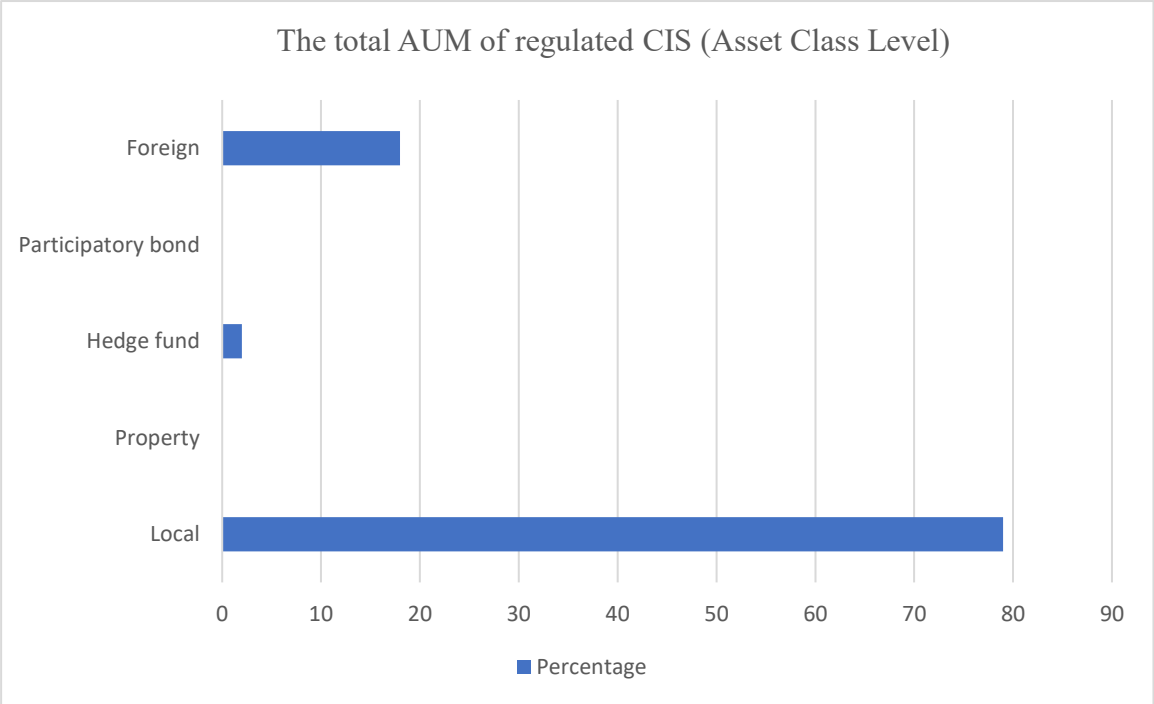
The investment industry has approximately R4.26 trillion AUM as of September 2021, of which 79 percent were held under local CIS, 18 percent by foreign CIS, and 2 percent by CIS in hedge funds. CIS in property and participatory bonds held assets to a total value of R6,2 billion in 2021 but, compared to local and foreign CIS in securities and hedge funds, they do not account for a significant portion of the assets in the industry. Furthermore, the majority of the property fund investment market is situated within Real Estate Investment Trusts (REITSs). Notably, the market capitalisation of publicly traded REITs in South Africa amounted to nearly R200 billion by the end of September 2021, which was significantly lower than the high value achieved in 2017 of R400 billion (FSCA, 2022).

During 2016 to September 2021, the growth in CIS securities and hedge funds was 9 and 7 percent CAGR, respectively. Significant growth was observed in exchange-traded funds (ETFs) and exchange-traded notes (ETNs); however, they constitute only a small portion of the total CIS market. The ETF SA report *State of the South African Exchange Traded Product Industry* reported the market value of the 85 ETFs and 69 ETNs to be at R125.5 billion at the last day of September, 2021.The interest in passive funds, which are generally synonymous with lower costs, is reflected in the growth in market value experienced since 2016, with CAGR at 11.29

percent. Additionally, commodities and added foreign exposure have attracted investor interest in the years leading up to September, 2021 (FSCA, 2022).

Figure 4

The total value of regulated CIS at asset class level



Source: Financial Services Conduct Authority, 2022.

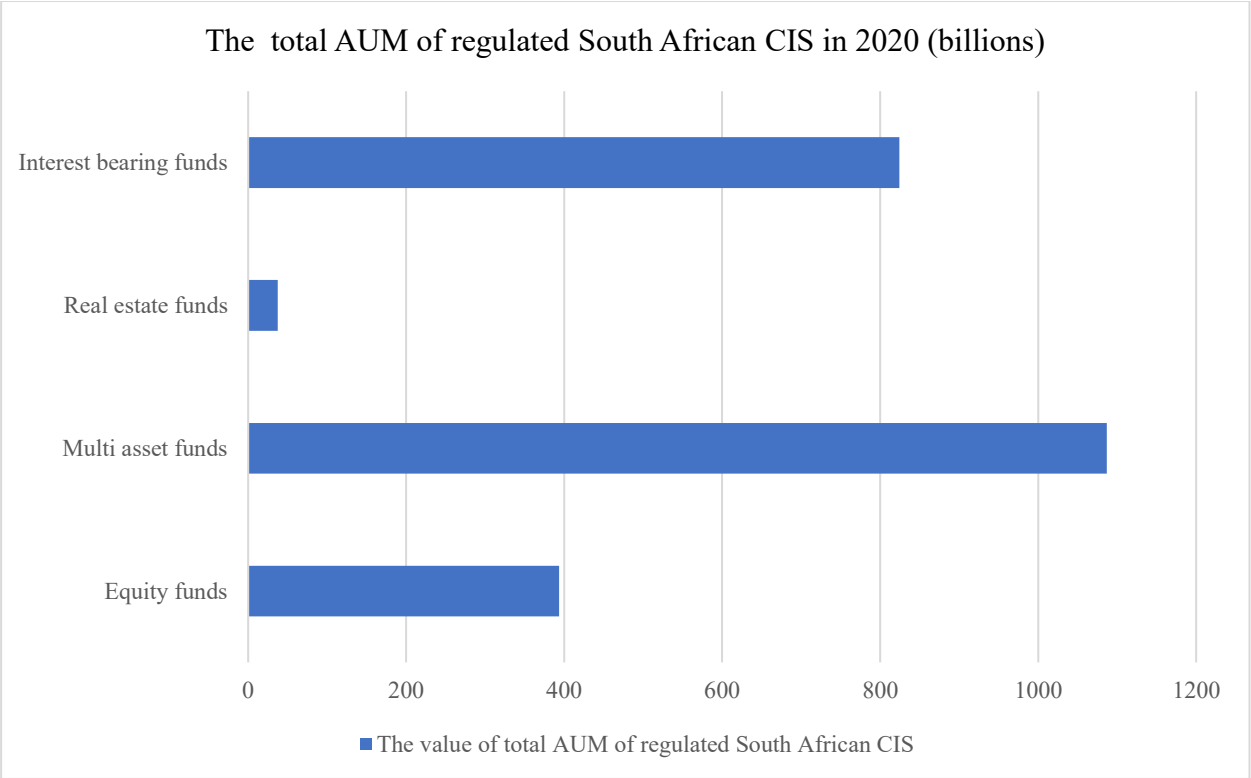
In analysing the identified investment patterns within the industry, it appears that institutional investment is the preferred choice for investors. This is evidenced by the fact that 63 percent of the local CIS assets under the management of members of the Association for Savings and Investments South Africa (ASISA) were held by institutional investors (FSCA, 2022). Institutional investors invest in pooled funds sourced from multiple investors, and the remainder of the assets under management in local investment schemes are held by retail investors or traders that invest through brokerage firms (FSCA, 2022).

Moreover, multi-asset funds hold a significant portion of the AUM with the local CIS. Multi-asset funds give financial investors the ability to invest in a blend of asset classes, including real estate, money market instruments, equities, and bonds, thus providing a greater level of diversification. The total assets under management by the South African CIS held in multi-asset funds revealed a CAGR of 5 percent between 2015 and 2020. The growth in these figures

indicate the changing financial and economic landscapes and the subsequent need for risk aversion from investors to adapt (FSCA, 2022).

Figure 5

The total AUM of regulated South African CIS in 2020



Source: Financial Services Conduct Authority, 2022.

Although the private equity industry has experienced high levels of growth over the past 20 years, it has become more volatile. This is evidenced by the significant decline in investments from 2008 to 2009, with investments falling from nearly R16 billion to R7.2 billion. However, the industry recovered well, as evidenced by the approximately 100 percent growth in investments to R13.9 billion in 2013. By 2020, the market value of investments was R14.5 billion: however, this was a significant decline from R25.4 billion in the previous year. The percentage of new investment deals compared to follow-on investments fluctuated year-on-year, with 60 percent of investments in 2017 constituting new deals and 57 percent of investments in 2018 as follow-on investments. Furthermore, the frequency of deals continued to increase from 2014, with the total number of deals amounting to 818 in 2018, indicating an even split between new deals and follow-on investments (FSCA, 2022).

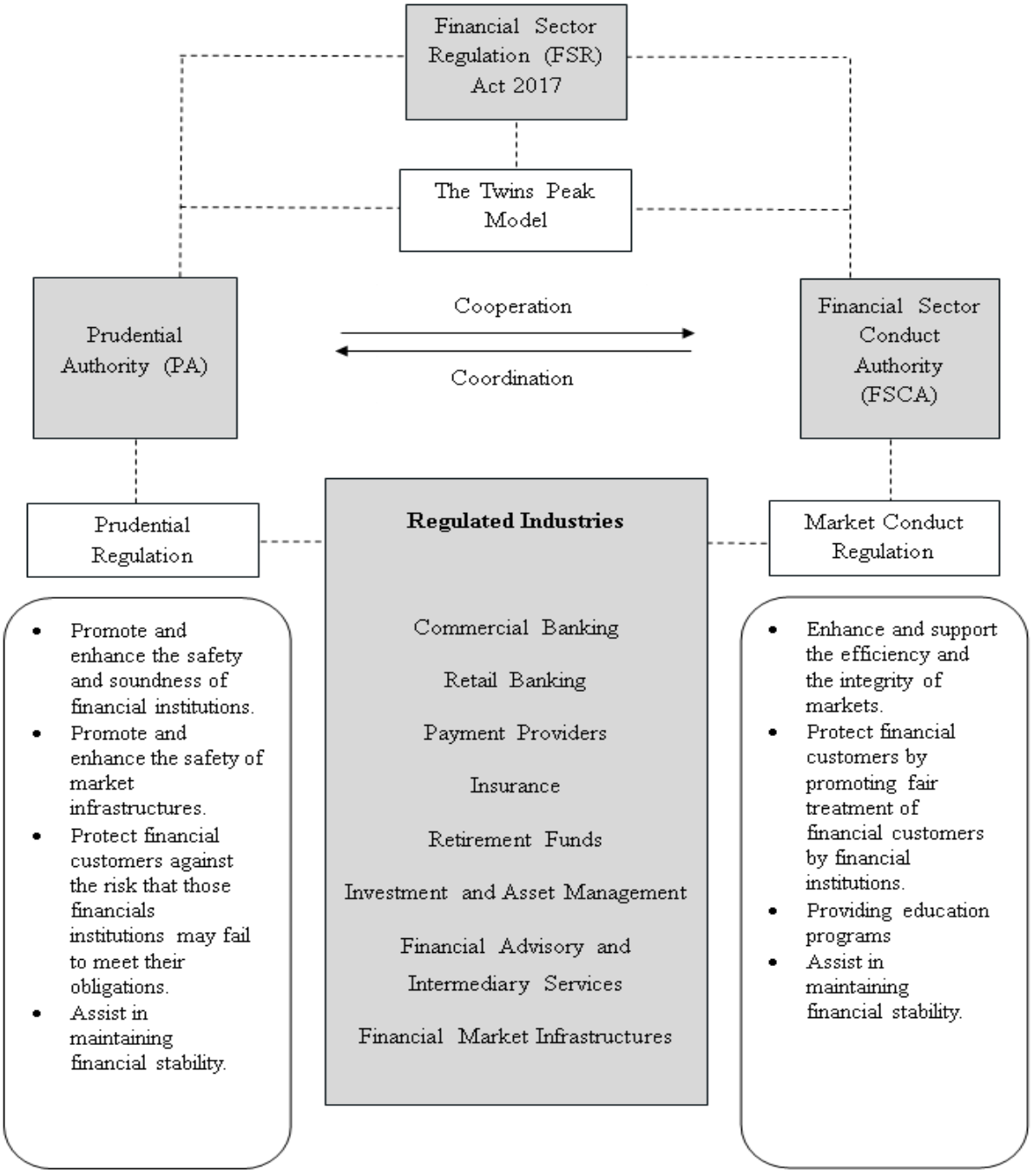
Venture capital investment is still in its infancy but is rapidly growing. This is indicated by the 35 percent CAGR in the value of new investment deals from 2015 to 2019. Furthermore, the number of deals concluded increased from approximately 100 in 2015 to 180 in 2019. Venture capitalists can be described as private equity investors who predominantly invest in start-ups or companies in the early growth phase, exhibiting the potential for high growth, which helps address the limited access to financing and capital that remains a bottleneck for such businesses. The value of deals finalised in 2019 amounted to R1.3 billion which translated to a 21 percent increase with the agricultural sector benefiting from the highest investment, followed by fintech's (technology enabled financial service providers). However, it should also be noted that an extensive amount of these funds was funnelled into late-stage investments. Furthermore, venture capital funds intended to support early-stage businesses constitute only 2 percent of the funds devoted to later-stage investments (FSCA, 2022).

The need for more risk capital to fund start-ups before a proposition is established remains an issue. Deploying more funds to early startups can enhance innovation and competition within the sector. Only 41 percent of start-ups received funding solely from local funds, 45 percent of start-ups were funded by local and foreign investors, and the remaining 14 percent were exclusively funded by foreign investors. Local and foreign co-investment is both vital and beneficial, as foreign investors provide access to international markets and local providers of funds are crucial in identifying and developing domestic start-ups to bring in foreign partners (FSCA, 2022).

2.3.4 The Regulatory Environment of the Asset Management Industry

Figure 6

The regulatory landscape of the South African financial system



Source: Financial Services Conduct Authority, 2022.

The South African investment and asset management industry comprises FAIS asset managers, investment administrators, and CIS and forms part of the South African financial services sector. The sector is governed by the Financial Sector Regulation (FSR) Act of 2017, which follows a Twins Peak regulatory model. The Twins Peak model is an intrusive, intensive, and effective form of regulatory and supervisory framework within the financial sector, underpinned by the Prudential Authority (PA), that is, the first peak, and the FSCA, which is the second peak. After the 2008 global financial crisis, the Twins Peak model aimed to provide financial regulations that promote financial stability and ensure the fair treatment of customers. In addition, inclusion and transformation within the South African financial sector are the key objectives of the Twins Peak model, which is of fundamental importance in the South African context. Moreover, the Twins Peak regulatory model aims to achieve a pervasive regulatory framework across the financial sector, thereby mitigating historical regulatory gaps. This objective is achieved through supervisory and regulatory laws that are standardised, integrated, consistent, and complete across the entire financial sector (FSCA, 2022).

2.3.4.1 The Prudential Authority

The explicit mandate to maintain and enhance financial stability is bestowed on SARB by the FSR, which has consequently delegated the administration of the prudential regulator (i.e. prudential authority) to the SARB. In executing this mandate, the PA is responsible for promoting and enhancing the trust, integrity, and soundness of financial institutions (e.g. banks and insurers) and market infrastructure (such as clearing houses, central securities depositories, central counterparties, trade repositories, and exchanges). In addition, the PA is responsible for protecting customers against the going-concern risks of those institutions as a result of insolvency or illiquidity, which inherently carries out the PA's primary responsibility of maintaining financial stability (SARB, 2024).

2.3.4.2 The Financial Services Conduct Authority

Conceptually, the FSCA focuses on the regulation of market conduct within the financial sector. This responsibility entails the promotion of financial market efficiency and integrity, fair customer treatment by financial institutions, and the provision of financial education and financial literacy. This ensures that consumers are treated fairly and that financial markets operate with integrity, thus mitigating issues such as collusion and anticompetitive practices.

Additionally, through collaboration with other regulatory bodies, the FSCA assists in maintaining financial stability.

i) Treating Customers Fairly Framework:

The framework underpinning the mandate for the promotion of fair treatment of customers in the financial services sector is the Treating Customers Fairly (TCF) framework. The TCF Framework informs financial institutions of the principles that are to be adhered to in the furtherance of this objective when performing transactions with consumers in the sector. Financial Services organisations must meet six principles that are prescribed in the framework to achieve "fairness outcomes". The TCF framework takes a step further and requires appropriate measurement principles for the “fairness outcomes” such as customer attrition rates or the ease of access and maintenance of a complaint register within an organisation which helps provide more context on the issues that customers are facing with the financial products, what encourages the customers to cancel the financial products and whether the organisation addresses the concerns by putting in controls that detect and prevent future concerns (FSCA, 2022).

The framework is a moral-based approach to regulation and supervision that ensures that the fair treatment of customers is embedded in the culture of the organisation (TCF Outcome 1) and that financial retail market products meet the needs of identified customer groups (TCF Outcome 2). Furthermore, to achieve fairness, organisations must be transparent and provide information that is relevant, complete, and accurate, thus affording customers the opportunity to make informed decisions (Outcome 3). Organisations must maintain professional competence and due care in the provision of financial products and transaction advisory, which entails considering the unique facts and circumstances of each client (Outcome 4). Additionally, customers must experience professional behaviour and services with acceptable standards that ensure that product performance meets client expectations (Outcome 5). Lastly, organisations must provide customers with the ease of submitting claims, complaints, or assistance with requests that relate to making reasonable changes to an existing product offering with the firm (FSCA, 2022).

ii) Financial Advisory and Intermediary Services Act, 2002 (FAIS Act)

The FSCA introduced the FAIS Act, which provides codes of professional conduct to authorised financial service providers (FSPs) when transacting with consumers. The Act fundamentally requires FSPs not to bring the financial services sector to disrepute by providing

professional services and protecting customers from maltreatment in the provision of financial products and financial transaction advisory. The Act achieves this objective by following a functional regulatory approach as opposed to an institutional regulatory approach. As such, the FAIS Act has a specific interest in regulating and implementing enforceable laws on specific functions of the financial services industry, which is in contrast to regulating all functions of an entire sector (i.e., the Bank Act). The key players in regulating and enforcing the FAIS Act are the FSCA, FSPs, and their representatives who are licensed by the FSCA to provide financial products and financial transaction advisory and compliance officers, whose main duty is to ensure that the FSP complies with the FAIS Act. The fundamental principles of FSPs in the FAIS Act are integrity, financial security and stability, professional competence and due care, professional behaviour, and operational ability (FSCA, 2022).

2.3.4.3 Pension Fund Act, 1956 (Regulation 28)

Among other investors, FAIS asset managers act in a fiduciary capacity for institutional investors, including pension funds. As such, asset managers have an obligation to inherently comply with the provisions of the Pension Fund Act as per the investment mandate of the institutional investor. The Pension Fund Act provides for the registration, incorporation, regulation, and dissolution of pension funds. In addition to this, the Pension Fund Act protects the rights of members and prescribes minimum solvency standards. The Pension Fund Act prescribes two components: Section 37C, which relates to death distributions, and Regulation 28, which promotes sound and responsible investments by retirement trustees. Furthermore, Regulation 28 specifies the maximus in which members' funds should be invested to prevent excessive concentration risk. Regulation 28 prescribes quantitative limitations that stipulate the extent to which funds can be invested in various asset classes. On the other hand, the qualitative limitations focus on the nature of the asset classes that can be invested in or the region (i.e. the extent of investable funds within local or foreign regions). The most recent amendment to Regulation 28 was implemented to allow for a maximum of 45 percent, an increase of 15 percent in aggregate investment exposure in foreign assets. Interestingly, there was no notable change in offshore investments despite the amendment to the Act (Alexander Forbes, 2022).

2.3.4.4 The Financial Intelligence Centre

i) Financial Intelligence Centre Act, 2001 (FICA):

The Financial Intelligence Centre (FIC) was established under the Financial Intelligence Centre Act (FICA) No. 38 of 2001. FICA is also supported by other relevant legislation, including the Prevention of Organised Crime Act of 1998 and the Protection of Constitutional Democracy against Terrorist and Related Activities Act of 2004. The FICA's objective is to mitigate South Africa's economy from being downgraded, marginalised, and blacklisted. The primary mandate bestowed on FICA is to identify the proceeds derived from crime and to assist in combating money laundering and the financing of terrorism. The centre achieves this by requiring all accountable and reporting institutions operating in South Africa to register with the FIC, including banks, lawyers, FSP's, Credit Providers and Foreign Exchange Dealers among others. However, all organisations operating in South Africa are required to report suspicious or unusual transactions to the FIC. Asset management firms play a key role and act as conduits for significant financial flows in the South African economy, therefore, as per Schedule 1 of the FICA Act, Asset Managers are accountable institutions and are therefore obligated to comply with the legislative requirements of the FICA (South African Government, 2024).

2.3.4.5 Companies Act, 2008

The Companies Act No. 71 of 2008 is responsible for prescribing regulations on the formation, administration, and dissolution of companies and further enforces regulations on the public offering of company securities. Among other significant regulations, the Act stipulates laws on fundamental transactions of companies, takeovers, and offers.

i) The Companies and Intellectual Properties Commission:

The Companies and Intellectual Property Commission (CIPC) is an agency of the Department of Trade and Industry in South Africa and was established by the Companies Act No. 71 of 2008 as a juristic person to function as an organ of the state in terms of public administration and to operate as an institution outside of public service. The CIPC is responsible for the registration and maintenance thereof of companies, cooperatives, and intellectual property rights (i.e. trademarks, patents, designs, and copyright). The CIPC must further disclose the information of its business registers to the public and promote education and awareness of the company and intellectual property law. Furthermore, through its administration, the CIPC serves to effectively enforce legislation and promote efficiency in compliance with relevant legislation, in addition to monitoring compliance with relevant financial reporting standards (South African Government, 2024).

ii) The Takeover Regulation Panel:

As the CIPC plays a significant role as a barrier or entry into various industries of the South African economy for organisations, as a form of segregation of duties, Section 196 of the Companies Act established a regulatory body, that is, the Takeover Regulation Panel (TRP). As per section 201 of the Companies Act, the TRP is a juristic person responsible for the regulation of merger and takeover transactions that meet the definition of "affected transactions" (South African Government, 2024).

One of the mandatory regulatory requirements governing affected transactions is the disclosure of certain share transactions. Section 122 of the Companies Act requires the acquisition or disposal of 5, 10, 15, or any further multiples of 5 percent of the issued securities of that class in the investee by the holder to be reported and disclosed to the TRP and JSE. Holders include individuals and, importantly, asset managers, which are also prohibited from acquiring a shareholding of more than 35 percent in listed investee companies, unless exempted by the TRP. As such, the TRP promotes transparency and integrity in the asset management industry (South African Government, 2024).

As evidenced above, South Africa has designed an appropriate regulatory framework for the financial services industry. The FSB was previously mandated with dual authority to oversee the conduct and prudential concerns of financial institutions other than banks, with the prudential authority overseeing the financial stability of banks and not the conduct thereof. However, after the global financial crisis, the FSCA, a robust regulatory architecture that recognises and oversees the prudential issues of companies as well as market conduct across the board, was a mandatory development in the South African context. As such, asset managers operate in a highly regulated industry from both a financial stability and market conduct perspective, with conduct underpinned by various frameworks, such as the Treating Customers Fairly Framework (TCFT).

2.4 Theoretical Framework

This section discusses the philosophies and theories underlying the concept of corporate governance and begins with a review of the agency and stewardship theories. The agency theory acknowledges the existence of differentiating interests between principals and agents, whereas stewardship theory notes the absence thereof and puts forward the existence of a common interest between the relevant parties. Furthermore, this section reviews the theories of corporate

governance that have contrasting principles on the prioritisation of shareholder interests or the interests of all relevant stakeholders of the organisation, thus providing a deeper understanding of what it means to create sustainable value within an organisation.

2.4.1 The Agency Theory

The agency theory primarily refers to the relationship between the principal and agent. In the business context, shareholders hold the position of the principal, whereas the executive management team holds the position of the agent (Jensen & Meckling, 1976). The nature of this relationship requires the agent to act on behalf of the principal through a delegation of authority (Jensen & Meckling, 1976), which relieves shareholders from the day-to-day running of business operations and further facilitates the effective management of organisations by executive management teams due to autonomy.

However, it is important to note that a multidimensional agency problem arises when authority is delegated to the executive management team (Jensen & Meckling, 1976). First, there is the potential risk of an information disadvantage towards shareholders that may give rise to the inadequate awareness or lack of knowledge about any underlying issues within the organisation that may pose a significant risk to the income-earning capacity of their capital investments.

Second, there is the risk of goal incongruence between shareholders and management, which gives rise to a conflict of interest between the two parties (Shapiro, 2005). The nature of this conflict exposes the organisation to a going-concern risk, as the decisions made by the executive management team may not be in the best interest of the company and its stakeholders. In this context, managers are more inclined to make unsustainable short-term decisions to achieve short-term goals that are likely to be encouraged by a firm's short-term performance measurement system. As a result, the potential negative impact on the long-term goals of the company poses a significant threat to the future growth prospects and value creation process of any organisation.

2.4.2 Stewardship Theory

Stewardship theory states that executive management team members are regarded as the stewards of the organisation. In a business environment, stewardship is an ethical value that embodies responsibility for the planning and management of company resources (Davis *et al*., 1997). Therefore, the executive management team is expected to inherently act in the best

interest of the organisation by applying professional skills and due care in the execution of their fiduciary duties (Ahmadalipour *et al*., 2019); (Davis *et al*., 1997). It is noteworthy that stewardship theory, in contrast to agency theory, suggests that the objectives of the shareholders and that of the management team are congruent, which puts forward the absence of a conflict of interest between the two parties (Ahmadalipour et al., 2019). For this reason, there is an expectation that the strategic plans that are implemented by management align with the strategy of the organisation and consider the interests of shareholders.

2.4.3 Shareholder Theory

Shareholder theory states that because shareholders identify with the organisations in which they invest in as income-bearing property, the primary duties of the executive management team should, therefore, further the dominant interests of shareholders (Moore, 1999). As a result, the interests of other relevant stakeholders are deemed not to be a significant priority in the value creation process of the organisation, but rather an inherent benefit of maximising shareholder wealth (Moore, 1999).

2.4.4 Stakeholder Theory

In contrast to shareholder theory, stakeholder theory states that companies have a responsibility to consider and prioritise the equal interests of all the relevant stakeholders within an organisation and not that of the shareholders alone (Clarke, 1998). Stakeholders play a critical role in facilitating the creation of value within an organisation by providing resources that serve as inputs to the business model. As such, it is more likely than not for stakeholders to be directly impacted by the business activities of organisations (Clarke, 1998). While it is difficult to meet the interests of all relevant stakeholders, organisations are encouraged to perform a trade-off analysis that determines the highest yield of value created for the majority of the organisation's stakeholders (IIR Framework, 2021).

2.5 The Corporate Governance Framework in South Africa

2.5.1 Brief History of Corporate Governance in South Africa

In South Africa, corporate governance is governed by the King Code of Good Governance Report, which was first issued in 1994 (van Zyl & Mans-Kemp, 2020). This was followed by the issuances of King II, King III, and King IV in 2002, 2009, and 2016, respectively. From a

global perspective, the King Report was the second corporate governance report issued after the Cadbury Report by the UK in 1992 (Cheffins, 2011).

The King IV report is based on the stakeholder theory for organisational responsibility, as opposed to the shareholder theory that underpins the Cadbury report (Shah et al., 2017). The King IV report is also based on the dire socioeconomic environment that was and is still faced by many South African citizens today as a result of apartheid. While the Apartheid system came to an end in 1994, its existence has had an impact that ensued far beyond its repeal. The complex socio-political past was reinforced by a financial system that benefited the white minority and the wealthy, which led to the financial exclusion of the majority of the black community.

Moreover, financial exclusion has had an even greater impact on women and children who endure the lower end of income inequality in South Africa (Wentzel *et al*., 2016). Therefore, a shareholder-centric governance approach would not have been appropriate in the South African context. Understandably, the King IV report places a significant focus on the ethical and effective leadership of organisations, with great emphasis placed on the importance of the role of the board of directors as stewards for this form of leadership (IoDSA, 2016).

2.5.2 The Fundamental Concepts and Philosophies of King IV

i) Concept 1: Stakeholder-inclusive approach for organisational responsibility

King IV follows a stakeholder-inclusive approach to corporate governance; therefore, those charged with governance are not solely accountable to the shareholders of the organisation. Consequently, the interests of the other relevant stakeholders of the organisation are equally dominant within the value-creation process (IoDSA, 2016).

ii) Concept 2: Integrated Thinking

To ensure the smooth facilitation of stakeholder inclusivity theory, an appreciation by the board of directors of the interdependence that exists between the capital resources used as inputs within an organisation's business model is required (IoDSA, 2016). This concept is known as Integrated Thinking, and the capital resources referred to include financial, natural, manufactured, human, social and relationship, and intellectual capital (IIR Framework, 2021). Consequently, the adoption of integrated thinking within a business model helps create value for all stakeholders within the short, medium, and long-term horizon.

iii) Concept 3: Sustainable development

King IV is driven by the main objective of sustainable development (IoDSA, 2016). Integrated thinking promotes a more comprehensive and long-term thinking approach to management's decision-making process, which is conducive to a capital trade-off analysis process that determines whether the business activities of the organisation have a positive impact on the capitals on an overall basis (IoDSA, 2016). Consequently, the adoption of integrated thinking within a business model helps create value for all stakeholders while minimising the negative impact of the organisation's business activities on the six capitals. Therefore, it is evident that integrated thinking is aligned with the concept of sustainable development which reads: "the development that meets the needs of the present without compromising the ability of future generations to meet their needs." (Emas, 2015).

iv) Concept 4: The organisation is a corporate citizen and an integral part of society

King IV states that it is the Board's responsibility to ensure that an organisation is seen as a responsible corporate citizen. Therefore, organisations have rights and obligations that are similar to those of a natural person (IoDSA, 2016). Consequently, organisations have a legal and ethical right to operate in South Africa; however, there is an equal legal obligation for the organisation to operate under the compliance of the laws and regulations that govern Southern Africa and to operate ethically (IoDSA, 2016). Moreover, as an integral part of society, organisations should act in the best interests of the relevant stakeholders in accordance with societal norms (IoDSA, 2016).

v) Concept 5: Effective and ethical leadership

King IV is significantly concerned with the effective and ethical leadership of an organisation by those charged with governance. Effective leadership is defined as governance that is results-oriented, such that it ensures that the strategic objectives of the company are met and that value is created for all relevant stakeholders of the organisation (IoDSA, 2016). In addition, the Board of Directors is required to lead ethically based on characteristics that embody integrity, competence, responsibility, accountability, fairness, and transparency (IoDSA, 2016).

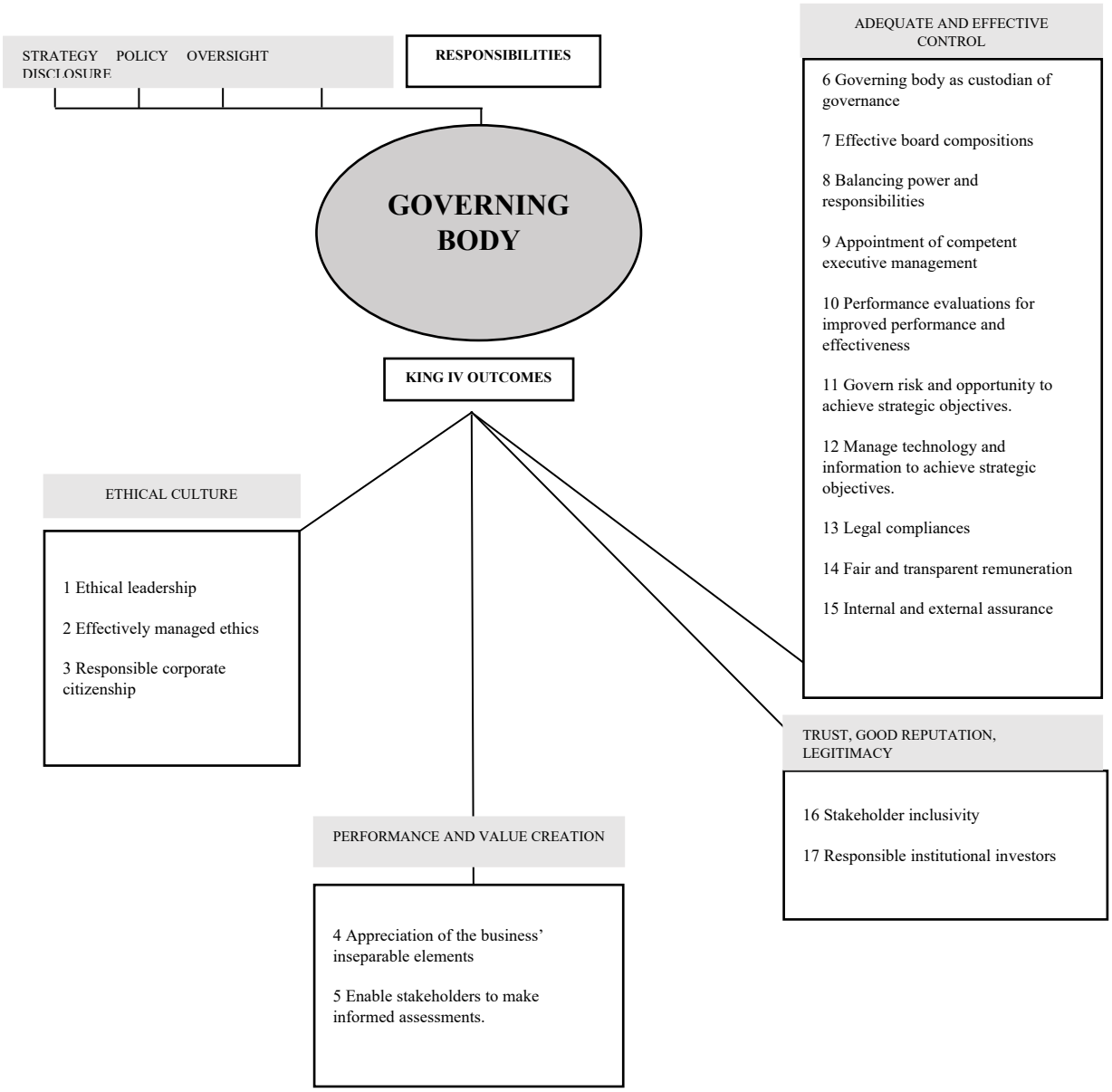
2.5.3 King IV: An Outcomes-Based Governance Approach

The King IV code is an outcomes-based corporate governance framework that aims to create legitimate and effectively controlled organisations that boast an ethical culture and good performance (IoDSA, 2016). While it may not be mandatory for South African companies to

report on the performance of King IV governance outcomes, the reporting thereof within the organisation's integrated report provides sufficient and relevant information that is material to the decision-making process of the stakeholders. Figure 7 below provides an illustration of King IV's corporate governance outcomes and the principles that underpin the outcomes.

Figure 7

The King IV Corporate Governance Outcomes



Source: IoDSA, 2016

2.5.4 The Relationship between Governance and Regulation in South Africa

i) Legislation or Common Law:

South African listed companies are subject to a robust governance framework comprising codes of best practice, regulation, common law, and statutes. Private, public, personal liability, and non-profit companies are constituted in accordance with Companies Act 71 of 2008 and the Memorandum of Incorporation, which documents the company's capacity, legal powers, and governance structure (South African Government, 2023). However, it is important to note that while governance can be comprehensively legislated, it does not resolve governance issues that have occurred in the past and present.

Legislation imposes compliance with good governance within organisations as a minimum requirement, whereas codes of good practice aim to inspire organisations to further achieve good governance above the minimum requirements set out by legislation. King IV achieves this by having an appreciation of the purpose of the organisation within society, which subsequently encourages a move from a for-profit organisational strategy to a for-impact organisational strategy.

ii) Hybrid – regulation:

Organisations with securities listed on the stock exchange are classified as public interest entities and are subject to additional regulations instituted by the JSE and the Independent Regulatory Board for Auditors. As such, compliance with King IV is a mandatory listing requirement for public companies in this context.

iii) Market and Social Forces:

Market and social forces further informally regulate corporate governance based on legitimacy and reputation (Jonty *et al*., 2018). This is demonstrated by how investors make investment decisions that take into consideration the historical corporate governance issues that negatively impact financial and operational performance, in addition to considering the going-concern assumption of the organisations they intend to invest in (Gillan & Starks, 2003).

Furthermore, customers are also likely to support organisations that have a positive brand value (Hess, 2008). As such, high-quality service delivery and the use of sustainable raw materials in the production process are among the organisational characteristics that have become increasingly important to consumers. Lastly, the steep increase in corporate governance failures

has resulted in the media playing a critical role in reporting on the credibility of the corporate governance structure of many organisations (Jonty *et al*., 2018). Therefore, it is evident that market and social forces reinforce the provision of relevant and material information that would otherwise not be disclosed to stakeholders by the organisation.

2.6 Review of Empirical Literature

2.6.1 Corporate Governance and Financial Performance: a cross-sector study.

The relationship between corporate governance and financial performance remains highly investigated in business management and financial accounting literature. As the world adopts an increased imperative for sustainable development and with corporate governance identified as a critical conduit towards the achievement of this objective, extensive research has been conducted to meet the needs of managers, as they face uncertainty in the ever-changing, integrated, and complex current economic and business environment. However, there remains a gap in the historical literature on the impact of corporate governance on the financial performance of asset management firms. Therefore, this study investigates this phenomenon from a cross-sectoral perspective.

Affes and Jarboui (2023) examined the relationship between corporate governance and financial performance in the United Kingdom, focusing on internal corporate governance mechanisms and their impact on the financial performance of organisations across various business sectors. In their study, Affes and Jarboui (2023) cast significant importance on the role of the different characteristics that are concomitant within different business sectors and the associated impact of the unique economic and operating environment that influence the relationship between corporate governance and financial performance.

Affes and Jarboui (2023) opted to use corporate governance scores as a proxy for corporate governance mechanisms, which better reflects managerial, strategic, and CRS characteristics comprehensively, as opposed to adopting two or more simple corporate governance mechanisms for the study. In addition, Affes and Jarboui (2023) identified the size, age, and leverage of the UK firms in the sample as control variables for this study. From a financial performance perspective, this study was restricted to Return on Equity (ROE) as a key performance indicator, with panel regression as the analytical model applied to analyse the relationship between the independent and dependent variables. Using the feasible generalised least squares (FGLS) method as the estimation technique of the panel regression, Affes and

Jarboui (2023) found a positive and significant relationship between CGS and financial performance from a sample of 160 listed companies on the London Stock Exchange across six sectors: Health, Technology, Basic Consumption, Secondary Consumption, Raw Materials, and the Industrial sector. This study is consistent with the fundamental concept of agency theory and further indicates the importance of corporate governance and its impact on financial performance, irrespective of the operating environment of an organisation (Affes & Jarboui, 2023).

2.6.2 Corporate Governance and Financial Performance: an emerging economy study

As there is insufficient literature evaluating the impact of corporate governance on the financial performance of asset management firms, this study investigates this phenomenon from the perspective of Bangladesh, an emerging economy. Bangladesh is the second largest economy in South Asia by nominal GDP, and the economic success of this emerging market is significantly attributable to its ready-made garment industry (Islam, 2020). Bangladesh is expected to become a developed country by 2041 with the country now home to approximately 25000 start-ups and has attracted over USD880 000 0000 in funding over the last decade, thus creating more than 1,5 million jobs. While Bangladesh is not an African country, it is a developing country and an emerging market similar to South Africa. As such, it is important to understand the relationship between corporate governance and financial performance from this perspective.

Haque and Arun (2016) evaluated the impact of corporate governance quality on the financial performance of listed companies in Bangladesh. In this study, corporate governance quality is evaluated using the corporate governance index (CGI). CGI comprises three corporate governance mechanisms that relate to shareholder rights, financial reporting, and the independence and responsibilities of the board and management. Financial performance was evaluated using (1) firm valuation and (2) operating performance. (Haque & Arun, 2016) use (A) Tobin's Q (the ratio of the market value of assets to the book value of assets) and (B) market-to-book value (the ratio of market capitalisation to shareholder equity) as proxies for firm valuation. By contrast, operational performance is measured based on accounting profitability ratios, which include ROA, Return on ROE, and Net Profit Margin (NPM). The regression methodology adopted in this study is the ordinary least squares (OLS) model, and the study found a positive relationship between CGI and firm valuation. This suggests that companies with good corporate governance quality are perceived by the market as having

positive future growth prospects, which subsequently increases their value. However, the relationship between CGI and operational performance is inconclusive.

2.6.3 Corporate Governance and Financial Performance: an African context

Jonty *et al*. (2018) explored the relationship between corporate governance and financial performance in listed South African companies. The study was performed in various industries, including financial services, consumer goods and services, and the industrial and basic materials sectors. In their study, Jonty *et al*. (2018) classified board size, board independence, board diversity, and the establishment of key board committees as independent variables. Additionally, Jonty *et al*. (2018) lagged behind all independent variables for a robust analysis of the relationship between corporate governance and financial performance. The study was performed over a 13-year period spanning from 2002 to 2014. Furthermore, this phenomenon was investigated within three different periods: prior to the financial crisis, during the financial crisis, and after the financial crisis (Jonty *et al*., 2018).

The results for the financial services industry suggest that prior to the financial crisis, board diversity, board size, and the existence of key board committees all have a positive relationship with Tobin's Q, however, board independence and board competence indicated an inverse relationship with Tobin's Q. Conversely, the study revealed that during the financial crisis, board competence had a positive impact on Tobin's Q. Post-financial crisis, the only governance mechanism that had a positive relationship with Tobin's Q was board size. Consequently, this study indicates an inverse relationship between Tobin's Q and the existence of key board committees, board independence, and board diversity post the financial crisis (Jonty *et al*., 2018).

Focusing on ROA, this study found a positive relationship between the establishment of key board committees and ROA, whereas board independence and board size had a negative relationship with ROA prior to the financial crisis. However, the study reveals a change in the impact of board size and board diversity on ROA, from negative prior to the financial crisis to positive during the financial crisis. This change in impact excludes board independence, suggesting that independent non-executive directors did not add significant value during the financial crisis. Finally, this study finds a positive relationship between board size and ROA after the financial crisis. In fact, all corporate governance mechanisms had a positive impact on ROA, except for board independence after the financial crisis. Therefore, the study indicates a

significant inverse relationship between board independence and ROA before, during, and after the financial crisis (Jonty *et al*., 2018).

2.6.4 Corporate Governance and Financial Performance: the financial services industry

Alhassan *et al*. (2021) performed a more comprehensive investigation of the relationship between corporate governance and financial performance in the South African financial services sector, particularly in the life insurance industry. Alhassan *et al*. (2021) underpinned their study on the resource dependency theory and agency theory with the former, suggesting that the extent of the external resources available to organisations has a positive impact on its performance. Furthermore, the access thereof in the context of corporate governance at the board level stimulates the efficient and effective management of an organisation as a result of the diversity in board member skill and experience, culture, age, race, and gender, thus promoting better decision-making and addressing the fundamental concerns identified by the agency theory. This study considered the following corporate governance principles: board size, audit committee size, board independence, and audit committee independence, with ROA and ROE as the key financial performance indicators observed.

This study used static and dynamic panel data regressions to analyse the relationship between corporate governance and financial performance. Alhassan *et al*. (2021) adopted the ordinary least squares panel corrected standard error (OLS-PCSE) and random effects method (REM) as estimation techniques for the static panel regression. Furthermore, Alhassan *et al*. (2021) used the two-step system generalised method of moments (S-GMM) for dynamic panel regression. Using OLS-PCSE and REM, the study found that board size has a positive and significant impact on ROA. In addition, the results indicated a significantly strong relationship between board size, ROA, and ROE, using S-GMM as the estimation technique. Alhassan *et al*. (2021) further observed a similar relationship between audit committee size and ROA using REM, with S-GMM indicating a positive and significant relationship between audit committee size and ROA and not ROE.

The findings of the study are therefore consistent with the resource dependency theory, in that a larger board committee results in the efficient and effective management of organisations, as demonstrated in the life insurance industry. Furthermore, the findings reinforce the important role of larger audit committees in effectively monitoring the efficient use of company assets to

generate revenue (ROA). However, it is important to note that the study found no significant relationship between larger audit committees and shareholder returns (i.e. ROE) as per the suggested results of the study.

From an independence perspective, Alhassan *et al*. (2021) found a strong and positive relationship between board independence and both measures of financial performance (i.e. ROA and ROE) using the S-GMM estimation technique. These results align with the fundamental principles of agency theory, which advocates for board independence in the realignment of interests between the executive management team and shareholders. Surprisingly, Alhassan *et al*. (2021) observed a negative relationship between audit committee independence and ROA using REM. This finding is also consistent with the negative correlation between audit committee independence and ROE, as indicated by the S-GMM estimation technique.

This suggests that audit committee independence is not a prerequisite for improving financial performance. In a South African context, audit committee members are normally chartered accountants in good standing with the South African Institute of Chartered Accountants (SAICA). CA(SA)'s are obligated to comply with the fundamental principles of the SAICA code of professional conduct (CPC), which include integrity, objectivity, professional competence and due care, confidentiality and professional behaviour. Therefore, the findings of Alhassan *et al*. (2021) support the fundamental principles of the SAICA CPC, as independence is an inherent characteristic of being a CA(SA) in both executive and non-executive management positions.

2.6.5 Corporate Governance and Financial Performance: board size as a moderator variable

Bakri *et al*. (2024), investigated the relationship between corporate governance and financial performance due to the identified need to map the inconsistency in the literature related to the relevance of dividends to firm value. The dividend relevance theory suggests that an increase in dividends places a firm in a favourable position in the stock market. Furthermore, investors are assumed to be risk-averse and, therefore, hold dividends at a higher preference than capital gains, which consequently allows for a lower discount rate of firm earnings, thereby increasing firm value. However, contrary to the dividend relevance theory, other researchers still cast doubt on the role of dividends in firm value. Consequently, Bakri *et al*. (2024) identified the

need to map the relationship between dividends and firm value by considering the relevance of the board size as a conduit towards this objective.

Bakri *et al*. (2024) concluded that there is a positive association between corporate governance and firm performance in Malaysia. This study considers board size as the principal corporate governance principle and adopts Tobin's Q as the observable key financial performance indicator. To analyse the relationship between these variables, Bakri *et al*. (2024) adopted a panel data regression model and applied pooled ordinary least squares (OLS), random effects, and fixed effects methods as the appropriate estimation technique. The study found a strong and positive relationship between board size and firm value, as indicated by OLS and the random-effects model. To determine the significance of board size as a conduit between dividends and firm size, Bakri *et al*. (2024) subsumed (board size and dividend per share) as the moderator variable in the study. Using pooled OLS and random effects, this study found a correlation with firm value at the 1 percent significance level, suggesting that board size critically moderates the relationship between dividends and firm size.

2.7 Summary of Empirical Literature

From the above literature review, it is evident that there is empirical evidence of a relationship between corporate governance and financial performance. However, owing to this plethora of empirical evidence, there exists an inconsistency in the conclusions regarding the nature of the relationship of this phenomenon. This is evidenced by Affes and Jarboui (2023) and Haque and Arun (2016), who found a positive and significant relationship between corporate governance (i.e. CGS and CGI) and financial performance (i.e. ROE and Tobin’s Q). The CGS and CGI consider multiple corporate governance mechanisms that are quantified as percentages that allow the indicators to be subject to a rating framework that reflects the quality of corporate governance within organisations. However, the application of CGS and CGI is not an adopted formal framework for the analysis of corporate governance in organisations in the South African context.

Among the studies that do not adopt CGS or CGI in the analysis of corporate governance and financial performance, the contradicting conclusions on this phenomenon are more visible. This is supported by Jonty *et al*. (2018), who revealed that the consideration of the external economic environment of organisations does indeed have an impact on the nature of the relationship between singular corporate governance mechanisms and financial performance. Prior to the

financial crisis, board independence and board competence indicated an inverse relationship with Tobin's Q; conversely, the study also revealed that during the financial crisis, board competence had a positive impact on Tobin's Q, with board size as the only corporate governance mechanism to indicate a positive relationship with Tobin's Q, after the financial crisis (Jonty *et al*., 2018). Additionally, this study indicated an inverse relationship between board independence and ROA before, during, and after the financial crisis, with board size revealing a negative, positive, and positive relationship with ROA before, during, and after the financial crisis, respectively.

Similarly, Alhassan *et al*. (2021) performed a robust analysis of this phenomenon using different estimation techniques, which indicated varying conclusions on the relationship between corporate governance and financial performance. From an independence perspective, Alhassan *et al*. (2021) found a strong and positive relationship between board independence and both measures of financial performance (i.e. ROA and ROE) using the S-GMM estimation technique, while observing a negative relationship between audit committee independence and ROA using REM. As previously noted, from a committee size perspective, this study found that board size has a positive and significant impact on ROA using OLS-PCSE and REM. In addition, the results indicate a significantly strong relationship between board size, ROA, and ROE, using S-GMM as the estimation technique. Alhassan *et al*. (2021) further observed a similar relationship between audit committee size and ROA using REM, with S-GMM indicating a positive and significant relationship between audit committee size and ROA and not ROE.

Bakri *et al*. (2024) corroborated the findings of Alhassan *et al*. (2021) with regard to a positive and significant relationship between board size and performance, by applying estimation techniques that follow an approach similar to that of Alhassan *et al*. (2021). Bakri *et al*. (2024) adopted a panel data regression model and applied pooled ordinary least squares (OLS), random effects, and fixed effects methods as appropriate estimation techniques. It is important to note, however, that Bakri *et al*. (2024) and Alhassan *et al*. (2021) analysed this phenomenon in different industries, but both fundamentally reinforce the importance of the resource and agency theory and, therefore, the effectiveness of a larger board size on firm performance. Therefore, as per the above observation, there is no knowledge gap that exists, but rather the inconsistency of conclusions that motivates further investigations on this phenomenon. Additionally, previous studies have focused on data collected from listed companies, as evidenced by Jonty *et al*.

(2018), Haque and Arun (2016), Affes and Jarboui (2023), and Bakri *et al*. (2024), with Alhassan *et al*. (2021) as an exception. Therefore, this study aims to account for this bias by collecting data from both listed and unlisted companies in the asset management industry.

This brings to the conclusion the limited literary visibility from previous studies on the analysis of the relationship between corporate governance and financial performance within the asset management industry in the South African context. Therefore, this study aims to primarily address this gap in knowledge, provide an understanding of the effectiveness of King IV corporate governance mechanisms on financial performance, and provide key recommendations to enhance monitoring duties, which subsequently reduce agency costs within the asset management industry.

CHAPTER 3: METHODOLOGY

3.1 Introduction

This section outlines the research approach and research design adopted for the collection and analysis of data on South Africa's asset management industry. The Chapter further outlines previously adopted empirical methodologies and the appropriateness or limitations thereof for this study.

3.2 Research Approach

The study embarked on a quantitative descriptive research approach. This approach was deemed appropriate for the study, as the objective was to analyse and infer the relationship between corporate governance principles and the financial performance of fund managers in a South African context. Furthermore, the research question in this study supported a quantitative study as it deliberated on "what" the effect of corporate governance was on the financial performance of fund management firms. The outcome of the study will provide the existence and correlation of the relationship between corporate governance and the financial performance of asset management firms within South Africa.

3.3 Research Design

3.3.1 Unit of Analysis

Per King IV, corporate governance is primarily concerned with the effective and ethical management of organisations by the board of directors. Therefore, the unit of analysis for this study is at the organisational level, which spans unlisted and listed asset management firms on the JSE.

3.3.2 Sample Size, Data Period and Source

This study used a non-probability sampling methodology for asset management firms in South Africa between 2012 and 2023. Therefore, this section presents an understanding of the rationale for the adopted sampling methodology and elaborates on the rationale for the data-collection period. Sampling techniques encompass probability and non-probability sampling approaches (Teddlie & Yu, 2007). For this quantitative study, a non-probability sampling methodology, particularly convenience sampling, was used to avoid statistical bias that may

arise from incomplete data variables from a corporate governance perspective. The target population from which the sample was drawn is JSE-listed and unlisted asset managers in South Africa. Thus, unlisted and listed asset managers who adhered to King IV were subject to the sampling methodology with the proposed sample size of 11 listed and unlisted firms. The chosen sampling methodology will help to avoid statistical bias due to missing data: thus, some of the largest South African asset managers that do not publicly disclose their financial information, or integrated reports have been excluded from the sample selection. In addition, missing data would require further mathematical adjustments to accurately interpret the results of the analysis. This study considered the financial period between 2012 and 2023. This data period was deemed appropriate as it was representative of the prevailing economic environment of the asset management industry.

To fulfil the research objectives of this study, data was obtained from a secondary source, that is, from the annual reports issued by asset managers. The secondary data is appropriate as annual reports from listed companies are subject to statutory audits as per the International Standards on Auditing. In addition, annual reports from unlisted companies subject to the International Standards on Auditing are considered for the study, as per the convenience sampling methodology adopted.

3.4 Analytical Framework

3.4.1 Regression Equation

The regression methodology adopted in this study is panel regression. In contrast to cross-sectional and time-series regression, panel regression considers all the observations of each of the x-variables that are subsumed in the model for each fund manager within a given time period (Wahba, 2015; Bell & Jones, 2014). This allows for a larger number of observations, more cross-sectional information, and more degrees-of-freedom (Hsiao, 2007). Consequently, a panel regression can measure the changes that may occur within a fund manager and across other fund managers over time. In addition, the model assesses the impact of firm-specific characteristics that distinguish one fund manager from another. Accordingly, the panel regression examines heterogeneous observations and provides more information about the examined data and their variability. Therefore, this allows for a more meaningful and robust analysis of the study given the minimal occurrence of collinearity (Hsiao, 2007).

The panel data regression equation is presented below:

$$Fp_{i,t} = \beta_0 + \beta_1\, Bsize_{i,t} + \beta_2 BInd_{i,t} + \beta_3 ChairInd_{i,t} + \beta_4 ACInd_{i,t} + \beta_5 ACcomp_{i,t} + \beta_6 Fsize_{i,t} + \upsilon_{i,t}$$

Where: (i) represents asset management firm as per the sample selection; (t) is the time period for the purposes of the study; Fp represents financial performance (ROA); $Bsize$ measures board size; $BInd$ indicates board independence; $ChairInd$ reflects chairman independence; $ACsize$ measures audit committee size; $ACInd$ represents audit committee independence; $ACcomp$ measures audit committee competence; and $Fsize$ reflects firm size. v denotes the two-sided error term.

3.4.2 Description of Independent Variables

3.4.2.1 Dependent Variable: Financial Performance – Return on Assets

The ROA ratio measures the efficient use of an organisation's assets in the effective generation of profits. Following previous panel regression research that investigates the impact of corporate governance and accounting based financial performance (Alhassan *et al*., 2021), this study uses ROA as a measure of firm performance, which serves as the dependent variable in the study. ROA is measured as net operating income divided by total assets.

3.4.2.2 Independent Variable: Corporate Governance

i) Board Size:

King IV does not explicitly suggest the number of board members that constitute an effective board committee. However, in determining the requisite number of members, Principle 7 of King IV recommends that organisations consider regulatory board composition requirements as per the Companies Act 71 of 2008, which requires a minimum of three members to be appointed to a board committee. Therefore, board size is measured by the total number of directors on the board committee, including both non-executive and executive directors.

It is more probable than not for board size to increase the profitability or financial performance of asset management firms. This is in line with resource theory, which suggests that a larger board results in the effective and efficient management of organisations due to increased monitoring and access to diversified professional competence, as corroborated by Alhassan *et al.* (2021) and Bakri *et al*. (2024).

ii) Board Independence:

King IV recommends that the board should comprise a majority of non-executive directors. In addition, board independence means that most non-executive directors are independent of the organisation: in addition to not being involved in the day-to-day running of the business, the independent non-executive director is not involved in transactions with the organisation through connected persons. Therefore, Board independence is measured by the total number of independent non-executive directors on the board committee, which comprises the majority.

Board independence is expected to improve the profitability/financial performance of asset managers because independence at the board level facilitates decision-making that is free from conflict of interest and in the best interest of the organisation. This relationship is evidenced by Alhassan *et al*. (2021), who found a positive relationship between board independence and financial performance. Conversely, Jonty *et al*. (2018) suggested a significant inverse relationship between board independence and ROA before, during, and after the financial crisis.

iii) Chairman Independence:

King IV recommends that the appointment of the chairperson of the board should be that of an independent non-executive director. Furthermore, a lead-independent non-executive member should be appointed as advisor to the chair and, importantly, lead in the absence of a chairman. Moreover, the appointment of a lead-independent director is imperative if the chairperson of the board is a connected person to the organisation (i.e. not independent) (IoDSA, 2016).

It is also important to note that King IV recommends that organisations should not appoint the CEO as the chairman of the board and that if a retired CEO is appointed, a minimum of three years after the CEO's tenure should lapse before the appointment to chairmanship (IoDSA, 2016). In accordance with research on leadership structures, chairman independence has been identified as a conduit for strengthened board leadership (Coombes & Wong, 2004). Consistent with the findings of Hashim and Suppiah (2010), a strong and positive relationship between chairman independence and earnings quality has been established in historical literature.

iv) Audit Committee Independence:

The audit committee is an integral component of an organisation's risk management process and is responsible for the independent oversight of the effectiveness of the organisation's combined assurance function, which includes external auditors, internal audits, and the finance function. According to King IV's recommended principles, the audit committee should

therefore comprise only independent non-executive directors, and the chairperson of the board should not be a member of the audit committee. Therefore, in this study, audit committee independence is measured by the total number of independent non-executive directors on the audit committee.

Audit committee independence is expected to improve profitability and financial performance because committed and independent audit committees reliably act in the best interests of the organisation and the public interest. This is evidenced by Altin (2024), who found a positive relationship between audit committee independence and financial performance, in contrast to Bolton (2012) and Pathiraja *et al*. (2023) who revealed an insignificant relationship between audit committee independence and financial performance.

v) Audit Committee Competence:

King IV recommends the independence and skill of audit committee members as a prerequisite to ensure the integrity of the organisation's financial statements. Audit committee members should have the necessary experience and competence, which spans financial reporting, taxation, corporate finance, and assurance, to effectively execute their fiduciary duties. Therefore, in this study, audit committee competence is measured by the total number of independent non-executive directors on an audit committee with experience and professional qualifications in financial reporting, corporate governance and assurance, taxation, and corporate finance.

There is a plethora of studies which have investigated the relationship between financial expertise and firm performance, thus suggesting that audit committee competence is expected to improve profitability and financial performance. This is reinforced by Jonty *et al*. (2018) who, in their study, revealed that board competence had a positive impact on Tobin's Q during the financial crisis. This finding is also supported by Aldamen *et al*. (2011), who found that more members of the audit committee with finance and accounting qualifications positively impacted accounting and market performance during the financial crisis, an era in which competence was imperative to overcome uncertainty. In contrast, Pathiraja *et al*. (2023) indicated that, while there may be a relationship between audit committee financial expertise and firm performance, it is not significant.

3.4.3 Control Variables

i) Firm Size:

Firm size was identified as the control variable in this study. . Kinney and McDaniel (1989) found that public interest entities and large organisations have sophisticated internal controls reinforced by a strong control environment that provides a framework, an ethical culture from top management, processes, and structures that form the foundation for internal controls. This includes a robust risk assessment process that identifies any weaknesses in the internal controls and their ability to detect and prevent misstatements. Furthermore, large organisations have policies and procedures that manifest as control activities such as authorisation, reconciliations and or segregation of duties. Large organisations depend on high-quality information to implement effective internal controls and therefore have sophisticated accounting and information systems that accurately record and present financial information. In addition, large organisations implement monitoring activities to evaluate the performance of internal controls. As such, high-quality information produced by large organisations is deemed to improve financial reporting, and therefore, financial performance (Wild, 1996).

Furthermore, in their analysis of the relationship between corporate governance and financial performance, Paniagua *et al*. (2018) used a stepwise estimation technique which helped identify omitted variable bias and facilitate the sequential addition of control variables with firm size identified as one of the missing control variables. As such, the study controlled for size with the variable $Fsize_{i,t}$ measured as the natural logarithm of the book value of the total assets (Pathiraja *et al.,* 2023).

Table 2

Measurement of Regression Variables

VARIABLE	TYPE OF VARIABLE	MEASUREMENT	UNIT OF MEASUREMENT
Financial performance variables			
Return On Assets (ROA)	Dependent Quantitative	Profit for the year after tax/Total assets	Ratio
Governance Variables			
Board size	Independent Quantitative	Number of directors on the board	Integer
Board independence	Independent Quantitative	Number of independent non-executive board members / Total number of board members	Ratio
Board Chairman independence	Independent Quantitative	Dummy variable: 1 = Not Independent; 0 = Independent	Integer
Audit committee independence	Independent Quantitative	Number of independent non-executive directors/ Total audit committee members	Ratio
Audit committee financial expertise	Independent Quantitative	Number of members with a financial expertise/Total Audit committee member	Ratio
Control variables			
Firm size	Independent Quantitative	The natural log of total assets	Integer

Source: Authors Estimation in STATA18

3.4.4 Estimation Technique

The study took on three typical estimation techniques for linear panel data regression models: pooled ordinary least squares (OLS), fixed effects, and random effects. The equation in terms of the pooled OLS is as follows:

$$Fp_{i,t} = \beta_0 + \beta_1\, Bsize_{i,t} + \beta_2 BInd_{i,t} + \beta_3 ChairInd_{i,t} + \beta_4 ACInd_{i,t} + \beta_5 ACcomp_{i,t} + \beta_6 Fsize_{i,t} + v_{i,t}$$

The pooled OLS estimation technique is underpinned by three principle assumptions. The first (1) is that the regression coefficients are the same for all firms that are subsumed in the model (Bass & Wittink, 1975). This indicates that the y-intercept and mean for every x-variable in the

model are the same across all firms. The second (2) assumption is that the regressors in the model are non-stochastic and, as such, the errors are assumed to not be correlated with explanatory x-variables. Therefore, this assumption suggests that the model parameters are consistent and unbiased.

The third (3) assumption assumes that $V_{i,t}$ is "iid" which denotes that the error term is identical and independently distributed. Accordingly, the error term in one year is assumed to not affect the error term in another year; therefore, the error term is deemed to be constant and meets the conditions of heteroskedasticity (Bell & Jones, 2014). Consequently, the three assumptions make it permissible to use pooled OLS.

However, pooled OLS has significant limitations in that it does not make provision for firm-specific characteristics. As previously noted, panel regression examines heterogeneous observations and provides more information about the examined data and its variability given the minimal occurrence of collinearity (Hsiao, 2007). As a result, there is a higher likelihood of heterogeneity (i.e. unobserved firm-specific characteristics) within the pooled OLS estimation technique (Hsiao, 2007).

This signifies that the firm-specific characteristics omitted in the regression model are subsumed in the error term and thus contradict assumption (2), as the error term is correlated to one or more regressors in the model. On this basis, assumption (2) is nullified, and, as a result, the coefficients of the regressors are deemed biased and inconsistent. Thus, adopting a pooled OLS estimation technique is more likely to result in erroneous inferences (Bell & Jones, 2014).

The fixed effects method accounts for heterogeneity by allowing different y-intercepts for each firm according to the least squares dummy variable (LSDV) approach. The differences in the y-intercepts are denoted by β_{0i} which captures the unique characteristics of each firm. However, it is important to note that while β_{0i} varies cross-sectionally (i.e. across all firms) in capturing the different characteristics of each firm, β_{0i} is classified as a fixed term. For this reason, there is no (t) subscript associated with β_{0i} because it is time invariant. Importantly, the heterogeneity error term is assumed to be correlated with the explanatory x-variables within the realm of the fixed effects model.

In contrast, the equation in terms of random effects is as follows:

$$Fp_{i,t} = \beta_0 + \beta_1 Bsize_{i,t} + \beta_2 BInd_{i,t} + \beta_3 ChairInd_{i,t} + \beta_4 ACInd_{i,t} + \beta_5 ACcomp_{i,t} + \beta_6 Fsize_{i,t} + \upsilon_{i,t}$$

Where $\upsilon_{i,t} = W_{i,t} + E_{i,t}$

The random effects method breaks the error term $V_{i,t}$ into two components, which $W_{i,t}$ and $E_{i,t}$ denote. $E_{i,t}$ represents the common error term that varies across panels and $W_{i,t}$ represents the firm-dependent error term due to unobserved heterogeneity. As such, this conveys a construct that indicates that the firms analysed in the model constitute a random sample from a larger population of similar firms. Consequently, all firms have a common y-intercept equal to β_0 where $W_{i,t}$ is the measure of the random deviation of each firm's intercept from the common intercept. Finally, in the sphere of REM, the heterogeneity error term is assumed to be correlated with the independent explanatory x-variables.

3.4.5 Estimation Technique Validity

The study used the Wald statistic to determine the appropriate model between Pooled OLS and panel data estimation techniques: Fixed Effects Model (FEM) and Random Effects Model (REM) (Wahba, 2015). The adoption thereof aimed to determine the relationship between corporate governance principles (i.e. independent x-variables) and financial performance (i.e. dependent y-variable) within the fund management industry. Should the Wald statistic indicate the appropriateness of the Fixed Effects Model (FEM) and Random Effects Model for the study, the results of both models will be tested for validity by considering the required conditions for the error variable, which includes an assessment of heteroscedasticity along with an assessment of the residual independence. Furthermore, both models are tested for serial correlation.

The Hausman Test is the adopted methodology for determining the appropriate estimation technique between FEM and REM. As such, the null hypothesis conveys that REM is the efficient estimator, or that REM/FEM does not differ substantially. Consequently, the alternative hypothesis states that FEM is an appropriate estimator.

3.4.6 Research Reliability

In this study, a panel regression model was used to ensure reliability, with the analysis employing ROA as the dependent variable. Subsequently, the study compared the coefficients and statistical significance of the model to determine the nature of the relationship between corporate governance and financial performance; therefore, consistent results were deemed reliable. Finally, the study obtained data from audited financial statements that provided reasonable assurance over the validity, accuracy, and completeness of financial information.

3.4.7 Limitations

This section presents the limitations of this study. First (1), the sampling method constitutes one of these limitations, as the study adopted a purposive sampling methodology. This sampling method lacks randomness and may be biased because only companies that adhere to King IV are included in the analysis.

The second (2) limitation relates to the possible measurement error of the proxies for financial performance. This is because this study uses audited financial statements as the data source. As such, there are differences in the underlying accounting policies of organisations, as the IFRS require accounting policy choices to result in information that is relevant to the economic decision-making needs of users. Furthermore, IFRS requires accounting policy choices to provide reliable information in that financial statements are faithfully represented and reflect the economic substance of transactions. Therefore, these differences may result in inconsistent and incomparable financial performance indicators.

The third limitation (3) is attributable to the estimation technique. While the fixed effects and random effects models might address endogeneity arising from unobserved heterogeneity, these estimation techniques do not address endogeneity arising from reverse causality between firm performance and corporate governance. The evidence of reverse causality between firm performance and corporate governance has also been identified by Ronoowah & Seetanah (2022), among other previous studies.

The fourth (4) limitation is underpinned by the sample size of this study. A large number of the significant players within the asset management industry in South Africa are not listed. As such, the financial statements of these organisations are not public knowledge, which has a direct impact on the sample size for the study.

Finally, the fifth (5) limitation relates to captive asset managers. Captive asset managers form part of a larger organisation, and this study applied group financial statements in the data analysis where segment reporting was not presented within the group financial statements, or no separate financial statements were available for the divisions. Therefore, in this case, the data analysis may include other business activities of the organisation in addition to the asset management activities.

CHAPTER 4: DISCUSSION OF FINDINGS

4.1 Introduction

This Chapter consists of four subsections on data analysis. The first section presents descriptive statistics on the financial performance indicators, corporate governance characteristics, and control variables over the sample period. The second section provides the correlation matrix of the regression variables, and the third section presents the model diagnostics. Lastly, the final section presents results of the panel regression model which consists of the interpretation of the model results within the context of the South African asset management industry. Furthermore, Table 5 presents the estimation technique of the regression model with the results identifying the determinants of financial performance.

4.2 Descriptive Statistics

Table 3 provides descriptive statistics for the independent, dependent, and control variables embodied in the regression model. The independent variables include board size, board independence, board chairman independence, audit committee independence, and audit committee financial expertise. The dependent variable is financial performance, with return on assets (ROA) as the proxy for financial performance, and firm size as the control variable.

ROA averaged 1.9510, which is in line with the United States asset management industry which has reported an average ROA of 1.9 as at January 2025 (Full Ratio, 2025). This is good performance and suggests that South Africa manages its assets efficiently and effectively, given that the United States has one of the largest asset management industries (Epstein, 2019). This performance is also attributable to the fact that South Africa has the most deepened financial system in the African continent to which the asset management industry belongs to.

While board size approximates an average of 13 members, the table indicates an average board independence score of 4.3117, representing only 0.3379 of independent non-executive directors on the board structure in contrast to non-executive directors. Whether the average of 13 members is the optimal board size depends on the trade-off between minimised coordination costs of non-executive directors, minimised information asymmetry from executive directors and the maximisation of rejection votes from non-executive directors of board agenda's that are not in the interest of the organisation (Rajeha, 2005). However, it is noteworthy to mention that the proportion of independent non-executive directors is not aligned to Principle 7 of King IV,

which recommends a majority proportion of independent non-executive directors to non-executive directors (IoDSA, 2016).

Table 3 further indicates an average score of 3.6883 of non-executive directors with financial expertise on the audit committee. This represents an average of 0.8466 of non-executive directors with competence in financial accounting, management accounting and finance, auditing, and taxation on the audit committee. This is in line with Principle 8 of King IV which recommends the appointment of financial experts on the audit committee in order to execute the functions of the committee effectively (IoDSA, 2016).

Additionally, Table 3 shows that, on average, 4.3117 of audit committee members are independent non-executive directors, which illustrates an average audit committee independence ratio of 0.9981. This suggests that all the directors that comprise the audit committees within the asset management industry are independent and non-executive and thus have no interest in the organisations. This is in line with Principle 8 of King IV which recommends the appointment of independent non-executive directors on the audit committee (IoDSA, 2016).

The mean board chairman independence score of 0.6883 is relatively high and aligned to other countries such as Malaysia, which follows a non-dual approach for the appointment of CEO and Chairman (Hashim & Suppiah, 2010). The prevalent appointment of an independent chairman within the South African asset management industry is reinforced by the recommendations of Principle 2 of the South African King IV Code of Good Corporate Governance (IoDSA, 2016).

Table 3

Descriptive Statistics

	Mean	Median	SD	Min	Max	N
ROA	1.9510	0.0443	8.8869	-0.2472	67.3553	76
BS	13.3377	15.0000	3.8307	6.0000	20.0000	77
BIND	4.3117	4.0000	1.1269	3.0000	8.0000	77
BINDR	0.3379	0.3333	0.0788	0.1667	0.5000	77
BCHAIRIND	0.6883	1.0000	0.4662	0.0000	1.0000	77
AUDITFINEXPERT	3.6883	4.0000	1.2488	1.0000	7.0000	77
AUDITFINEXPERTR	0.8466	0.8750	0.1841	0.3333	1.0000	77
AUDITCOMIND	4.3117	4.0000	1.1269	3.0000	8.0000	77
AUDITCOMINDR	0.9981	1.0000	0.0163	0.8571	1.0000	77
FSIZE	19.3558	18.9241	3.8434	10.7263	26.3642	76

Note: ROA=Return on assets; BS=Board size; BIND= Number of Independent directors on Board; BINDR= Board independence ratio; CHAIRIND=Board Chairman independence; AUDITCOMIND= Number of Independent directors on Audit Committee; AUDITCOMINDR=Audit Committee independence ratio; AUDITFINEXPERT= Number of Financial Experts on Audit Committee; AUDITFINEXPERTR =Financial Expertise on Audit Committee ratio. FSIZE=Firm size

Source: Authors Estimation in STATA18

4.3 Correlation Matrix

A basic assumption subsumed in linear regression is the independence of the explanatory variables. An empirical examination of this assumption considers, in pairs, the correlation coefficients of independent variables within the regression model, using a correlation matrix as estimated and presented in Table 4 below.

Akoglu (2018) and Schober *et al*. (2018) inferred that a correlation coefficient of 0.3 is indicative of a weak correlation between independent variables. As such, Table 4 shows that there is a weak and statistically nonsignificant correlation between board size and ROA , board independence ratio and ROA, board chairman independence and ROA, board chairman independence and board size, board chairman independence and board independence ratio, audit committee financial expertise ratio and ROA, audit committee financial expertise ratio and board independence ratio, audit committee independence ratio and ROA, audit committee independence ratio and board size, audit committee independence ratio and board independence ratio, audit committee independence ratio and board chairman independence, audit committee

independence ratio and audit committee financial expertise ratio, firm size and audit committee financial expertise ratio and, lastly, firm size and audit committee independence ratio.

In contrast, the variables board independence ratio and board size, audit committee financial expertise ratio and board size, audit committee financial expertise ratio and board independence ratio, firm size and ROA, firm size and board size, firm size and board independence ratio, firm size and board chairman independence, all present correlation coefficients that are above 0.3 and statistically significant. Kennedy (2008) inferred that it is more probable than not for estimated correlation coefficients that are equal to or more than 0.7, to result in biased estimates of the regression model due to the occurrence of multicollinearity. As this is not observed in Table 4 it can be concluded that there is no multicollinearity between the independent variables and therefore a stepwise regression model has not been adopted for this study.

Table 4

Correlation Results

	ROA	**BS**	**BINDR**	**4**	**5**	**6**	**7**
1.ROA	1						
2.BS	-0.1418	1					
	0.2217						
3.BINDR	0.0851	-0.6855	1				
	0.4650	*0.0000*					
4.BCHAIRIND	-0.1335	0.2252	0.0933	1			
	0.2503	*0.0490*	*0.4197*				
5. AUDITFINEXPERTR	-0.0069	0.4892	-0.5018	0.1996	1		
	0.9530	*0.0000*	*0.0000*	*0.0818*			
6. AUDITCOMINDR	-0.0243	-0.1223	0.0067	-0.0772	-0.0962	1	
	0.8353	*0.2891*	*0.9535*	*0.5046*	*0.4053*		
7.FSIZE	-0.3294	-0.3678	0.3188	0.3379	-0.2066	0.0184	1
	0.0037	*0.0011*	*0.0050*	*0.0028*	*0.0734*	*0.8749*	

Note: ROA=Return on assets; BS=Board size; BINDR= Board independence ratio; CHAIRIND=Board Chairman independence; AUDITCOMINDR=Audit Committee independence ratio; AUDITFINEXPERTR =Financial Expertise on Audit Committee ratio; FSIZE=Firm size; Italized values denotes p-values

Source: Authors Estimation in STATA18

4.4 Regression Results

This section provides the panel regression results of the impact of corporate governance on the financial performance of asset managers in South Africa. As depicted in Table 5, the Wald Statistic $\chi 2$ ($P>\chi 2$ of less than 0.05) is significant. As the parameters associated with the explanatory variables are not zero, the study rejects the null hypothesis. This means that accounting for heterogeneity is important in examining the relationship between corporate governance and financial performance within the South African asset management industry. In conclusion, these results indicate the appropriateness and fitness of the random effects and fixed effects model in estimating the relationship between corporate governance and the financial performance in contrast to pooled OLS.

It is noteworthy to mention that the fixed effects method does provide better explanatory power in contrast to the random effects method as per the estimated R-squared. Notwithstanding the evidence presented, the regression model is estimated using the random effects (REM) estimation technique as per Hausman specifications. The results show that the Hausman specification test cannot be rejected at the 5 percent significance level and as such failed to reject the null hypothesis. Accordingly, REM is the efficient estimator and the scope for the discussion of the regression analysis is therefore limited to REM.

One of the key assumptions of linear regression analysis is that the residuals are distributed with equal variance at each level of the dependent variable. This assumption of equal variance is known as homoscedasticity, whereas, if the assumption is violated, it can be concluded that heteroscedasticity is present in the residuals. The study adopted the Breusch-Pagan test to examine the existence of homoscedasticity and as per Table 5, the random effects model rejects the null hypothesis of a constant variance (p-value is less than 0.05). Non-autocorrelation assumes that the error terms are not correlated and as such, the study adopted the Wooldridge test to assess non-autocorrelation in the random effects model. The null hypothesis that there is no serial autocorrelation is not rejected for ROA as per table 5 which presents a (p-value greater than 0.05).

From Table 5, the coefficient of the board independence ratio (BINDR) exhibits a positive but insignificant relationship with return on assets (ROA), as per the random effects model (REM) and the fixed effects model (FEM). This suggests that a higher proportion of independent non-executive directors on the board committee in contrast to non-executive directors does not result

in improved financial performance. This finding is in contrast to the body of work of other cross-country studies in this area that link board independence to financial performance (Aggarwal *et al*., 2007; Dahya *et al*., 2007). This could be attributable to the robust regulatory landscape of South Africa's financial services industry to which the asset management industry belongs to (as above-mentioned). Consequently, these results corroborate the stewardship theory, which suggests goal congruency between the executive management team, shareholders and other relevant stakeholders of the organisation, deeming the existence of a conflict of interest between the principal and agent null and void.

One surprising variable found to be negatively correlated with ROA and statistically significant at the 1 percent level (REM) is board size (BSIZE). Additionally, the impact of BSIZE is observed to be negative and significant at 5 percent, as per the FEM. This finding is contrary to the resource dependency theory and indicates that a larger board size does not necessarily enhance financial performance in the South African asset management industry. Several factors could explain this observation. First, in accordance with the present results, previous studies have also demonstrated that board size is firm value irrelevant (Aggarwal *et al*., 2007), nor correlated with financial performance (Ujunwa, 2012) because of the occurrence of free riding from incompetent directors or well-known directors who hold multiple directorships, limiting their ability to conduct their oversight fiduciary duties with due care, thus contributing minimal value to the directorship and, therefore, the overall inefficiency of the board. Secondly, other theorists have argued for smaller board sizes as conduits for cohesion, cooperation, and the efficient collaboration of the board of directors, and therefore productive monitoring responsibilities (Wu, 2009).

With respect to board chair independence (BCHAIRIND), the result supports earlier projections. (BCHAIRIND) is observed to be positive as per the REM and FEM models, with FEM indicating statistical significance at the 10 percent level on ROA. This suggests that the appointment of an independent non-executive board chairman and/or, in the absence thereof, the appointment of a lead-independent director results in the improved financial performance of South African asset managers. While previous studies have focused on the impact of CEO/chairman non-duality/duality on financial performance, it should be emphasised that the results rendering the impact thereof on financial performance remain inconclusive in this area of study (Callaghan, 2005). Furthermore, it is noteworthy to mention that CEO/chairman non-duality is not suggestive of an independent non-executive chairman; therefore, it is encouraging

to compare this result with that found by Hashim and Suppiah (2010), who also found a positive and significant correlation between chairman independence and earnings quality, and therefore overall board independence, as previously observed in this study. Lastly, these results corroborate the agency theory, which acknowledges the principle versus agent problem and identifies the significant importance of independence within the directorship to ensure improved monitoring and supervisory responsibilities within the organisation, in an effort to address and alleviate the conflict of interest that is inherent to the nature of the relationship between the principle and agent.

Contrary to expectations, this study did not find a positive relationship between the audit committee independence ratio (AUDITCOMINDR) and ROA. The AUDITCOMINDR coefficient is negatively related to ROA at a significance level of 1 percent, as indicated by both the REM and FEM models. Although these results differ from some published studies (Aanu *et al*., 2014), they are almost consistent with those of Pathiraja *et al*. (2023), who found a positive but insignificant relationship between audit committee independence and firm performance. While the audit committees have been determined as catalysts of governance, the results indicate that a lower proportion of independent non-executive directors on the audit committee in contrast to non-executive directors does not affect the integrity and validity of earnings quality within the South African asset management industry.

The audit committee financial expertise ratio (AUDITFINEXPERTR) is, however, observed to be positively correlated with ROA as per REM and FEM, with REM indicating a 10 percent significance level. In accordance with the present results, previous studies have also demonstrated a similar relationship between these variables (Aanu *et al*., 2014) (Komal *et al*., 2021), indicating that a higher proportion of members with financial expertise in financial accounting principles and standards as well as risk management results in more accurate and complete financial reporting and therefore improved earnings quality.

Table 5

Random Effects and Fixed Effects Method Regression Results

	Dependent Variable: Return on Assets			
	REM		**FEM**	
	Coefficient	**std. err.**	**Coefficient**	**std. err.**
Constant	50.5289**	20.7711	3.624***	1.166
BS	-0.3369***	0.0718	-0.320**	0.131
BINDR	0.1789	0.5239	0.534	0.549
BCHAIRIND	0.0566	0.0776	0.132*	0.075
AUDITCOMINDR	-1.1391***	0.4294	-2.239***	0.773
AUDITFINEXPERTR	0.3215*	0.1873	0.091	0.195
FSIZE	-0.0339*	0.0101	-0.043***	0.008
Year Dummy?	YES		YES	
R-squared	0.2367		0.6131	
Wald $\chi^2(7)$	90.47		133.59	
Prob > χ^2	0.000		0.0000	
BP/CW Hettest χ^2	17.96			
Prob > χ^2	0.0000			
AR (1): F	2.332			
Prob > F	0.1611			
Hausman χ^2	17.22			
Prob > χ^2	0.2444			
Number of firms	11		11	
Observations	76		76	

Note: BS=Board size; BINDR= Board independence ratio; CHAIRIND=Board Chairman independence; AUDITCOMINDR=Audit Committee independence ratio; AUDITFINEXPERTR =Financial Expertise on Audit Committee ratio; FSIZE=Firm size. BP/CW Hettest=Breusch–Pagan/Cook–Weisberg test for heteroskedasticity; AR(1)=Wooldridge test for autocorrelation in panel data***, ** and * denote significance at 1%, 5% and 10% respectively.

Source: Authors Estimation in STATA18

CHAPTER 5: CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This final Chapter draws together the various strands of the thesis, focusing on four key themes. The first section summarises the research, and the second section provides the principal findings and conclusions of the study. The third section draws upon the findings of this thesis and presents policy recommendations. Finally, the third section discusses the implications of the findings for future research into corporate governance characteristics and financial performance.

5.2 Summary of the Study

This study examined the influence of corporate governance characteristics on the financial performance of asset management firms in South Africa. This study was motivated by the fact that this phenomenon has historically been conducted at a generic level, where the unit of analysis (i.e. organisations) varies across multiple industries (Paniagua *et al*., 2018) (Jensen & Meckling, 1976). To date, no study has focused specifically on the asset management industry, particularly within the South African context. Additionally, asset managers play a critical role as financial intermediaries in the financial services industry, which contributes significantly to South Africa's economic and sustainable development, rendering the examination of the governance and financial health of these institutions critically important. As such, the core argument is that corporate governance characteristics enhance financial performance. Previous studies support this contention and infer the relationships between these variables (Jensen & Meckling, 1976). Therefore, this study builds on this work and tests the hypothesis for asset managers in South Africa.

The study used integrated reports and annual financial statements of 11 asset management firms from 2012 to 2023. The corporate governance characteristics under consideration include board size, board independence, chairman independence, audit committee independence, and audit committee financial expertise. The proxy for financial performance is Return on Assets (ROA). This dissertation was conducted using a panel regression model to investigate the relationship between the aforementioned variables, while controlling for firm size. It is worth noting that while the fixed effects model provides the highest R-squared value, explaining 61 percent of the total variation in ROA, the random effects model is deemed an efficient estimating model for the study, as per Hausman specifications.

Overall, the findings of the empirical analysis reveal two corporate governance attributes that influence the financial performance of asset managers in South Africa: the appointment of an independent non-executive chairman on the board of directors and audit committees comprising more members with financial expertise.

5.3 Findings and Conclusions

The most significant variables with ROA were board size, audit committee independence, chairman independence, and audit committee financial expertise. By contrast, board independence was not found to be statistically significant with financial performance.

Unexpectedly, board size was found to have an inverse relationship with ROA, showing that a larger board size does not necessarily result in improved financial performance as per the resource theory. Not only are larger boards associated with inefficient collaboration (Wu, 2009), but a larger board size also exposes the board structure to the free-riding problem, which suggests that some directors may be incompetent or hold too many directorships that limit their contributions in terms of monitoring and oversight duties (Ujunwa, 2012), resulting in a decline in financial performance.

Similar to board size, the relationship between audit committee independence ratio and ROA is observed to be negative, indicating that a lower proportion of independent non-executive directors on the audit committee, in contrast to non-executive directors, does not reduce the integrity and validity of earnings quality in the South African asset management industry. Alternatively, a higher proportion of independent non-executive directors may influence the use of the assets of the organisation in a more conservative approach, so as to mitigate loss and risk with a view to achieve conservative and sustainable ROA, as opposed to volatile and/or short-term high returns.

By contrast, the study finds evidence that a higher proportion of financial experts on the audit committee is positively related to ROA, indicating that audit committees comprising more members with qualifications and experience in IFRS, audit, finance, and/or risk management enhance the financial performance of South African asset managers.

Furthermore, the study shows a positive relationship between chairman independence and ROA, indicating that the appointment of an independent non-executive chairman on the board of directors plays a critical role as a conduit for enhanced financial performance. The

appointment of an independent non-executive chairman has been determined to strengthen overall independence within the board leadership structure (Coombes & Wong, 2004), which may account for the limited influence of a higher proportion of independent non-executive directors, in contrast to non-executive directors on the board) as per the observed positive but not significant impact of board independence on ROA.

5.4 Policy Recommendations

This study contributes to existing literature. Previous theoretical and empirical literature, in most instances, examined the influence of corporate governance characteristics on financial performance from a cross-country and/or multiple-industry perspective. To date, no study has examined this relationship in the asset management industry within the South African context. Consequently, policy recommendations can be inferred from the findings of this study for the aforementioned scope.

The study does not support the view that audit committee independence drives financial performance. This may be attributable to the stringent regulatory environment of the financial services sector, which helps reinforce the integrity, impartiality, and objectivity of audit committee members in the asset management industry. Furthermore, it is worth noting that Section 94 of the Companies Act 71 of 2008 prescribes that all members of the audit committee must be independent of the organisation. As audit committee independence is not a bottleneck for quality decision-making, this study recommends a mindset shift in asset managers from ethical leadership to effective leadership in terms of the appointment of audit committee members, as supported by the findings of the study in terms of the relationship between audit committee financial expertise and financial performance.

In terms of board size, the study does not find support for a larger board in the context of the asset management industry. While the Companies Act 71 of 2008 prescribes the minimum number of members to be drafted to the board committee, there is no regulation or guidelines which suggest an optimal board size. However, given the free-riding phenomenon, the study recommends that the appointment process of directors should place consideration and emphasis on reasonable capacity to execute fiduciary duties, expertise and diversity in experience and historical performance.

The study supports prior empirical literature with a view that more members with financial expertise on the audit committee drive financial performance. From a regulatory perspective,

the audit committee must be comprised of members with adequate relevant knowledge and experience to perform their fiduciary duties diligently, as per Section 94 of the Companies Act 71 of 2008. Therefore, the study recommends that asset managers place more focus on audit committee members with knowledge and experience in IFRS, corporate governance and auditing, taxation and finance, in the appointment process of audit committee members.

Although the study does not find support for board independence through the appointment of more independent non-executive directors, it provides some evidence that supports literature that chairman independence strengthens overall board independence and thus improved financial performance in asset management. The Companies Act 71 of 2008 does not have specific requirements for an independent board chairman; however, in line with King IV, the study recommends the appointment thereof within the asset management industry.

5.5 Avenues for Future Research

In accordance with the principal findings, future research can build on this study by examining the optimal board size that results in the improved financial performance of asset managers in South Africa. In addition, future research could examine the role of the relevant knowledge, experience, and historical performance of board members in driving financial performance in this industry. As the study indicates support for audit committee financial expertise, the scope of future research could be expanded further to determine the impact of the number of Chartered Financial Analysts (CFA)/Chartered Accountants [CA(SA)] on the board committee.

Considering South Africa's socioeconomic context, future studies could further examine board diversity by considering the influence of gender and/or ethnicity on financial performance. This would help provide a better understanding of the appointment process of directors, from both quantitative and qualitative perspectives.

In terms of research design, a robust investigation can be conducted by sampling more asset managers in South Africa. However, this is a potential possibility under the circumstances that ASISA or the FSCA prescribe as a minimum requirement: the disclosure of a corporate governance report that mirrors an integrated report that details the board of directors, audit committee members, and other relevant corporate governance characteristics. In addition, an abridged annual statement of financial position and statement of profit/loss and other comprehensive income of both listed and unlisted asset managers should be prescribed as a

minimum disclosure requirement by ASISA or the FSCA to allow for further analysis of this nature.

Finally, a cross-country investigation of the influence of corporate governance on financial performance is instrumental in determining whether the prevalence of the King IV corporate governance framework optimises financial performance within the asset management industry, in contrast to other countries that have not adopted similar corporate governance characteristics.

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APPENDIX A:
LIST OF SAMPLED ASSET MANAGEMENT FIRMS

1. Stanlib Fund Managers
2. Coronation Fund Managers
3. Sygnia Collective Investment Scheme Limited
4. Glacier by Sanlam Collective Investment Scheme
5. Nedgroup Investments – Unit Trusts
6. PSG Collective Investment Scheme (RF) Limited
7. Momentum Collective Investment Scheme
8. Old Mutual Trust Managers
9. Prescient Management Company
10. Professional Provident Society Multi-Managers Proprietary Limited
11. FNB Collective Investment Scheme Management Company/ Ashburton Fund Managers (Proprietary) Limited