

UNIVERSITY OF ZIMBABWE



**AGENCY COSTS: AN ANALYSIS OF THE IMPACT OF CORPORATE
GOVERNANCE ON THE PERFORMANCE OF PUBLIC SECTOR ENTITIES IN
ZIMBABWE**

BY

BHANDE TAONA

MACC/R097339A

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SUPERVISOR : DR W MKUMBUZI

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ABSTRACT

The impact of corporate governance on organisational performance is an area that has long been debated by behavioural scientists, legal practitioners, financiers, economists, and business operators. However, there seems to be no agreement over what constitutes an effective corporate governance mechanism that aligns agents' or managers' interests with those of principals (owners/shareholders). This research examines the role of corporate governance in mitigating agency cost (thereby promoting firm performance) in a sample of thirty six public sector companies in Zimbabwe selected on the basis that all required information is available and the organisations are the biggest in the sector in terms of market capitalisation. It is suggested that observance of corporate governance can lower agency costs resulting in higher firm performance. This research uses the asset utilisation ratio (dependent variable) as a proxy to measure agency cost. Multivariate fixed effect regression is used to analyse the findings. The independent variables are the potential determinants of agency costs which are categorised as representing ownership influences and corporate governance mechanisms (director ownership, institutional ownership, external ownership, board size, CEO-chair duality, board independence and board remuneration).

The research findings reveal that asset utilisation has a positive association with board independence and board remuneration. There is also a positive relationship between director ownership and CEO-Chair duality while institutional and external ownership was rare within the public sector in Zimbabwe. Additionally, institutional ownership was found to be negatively related to director ownership while the later also has no influence on asset utilisation ratio. There is also a negative association between asset utilisation ratio and CEO-Chair duality while board remuneration and board independence positively influences performance. The research findings thus reveal that more director and institutional ownership lessens agency costs. Moreover, small boards lower agency cost. Furthermore, segregation of the CEO and chairperson positions and higher remuneration lowers agency costs. However, from multivariate linear regression analysis, company specific fixed effects are also highly significant, implying considerable firm heterogeneity across sample firms. Moreover, 39% of variation in agency costs is explained by independent variables of corporate governance mechanisms while 61% is left to be explained by other factors implying corporate governance remains critical but certainly not the sole driver for agency costs and performance in public sector entities in Zimbabwe. Basing on results from this research, a number of recommendations to improve corporate governance and thus firm

performance by reducing the agency problem within the public sector in Zimbabwe were herein suggested.

DEDICATION

To the Almighty God who gave me wisdom throughout my studies

To my family members who continued to support me all the way

ORIGINALITY DECLARATION

I, Taona Bhande, Registration R097339A, do hereby declare that this dissertation report for the award of Masters Degree in Accountancy at the University of Zimbabwe is my original work and has not been previously submitted to any institution of higher learning. I also further declare that all sources cited in this research are indicated by means of a comprehensive list of references.

Signature.....

Date.....

Student

Signature.....

Date.....

Supervisor

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CHAPTER ONE

1.1 INTRODUCTION

This research is a study of the agency problem within the public sector in Zimbabwe with particular reference to the impact of corporate governance on firm performance. The research looks at the role of corporate governance in mitigating agency costs where these costs are taken as a proxy for performance. The dependent variable in the study is the agency costs which shall be measured using the proxy asset utilisation ratio following a similar approach in a study by Ang, Cole and Wuh Lin in 2000 and Singh and Davidson in 2003. An asset utilisation ratio which is bigger indicates that entities are making unsound investment decisions or that they are investing in inappropriate projects. The explanatory variables are the potential determinants of agency costs which are categorised as representing ownership influences and corporate governance mechanisms (director ownership, institutional ownership, external ownership, board size, CEO-chair duality, board independence and board remuneration).

The research is structured into five chapters. Chapter one touches on the introduction, the background to the problem, the statement of the problem, the research objectives and the research questions, the significance of the study, the scope, and the delimitations of the study and the definitions of key terms. Chapter two touches on a review of related literature and the conceptual framework where a number of theories are also reviewed as they relate to corporate governance within the public sector in Zimbabwe. Chapter three highlights the methodology, the research philosophy, data and operationalisation of variables and the model specification. Chapter four deals with data analysis and results while chapter five deals with conclusions, recommendations, limitations of the study and suggested future research. Every chapter has a conclusion which summarises main issues discussed in each chapter.

1.2 BACKGROUND TO THE PROBLEM

The agency problem has its origins within the private sector context. Agency then arises because of conflict of interest between the manager (agent) and the shareholders (principals) (Singh and Davidson, 2003). Within the private sector context, this problem was first observed by Berle and Means (1932) and further extended by Jensen and Meckling (1976) due to separation of control and ownership in the enterprise. Ross (1973) came up with the economic theory of agency in the study of agency in terms of problems of compensation contracting; agency was viewed as an incentives problem. Mitnick (1975) is responsible for the institutional theory of agency, though the basic concepts underlying his approach is similar to that of Ross (1973) hence the approaches seem complementary owing to use of similar concepts under different assumptions. Mitnick (1975), thus, pioneered the now common insight that institutions form around agency, and evolve to deal with agency, in response to the essential imperfection of agency relationships and the view that agents' behaviour is never perfect and never suits principal expectations because it does not pay to make it perfect. Societies then create institutions that manage these imperfections. It is suggested that to comprehend agency, one needs to see the incentives as well as the institutional structures. With this in mind, one may want to ask whether this problem is peculiar to private enterprises only since the government or the public sector does not have specific ownership. This research argues that the agency problem is observable and thus prevalent within the public sector in Zimbabwe and that it has a significant negative influence on performance.

At an international level, corporate governance has been discussed so often in the business vocabulary more so after the collapse of Enron in 2001. The UK responded by producing the Higgs Report (2003) and the Smith Report (2003) whereas the US produced the Sarbanes-Oxley Act (2002). Specifically, in 2003, the UK Government commissioned Derek Higgs to write a report reviewing the role and effectiveness of non-executive directors. The report made several observations and recommendations, amongst them, that the role of the non-executive directors should be outlined in The Combined Code on Corporate Governance (The Code). The Code is essentially a consolidation and refinement of many different reports and codes concerning opinions on good corporate governance. The initial step on the road to the first iteration of the code was the publication of the Cadbury Report in 1992 which was

produced by a committee chaired by Sir Adrian Cadbury. The Report was a response to major corporate scandals connected to governance failures in the UK. The committee was formed in 1991 after Polly Peck, a major UK company, went insolvent after years of falsifying financial reports. Initially restricted to preventing financial fraud, when BCCI and Tobert Maxwell scandals took place, Cadbury's mandate was extended to corporate governance generally. Hence, the final report covered auditing, financial and corporate governance matters, and recommended that the CEO and Chairperson position in companies should be different, boards should have at least three non-executive directors, two of whom should have no financial or personal ties to executives and that each board should have an audit committee composed of non-executive directors.

The Higgs report recommended that non-executives in general should meet independently of the board at least once a year. It also addressed issues on the recruitment of non-executives, their liability when on the board, their general responsibilities, remuneration of non-executives and even correct practice for their resignation. The report suggested that there is a positive role for non-executive directors to play in good corporate governance although a number of issues must be addressed for them to be truly effective.

The Smith Report was a corporate governance report submitted to the UK government in 2003. It touched on the independence of auditors in the wake of the collapse of Arthur Andersen and the Enron scandal in the US in 2002. The recommendations of the report now form part of the Combined Code on corporate governance, applicable through the Listing Rules for the London Stock Exchange. It was substantially influenced by the views taken by the EU Commission. One important point was that an auditor himself should look at whether a company's corporate governance structure provides safeguards to preserve his own independence.

The Sarbanes–Oxley Act of 2002 is a United States federal law that pioneered fresh and expanded requirements for all U.S. public company boards, management and public accounting firms. The Act also applies to privately held companies, for example, the wilful destruction of evidence to impede a Federal investigation. The Act, which contains eleven sections, was enacted as a response to a number of corporate and accounting scandals, including those at Enron and WorldCom. It covers responsibilities of a public corporation's board, criminal punishments for specified misconduct and required the Securities and

Exchange Commission to form laws to regulate public corporations compliance with the regulations.

At national level in Zimbabwe, there have also been many cases of scandals chief among them being those contained in the report by the Anti-Corruption Trust of Southern Africa in its 2012 edition which encapsulates cases of corruption that made headlines in Zimbabwe but whose outcomes remain obscure. Examples of poor governance noted in the public sector in Zimbabwe as cited in that report include the NRZ housing scandal, the ZRP Santana scandal, the salarygate scandal, the Willowgate Scandal, the National Oil Company Scandal, the Zimbabwe Iron and Steel Company (ZISCO) Scandal, the Kondozi Estate Looting, the Zimbabwe United Passenger Company (ZUPCO) Scandal, the Fertiliser Scandal, and the CMED fuel scandal. According to the European Union's Anti-Corruption Report of February 2014, bad corporate governance as reflected by corrupt practices are not useful at all since it impact negatively on the economy and society as a whole by retarding economic development, undermining democracy, and damaging social justice and the rule of law. It was also suggested that bad corporate governance impinges on good governance, sound management of public money, and competitive markets and in worse situations; it undermines the trust of citizens in democratic institutions and processes.

Currently, nations around the world are instigating far reaching corporate governance mechanisms and reforms as evidenced by the proliferation of corporate governance codes and policy documents both at national and supra-national level. The subject of corporate governance often involves the citizens (principals) and the governing elite and bureaucrats (agents) as represented by public office holders. Under normal circumstances, public office holders would have genuine interest in serving the public consistent with the stewardship theory. They may be guided by the four basic elements of good governance namely accountability, participation, predictability and transparency. However, in reality, public office bearers regard their highly esteemed offices as opportunities for self enrichment. Since it is not possible for the principal to identify in advance who may be susceptible to the agency problem, the public sector often rely on contractual arrangements, material incentives and the imposition of monitoring mechanisms that better align the interests of principals and agents. This is expected to result in agency costs.

According to Walsh (1993), the agency theory argues that the public as principals on whose behalf politicians and bureaucrats (as agents) govern is unable to hold the latter accountable because of insufficient information (information asymmetry), the incompleteness of the contracts of employment and the problems of monitoring behaviour (Lane, 1995). Therefore, the public sector underperforms because state officials pursue their own narrow self-interests rather than that of the public. It is therefore difficult to extract accountability and good performance from public servants (agents) because of the monopolistic characteristics of public services, the imperfect information about the services, the inabilities and conflicts of interest of public employees and the huge transaction costs (agency costs) that would be involved in efforts to write and monitor complete contracts. One of the solutions to the problem of the public sector is to expose public services to greater competition. However, the result of the above drivers for change would require the role and institutional character of the state to be reformed and to be more market oriented and in addition, management may be oriented with emphasis on doing more with fewer resources. One may then want to ask what the impact of corporate governance is on agency cost within the public sector. This paper therefore attempts to consider the broad ranging nature of corporate governance mechanisms and their role in reducing agency costs within the public sector whereupon agency costs as a proxy in this context shall be inversely related to performance.

1.3 STATEMENT OF THE PROBLEM

The public sector the world over has been experiencing poor governance as illustrated in the background information above. At an international level, we are informed of some major corporate scandals chief among them being those at Enron (2001), WorldCom (2002), Tyco International (2002), Adelphia (2002) and Peregrine Systems (2002) which sent shockwaves to the securities market. At national level in Zimbabwe, there have also been many cases of scandals chief among them being those contained in the report by the Anti-Corruption Trust of Southern Africa in its 2012 edition. The report encapsulates cases of corruption that made headlines in Zimbabwe but whose outcomes remain obscure. Those implicated have also been mentioned. However, it is acknowledged that all individuals are innocent until proven guilty. Nevertheless, it should also be further acknowledged that they remain implicated and labelled as suspects until proven innocent, which makes it urgent for both the implicated individuals, the law enforcement agencies and the judiciary to work in unison towards the finalisation of

such cases. Examples of poor governance noted in the public sector in Zimbabwe as cited in that report include the following:

- The NRZ housing scandal
- The ZRP Santana scandal
- The salarygate scandal
- The War Victims Compensation Fund Scandal (WVCF);
- Abusing the Constituency Development Fund (CDF);
- Diamond Scandals;
- Wealth Accumulation;
- The VIP Housing Scandal;
- The National Oil Company Scandal;
- The Zimbabwe Iron and Steel Company (ZISCO) Scandal;
- The Kondozi Estate Looting;
- The Willowgate Scandal;
- The Zimbabwe United Passenger Company (ZUPCO) Scandal;
- The Fertiliser Scandal;
- CMED fuel scandal
- Interference with the functions of the judiciary;
- Harare Airport Extension Scandal; and
- Minister Christopher Mushowe and the University of Zimbabwe scandal.

From the caption, it is not surprising that Zimbabwe is rated by the 2011 Transparency International (TI) Corruption Perception Index (CPI) among the most corrupt nations in the world. This is costly to Zimbabwe since this implies the country is a risk investment destination as evidenced by some international critics who are advocating for factoring in corruption in the cost of doing business in Zimbabwe. Thus, the implications of poor governance has far reaching effects given the fact that the global village had its eyes on Zimbabwe for over a decade now and any negative issue emanating from the country receive widespread publicity regardless of the intensity of the matter. Furthermore, some economic policies in Zimbabwe which at times are perceived counter-productive and most forms of conflict within the country are largely triggered by corruption and mostly by those in

leadership positions. It follows therefore that governance affects the credibility, stability and competitiveness of Zimbabwe's economy by increasing country risk, an undesirable element to investors who are often risk averse. To this effect, according to the European Union's Anti-Corruption Report of February 2014, bad corporate governance as reflected by corrupt practices are not useful at all since it impact negatively on the economy and society as a whole by retarding economic development, undermining democracy, and damaging social justice and the rule of law. It was also suggested that bad corporate governance impinges on good governance, sound management of public money, and competitive markets and in worse situations; it undermines the trust of citizens in democratic institutions and processes.

The inability to detect the immediate and remote causes of poor governance in the public sector in Zimbabwe remains the biggest challenge. For example, courts are over flooded with cases of fraud and or corruption due to lack of accountability and poor corporate governance mechanisms. Of late, we are informed that some top managers in some public sector entities are in the dock facing fraud and or corruption charges (The Herald, 12 October 2015; Newsday, 15 October 2015). In addition, the Auditor General's 2014 Report published that only ten of the twenty-two Ministries audited had unqualified reports emanating from poor governance and or corruption while the State Procurement Board continues to be both a player and a regulator thereby creating a conflict of interest and compromising proper governance principles. At Harare City Council, despite a full Council resolution, there seems to be no effort and political will to resolve the unsustainable salary bill of a few managers that has clear implications on service delivery on social services (Newsday, 15 October 2015). The result of such poor governance has been poor performance of the public sector, erosion of government integrity and an increase in job losses due to government retrenching excess staff (Newsday, 15 October 2015). Despite huge resources being channelled to arrest the scourge, fraud and corruption continue at the hands of executives charged with implementing and monitoring policy. Furthermore, it is argued that the failure to understand the impact of corporate governance on performance in the public sector will need to be addressed (Newsday, 15 October 2015). However, there remains serious challenges in corporate governance mechanisms within the public sector despite Chapter 9 of the New Constitution which imposes impressive standards and specifically states that, "public administration in all tiers of government, including institutions and agencies of the state, and government-controlled entities and other public enterprises, must be governed by the democratic values

and principles enshrined in this constitution,”9(194). A fundamental question which arises is whether corporate governance can impact on agency costs and thus enhance performance within the public sector in Zimbabwe.

1.4 RESEARCH OBJECTIVES

GENERAL OBJECTIVES

This research aims to explore the impact of corporate governance on performance within the public sector in Zimbabwe. Put differently, the paper aims to show the role of corporate governance in mitigating agency costs. One of the motivations for this paper is to articulate the overall concepts of corporate governance and its role in reducing agency costs in the public sector.

SPECIFIC OBJECTIVES

- To reach a conclusion or make inferences as to why corporate governance impacts performance
- To identify performance in the public sector
- To identify corporate governance mechanisms which are most important to the public sector in Zimbabwe
- To assess the impact of corporate governance on agency costs in the public sector in Zimbabwe
- To provide a framework and offer recommendations which help to reduce agency problems within the public sector in Zimbabwe.

1.5 RESEARCH QUESTIONS

- Why does corporate governance impact performance?
- How has the public sector been performing?
- What are the most important corporate governance mechanisms in Zimbabwe’s public sector?
- What is the impact of corporate governance on agency costs and performance in the public sector in Zimbabwe?

- What options does the public sector in Zimbabwe have to mitigate the agency problem and thus improve firm performance?

1.6 SIGNIFICANCE OF THE STUDY

The public sector is one of the most important cornerstones of the Zimbabwean economy. Unfortunately, it is generally regarded as the most inefficient sector of the economy due to agency problems. For example, corruption has become rampant within Zimbabwe as evidenced by the fact that Zimbabwe is at the 163rd position out of 176 countries in the 2012 Transparency International Corruption Perception Index thereby ranking equal to Equatorial Guinea. Ranked on a scale of 0 (implying highly corrupt countries) to 10 (corruption clean countries), the Corruption Perceptions Index score for Zimbabwe was 2.0. Such a result represents a marked increase in corruption since 1999, when the country scored a record 4.1. However, most literature on corporate governance associates it with private sector entities. For example, the collapse and scandals of big US corporations that triggered the emergence of the Sarbanes and Oxley Act showed that there is need for an improved corporate governance culture worldwide.

This research forms some initial work and studies done in the Zimbabwean context in highlighting the importance of corporate governance in minimising agency cost in the public sector with a view to enhance performance as the majority of studies were within the African context mostly in Kenya. For example, Cheema *et al.* (2003) looked at the nature of ownership structure of corporations in Kenya while Ghani *et al.* (2002) looked at business groups and their effects on corporate governance for the period spanning 1998 to 2002. Hasan and Butt (2009) also looked at the effect of ownership structure and corporate governance on the structure of capital for periods 2002 to 2005. Ashraf and Ghani (2005) further investigated the origins, growth, and the development of accounting practices and disclosures and their drivers in Kenya while Mir and Nishat (2004), Shaheen and Nishat (2004), Tariq and Butt (2008), Javed and Iqbal (2006), Javed and Iqbal (2010) and Humera Khatab *et al.* (2010) investigated the association between corporate governance and company performance. This study therefore forms some initial formal work done in the Zimbabwean context to look at agency costs, the agency problem and the impact of corporate governance and ownership influences in constraining these costs. In addition, the study is appropriate at this time

especially after Zimbabwe launched The National Code on Corporate Governance (2014) on 9 April 2015.

Few studies have been carried out too in developed economies in the corporate governance subject. Additionally, former research that openly measured agency cost level and then determined factors that affect firm's agency costs are limited in number. Research that investigated the agency cost factors and the impact of corporate governance on agency cost includes those by Ang *et al.* (2000) who took information from US non-listed companies, Singh and Davidson (2003) and Doukas, Kim and Pantzalis (2000) who employed a sample of large listed American firms, Fleming *et al.* (2005) and Darren Henry (2006) in the context of Australia, in UK companies Florackis and Ozkan (2004) during the period spanning from 1999 to 2003 and Doukas *et al.* (2005).

Being a less developed country, Zimbabwe's corporate governance practices are expected to be still at infant stage and evolving hence the practices are likely to be substantially different from those of more developed countries. Carcello *et al.* (2002) and Yatim *et al.* (2006) complements this by highlighting that former research suggests that substantial work in the corporate governance subject was carried out in developed economies while limited work was in developing economies because their mechanisms of corporate governance are still developing or evolving.

In addition, Ferris and Graddy (1998) evaluated the potential for institutional economics to help frame choices for the design of institutional arrangements aimed at improving public sector performance and the lessons offered in the development of a new Public Management Theory. The analysis however only illustrated the potential for a general framework for analysing alternative institutional arrangements for public sector performance, identifying characteristics of contracts, either explicit or implicit, that effectively balance efficiency and accountability for purposes of expanding the knowledge base in the field of public administration.

Ming- Cheng Wu *et al* (2009) also investigated the impact of corporate governance mechanisms on firm performance. They however employed different variables to measure firm performance, that is, return on assets, stock return, and Tobin' Q, in addition to the fact

that the research was for firms listed in Taiwan over a period 2001-2008. Additionally, Benz and Frey (2007) looked at how corporate governance can learn from public governance in areas of manager compensation, the division of power within firms, rules of succession in top positions and institutional competition in core areas of governance. The arguments have however been mainly developed with respect to the classical private corporation, but, to an even greater extent, they may be applied to not-for profit firms and firms with varying degree of government influence. Islam (2010), also identified various agency relationships in economics and business life and the related problems that may exist. However, the study was for Bangladesh private firms thereby limiting the applicability of the research findings to the Zimbabwean context. Moreover, the Anti-Corruption Trust of Southern Africa (ACT-Southern Africa) looked at corruption cases in Zimbabwe from 1980 to 2012. However, the research was not specific to the public sector. Thus, whilst a private sector context on corporate governance is a common discussion and research topic, there is also need to pay attention to the public sector. This suggests that there still exist a large vacuum in as far as research on public sector corporate governance is concerned particularly within the Zimbabwean context. No research in Zimbabwe has looked at corporate governance in the public sector as prior research was conducted at the firm specific levels. Complimenting this, Benz and Frey (2007) suggested that to improve the weakness and failures of the private sector practice as shown by the collapse and scandals of big corporations, private sector governance can learn more from public governance. This suggests that public governance can give a new insight in improving governance of corporations. Moreover, one of the motivations in this study is commercial. However, there exists a huge academic gap in literature which this study intends to fill. Consequently, the research should mainly benefit the following groups:

1.6.1 GOVERNMENT OF ZIMBABWE (GOZ)-The entire public sector falls under the responsibility of government. This research should therefore benefit the government by identifying agents costs applicable to the public sector and how corporate governance impacts on such costs. This should help in the formulation of policies and in decision making on selecting corporate governance mechanisms that assist in reducing agency costs. In any case, governments that do not go by cost effective governance mechanisms will be regarded as less efficient and may soon be replaced. In addition, government owned enterprises forms a substantial part of Gross

Domestic Product and national employment. Moreover, these entities are often prevalent in utilities and infrastructure industries, like energy, transport and telecommunication, whose performance is of paramount importance to broad parts of the society and to other parts of the business community. As a result, proper governance of these enterprises will be critical to ensure they continue to contribute positively to the country's economic efficiency and competitiveness (Johnston, 2005). Moreover, good corporate governance of government Enterprises is an important ingredient for sustainable privatisation since it will make the enterprises more lucrative to potential buyers and enhance their worth (Johnston, 2005). Furthermore, the country has a significant public sector, which is a dominant feature of the economy. Currently, the country is reforming the way in which it organises and manages its state-owned enterprises and this research should therefore assist in supporting such reforms at the national level.

1.6.2 BUSINESS COMMUNITY- the public sector interacts so often with the business community to an extent that there is a direct link between the performance of the public sector and that of the business community in Zimbabwe. The strength of this relationship is however beyond the scope of this study and shall be left for future research. However, it is worth mentioning that Zimbabwe has more than seventy state enterprises which once contributed 40% to GDP between 1980 and 1990 (World Bank 2012 Report). This clearly shows the importance of this sector. As such, the scope for efficiency of the sector to drive economic growth is considerable. Specifically, it is critical to note that the public sector is as important, if not more important, as the private sector in driving the economic growth as it provides a balance that allows private investment to grow and flourish. Therefore, the conclusions and recommendations from this study should benefit the business community.

1.6.3 THE PUBLIC- operations of the public sector impact on efficient service delivery to the public. As such, the efficiency brought about by contributions from this study is expected to impact on the general public through improved service delivery, accountability and transparency. Although the public sector enterprises may provide

essential services and products by venturing in to territories too risky or unattractive to the private sector, the governance of such entities has remained sub-standard. This study is expected to come up with appropriate recommendations to strengthen public sector governance so as to protect the public interest.

1.6.4 ACADEMIA- this research is expected to formulate a basis for future research on related areas explored in this project. The findings of the study may be helpful to academics in finance and accounting, management, legal, and other related fields in filling in the gap in literature.

1.6.5 PUBLIC SECTOR EMPLOYEES- they are interested in job security. Ideas from this research are expected to bring about the much needed public sector efficiency. This should contribute to allocative efficiency within the public sector resulting in a more stable economy. A stable economy guarantees the public sector employees of job security.

1.6.6 OTHER STAKEHOLDERS

The activities of the government normally affects a wide range of stakeholders particularly on welfare issues as government policy gives policy direction to all through laws and regulations. As a result, this research is expected to generate debate by all those affected by government policy through its positive effect on ongoing public sector reforms.

1.7 SCOPE/ DELIMITATIONS OF THE STUDY

Public sector agency costs and the impact of corporate governance on performance is a very extensive topic to research on. The public sector involves both central government through various ministries and public enterprises in which the government has a vested interest. This researcher concentrated on agency costs and the impact of corporate government in thirty-six public sector enterprises. Specifically, the research had to be completed within six months. The researcher needed time to seek the necessary clearance from authorities and to access information as well as to get more informed responses from the respondents. However, the exact names of the public sector companies sampled shall not be revealed in this report following an agreement with the company executives of those companies. Specifically, the said company executives feared sensitive information may end up in wrong hands like

competitors and regulators hence there is need to observe high levels of confidentiality as soft copies of the final report of this study are expected to be sent to all who participated in this study. Consequently, the sampled companies shall be coded as entities 1- 36 during data analysis to preserve the anonymity of data of those companies. The enterprises were chosen on the basis that all required information is available. In addition, these enterprises constitute the pillars of the public sector in terms of capitalisation.

1.8 KEY TERMS

Agency Costs- These are costs that arise from misalignment of interests of the owners and managers of firms when the separation of ownership and control occurs (Jensen, 1986). Put differently, it is the sum of monitoring costs, bonding costs and residual loss.

Bonding Costs- These are costs incurred by managers to assure the owners that they will act in the interest of the later (Jensen, 1986).

Public Sector- The public sector comprises of government controlled or publicly funded entities that deliver public programs, goods, or services (Sikhungo, 2011). It is however not always easy to identify a public entity due to increasing involvement of private entities providing public goods and services.

Corporate Governance- is the legal system and effective ways by which companies are led and controlled focusing on the internal and external company structure aimed at monitoring the actions of management and thus reducing agency risks which may arise from the misconducts of corporate managers (Shleifer and Vishny, 1977). India's SEBI Committee on Corporate Governance in May 1999, however, describes it as the acceptance by company executives of the alienable rights of stockholders as the legitimate owners of corporations and their individual role as trustees on behalf of the stockholders (Fenando, 2005). Therefore, corporate governance is all about commitment to values, norms, ethical business conduct and making a difference between personal and corporate funds in running an organisation.

Monitoring Costs- these are costs incurred by the owners to monitor the actions of the manager. Examples are the costs incurred in appointment of auditors, appointment of board of directors, installation of formal control systems and budget restrictions (Fernando, 2009).

Residual Loss- is the reduction in the utility or welfare experiences by the principal because of such divergence of interest between the owners and the managers despite incurring monitoring and bonding costs (Jensen and Meckling, 1976).

1.9 CONCLUSION

This chapter covered the introductory part and background information to a study on agency costs for public sector entities in Zimbabwe with particular reference to the impact of corporate governance on public sector performance. This researcher also developed a statement of the problem, research objectives and research questions. A review of prior studies on corporate governance in the public and private sector from an international perspective was also done in order to establish the gap in literature to justify this current study. The chapter ended with mention of the scope or delimitations of the study and the definition of key terms. In the next chapter, this researcher shall do a careful review of related literature and the conceptual framework on corporate governance including some related theories. The chapter shall also review the link between corporate governance and product market competition, capital structure and how corporate governance relates to voluntary disclosure. It shall also review the Organisation for Economic Co-operation and Development (OECD) Guidelines on Corporate Governance of State-Owned Enterprises as well as the Sarbanes-Oxley Act. Finally, the chapter shall look at what constitute corruption; highlight the levels of corruption in Zimbabwe, the role of media in fighting corruption as well as reflecting on Government efforts in Zimbabwe to promote corporate governance and fight corruption.

CHAPTER TWO: LITERATURE REVIEW AND THE CONCEPTUAL FRAMEWORK

2.1 INTRODUCTION

The previous chapter focused on the introduction to the research on the agency problem within the public sector in Zimbabwe with particular reference to the impact of corporate governance on firm performance. The researcher also demonstrated that this research is significant to the government, academia, and other stakeholders after highlighting the background to the problem, statement of the problem and the objectives of the study. In this, chapter, the researcher shall review what previous scholars have said concerning the study under review with a view to demonstrate new insights into the research topic. The conceptual framework underpinning corporate governance and the agency problem shall also be reviewed.

2.2 GOVERNANCE IN PUBLIC AND PRIVATE SECTOR

Public sector corporations are generally considered to be inefficient the world over (Dopson and Stewart, 1990). Literature also argues that the public sector has much to learn from management practices of the private sector (Dopson and Stewart, 1990). However, despite differences in their broad objectives, problems faced by the private and public sectors are almost identical. This suggests that private sector corporations may emulate some of the practices of public sector corporations particularly after noting that most Singaporean public sector corporations have registered a strong growth over several years (Stiglitz, 2002).

After the Asian financial crisis of 1997-98, more attention was placed on microeconomic reforms, mostly in the area of corporate governance and principal-agent relationship, in the Southeast Asian region (Jomo, 2004). Many studies have offered alternative explanations for the emergence of the crisis. Stiglitz (2002) and Mahani Zainal Abidin (2002), argue that rapid and excessive short-term capital flows triggered the crisis. The International Monetary Fund (IMF), however, rejected this view in the early stages of the crisis. However, as the crisis

began to affect the industrialised countries through the subsequent Russian and Brazilian crises, greater attention was paid to the role of capital flows and private sector governance (Jomo, 2004). The industrialised countries, for instance, initiated microeconomic reforms, in order to raise the standards of corporate governance. There were indeed many cases of questionable corporate behaviour before and during the Asian financial crisis. For example, Hyundai raised US\$1 billion to bail out the Halla Group when it collapsed in Korea in 1997(Jomo, 2004). Shareholders were not pleased with this arrangement, which could be attributed to the fact that the founder of the Halla Group was the younger brother of Hyundai's head. In Thailand, two senior managers of the Bangkok Bank of Commerce lent funds to themselves and senior politicians when the bank was already in financial distress (Jomo, 2004). Thailand's central bank had to spend a large amount of public money to bail out the institution rather than letting it collapse with bad debt amounting to US\$3 billion (Jomo, 2004). These examples illustrate how weak corporate governance could lead to questionable transactions.

From related literature, Mizruchi (2004) points out that much of the existing research concerns the means by which owners (shareholders) can effectively monitor the managers' behaviour to ensure fair returns from their investments. One such mechanism involves the provision of equity to management, but this has the effect of diluting the value of the remaining owners' equity. Another mechanism involves appointment of a competent board of directors, which on behalf of the owners is responsible for assisting and monitoring the management team. But the board itself, regardless of the composition and structure, needs to be monitored. The third approach subjects the firms to mergers and takeovers, which may subsequently result in the removal of inefficient and unethical managers. But corporate controls cannot unravel the agency problem concerning the budgeting process (Jensen, 2003). Takeovers can also be disruptive and generally occur only after the firm has already lost a significant proportion of its value, and hence the root cause of the agency problem may not be adequately addressed.

2.3 CORPORATE GOVERNANCE, PRODUCT MARKET COMPETITION AND THE EFFICIENT MARKET HYPOTHESIS

Other scholars query about the importance of corporate governance as product market competition should motivate companies to employ the most cost effective corporate governance mechanisms. In any case, companies that do not employ cost effective governance mechanisms will be regarded to be less efficient and will over time find themselves out of business (Jensen, 1976). This suggests that product competition is expected to carter for governance (Watts and Zimmerman, 1986). This is consistent with the Efficient Market Hypothesis theory. Specifically, this theory holds that financial reporting and other related disclosures are not all that important since all information is available and defined in share prices. The theory thus tends to undermine the reality of information asymmetry in most business undertakings due to agency problems. It is argued that the provision of quality information may not necessarily facilitate monitoring by shareholders, if the shareholders cannot utilise the information (Watts and Zimmerman, 1986). An obstacle to shareholders utilising information is the cost associated with processing it. In the case of a small shareholder, the related costs may not be commensurate with the envisaged benefits. A common solution to this problem used to be the semi-strong form of the Efficient Market Hypothesis (EMH), which posits that a small shareholder will enjoy freely on efforts of larger professional investors in appraising publicly available information (Watts and Zimmerman, 1986). Nevertheless, this often relies on the preposition that the EMH holds. However, there are apparent deviations from this position. Moreover, the EMH only relates to informational efficiency, not the market's ability to assess the future cash flows and other fundamental features of a firm's economic performance, yet good corporate governance, from the perspective of an economy as a whole, should preferably refer to the fundamentals of the firm. Consequently, the EMH does not preclude possible problems such as short-termism (Watts and Zimmerman, 1986).

The literature also suggests that the free market provision of accounting information, as propounded by members of the Rochester School (for example, Watts and Zimmerman, 1986), resonates on the importance of contracting between financiers and corporate executives. Companies will fail to raise capital, or will have to do so on extremely unfavourable terms, if such companies fail to design and implement contractual terms

allowing financiers to monitor performance to guard against misinformation in financial statements including the provision of relevant and timely financial information and its audit in terms of the cost/benefit trade-off. An additional ex-post check on management in this framework is provided by the EMH, which suggest, in its semi-strong form that the market “sees through” any misleading accounting practices. In the EMH’s strong form, all available information, including insider information which is not reported in the financial accounts, is reflected in stock market prices.

However, while product markets and corporate governance systems are closely related, market competition alone cannot solve the problems related to asymmetric information, hold up, and principal-agent problems that are central to the corporate governance problem. Rather, we should however be mindful that the usefulness and nature of different corporate governance systems is a function of numerous variables like product market competition, the structure of capital and labour markets, and regulatory and legal environments. All the same, a properly designed corporate governance system can minimise the agency costs and hold-up problems related to separation of ownership from control and three mechanisms are often employed to deal with the problem of conflict of interest by agents over the affairs of principals and to deal with problems of management entrenchment and monitoring. The first method involves motivating executives through for example executive compensation plans, stock option and direct monitoring by boards. The second method may encompass ensuring shareholder’s rights are strengthened with a view that shareholders are motivated and have the power to monitor management. This method capacitates investors through regulatory protection against conflict of interest by executives say through protection and enforcement of shareholders rights and fighting against insider-dealing. The third method employs indirect means of corporate control like those in capital markets, managerial labour markets, and markets for corporate control like takeovers as already alluded to above. This paper therefore offers an alternative approach to supplement or compliment the above mentioned measures. It is therefore suggested that in some cases, the public sector governance standards can offer some useful lessons to the private sector enterprises to further improve their management practices (Jensen, 1976).

2.4 AGENCY COSTS AND THE AGENCY THEORY

Literature suggests that Ross and Mitnick were the first scholars to propose, explicitly, that a theory of agency can be created (Ross, 1973 and Mitnick, 1975). Specifically, Ross (1973) originated the now economic theory of agency by studying agency in terms of problems of compensation contracting and viewed agency as an incentive problem. In this economic agency theory, the problem is viewed as generic in the society and not restricted to the theory of the firm and it resonates on selecting the best compensation and contracting system to produce agent behaviour consistent with expectations of the principal. Focus should therefore be on the nature of incentive systems and the contracting systems that guide the allocation of those incentives, in addition to the conditions of risk and information that guide the choices of the actors.

Mitnick (1973) gave insights that institutions form around agency and evolve to deal with agency in response to imperfections of various agency relationships in institutions. Agency behaviour can therefore never be perfect and to the expectations of the principals because it does not pay to do so. Societies therefore create institutions to deal with these imperfections, thereby affecting them either positively or negatively.

The agency theory can also be traced to contributions by Adam Smith (1776), Professor of Moral Philosophy who is popular owing to his contributions in the economics discipline who once commented in the *Wealth of Nations* in 1776 that “Being the managers of other people’s money..... it cannot be well expected that they should watch over it with the same anxious vigilance (as their own). Negligence and profusion, therefore, must always prevail more or less in the management of the affairs of such a company” (Jensen, 1976). This suggests that if corporations are to fulfil their mandate, the market’s invisible hand has to be guided. This is the reason of agency problem between agent and principal. In specific terms, agency theory asserts that the agency problem exists due to separation of ownership from control and thus agents will not always act in the best interest of principals (Fama, 1980).

The agency theory represents important problems in corporate governance in both the private sector and public sector. Under this theory, managers are likely to display a tendency of “egoism” (Boatright, 1999). Put differently, firms are described as necessary structures to

maintain contracts and through firms; it is possible to exercise control which minimises opportunistic behaviours of agents. The theory further highlights the inherent moral hazard in the principal-agent relations that give rise to agency costs. Bromwich (1992) concludes that it is the consequence of the agent's shirking that we call agency costs. This suggests that the theory recognises the information asymmetry relationship, interests or work performance of agents described as adverse selection and moral hazard which affects the output of the agent in two ways; not doing exactly what the agent is appointed to do and not possessing the requisite knowledge about what should be done.

Jensen and Meckling (1976) posit that the principal will always try to constrain agent conflict interests where there is evidence that it's imminent by incurring different monitoring and bonding costs. It is argued that monitoring activities include imposing budgets and operational restrictions and constrains on agents and linking compensation with the outcome of decision making power and agreeing to have accounts audited (Bromwich, 1992:320). It was suggested that there is no guarantee that the even the incurrence of enough monitoring and bonding costs will arrest diverging interests between agents and principals resulting in residual loss. To this end, it is therefore often argued that with executive compensation, the agency theorists have overlooked the strong incentive that pay-for-performance plans have created for managers to engage in deceitful and illegal activities (Becht *et al.*, 2002:47; Jensen *et al.*, 2004:98)

Other literature posits that agency cost covers all costs associated with addressing potential or actual opportunism, and includes devising mechanisms to monitor agent behaviour, and to ensure that the agent behaves as stipulated in the contract (Stan *et al.*, 2007; Wankhade and Dabade, 2006). This may mean providing incentives and/or investing in monitoring of agent's performance. This suggests that incentive-based contracts can be used to motivate agents. Supporting this, Zhao (2005) concludes that when risk is moderate, more incentives should be used to motivate agents to act in the principals' best interests. On the contrary, as the level of risk increases, more fixed fees and fewer incentives may be more effective. Two central themes in principal-agent theory are moral hazard and adverse selection. Moral hazard is the lack of effort exerted by an agent, since it is impossible for the principal to monitor all the agent's actions (Gauld, 2007; Brown *et al.*, 2006; Muller and Turner, 2005). Adverse selection refers to the misrepresentation of ability by the agent to the principal. The agent may

claim to have certain aptitudes when selected to perform in a contract. Adverse selection occurs when the principal cannot thoroughly appraise these skills or abilities at the time of contract (Nyman *et al.*, 2005; Rai and Kim, 2002; Zeng *et al.*, 2007). In the case of unobservable behaviour (due to moral hazard or adverse selection), the principal can discover the agent's behaviour through incurring agency costs, by investing in information systems, such as budgeting systems, reporting procedures, board of directors, and additional layers of management (Zeng *et al.*, 2007; Wankhade and Dabade, 2006). Such investments results in costs to reveal the agent's behaviour to the principal.

2.5 THE AGENCY PROBLEM AND THE CONTRACTING THEORY

The principal-agent model also emphasises on determining the contract that is most efficient under different levels of outcome uncertainty, risk aversion, information, and other related variables. It attempts to determine whether the optimal contract between the principal and agent is based on behaviour or outcome. It assumes an easily measured outcome, and an agent who is more risk averse than the principal (Eisenhardt, 1989; Gomez-Mejia *et al.*, 2005; Brown *et al.*, 2006; Nyman, 2005). One typical example is when the principal knows what the agent has done. Given that the principal is buying the agent's behaviour, a contract based on behaviour is more efficient. An important element of the task performed by the agent is the programmability of the task. Task programmability influences the ease of measuring behaviour where programmability can be described as the level to which an appropriate behaviour by the agent can be spelt in advance (Eisenhardt, 1989; Zeng *et al.*, 2007). For instance, the work of a motor sales cashier is more programmable than that of a high-technology entrepreneur (DeHoog and Salamon, 2002; Borins, 2001; Lai *et al.*, 2007). The behaviour of agents working in more programmed jobs is easier to observe and evaluate. Highly programmed tasks readily reveal agent behaviour. Thus, the more programmed the task, the more attractive are behaviour-based contracts because information about the agent's behaviour is more readily determined (Finkle, 2005; Eisenhardt, 1989; Brown *et al.*, 2006; Khalil *et al.*, 2007).

2.6 CAPITAL STRUCTURE AND THE AGENCY PROBLEM

Under the agency theory, the divorce between ownership and control even in properly run companies is likely to result in managers exerting insufficient work effort, indulging in perquisites, choosing inputs or outputs that dovetail with their own preferences, or at least failing to maximise firm value (Jensen and Meckling, 1976). In effect, the agency cost of outside ownership is the equivalent of the lost value from company executives maximising their own welfare, rather than the value to shareholders (Jensen and Meckling, 1976). It is suggested that the choice of capital structure may help lessen these agency problems. In terms of the agency costs hypothesis, high leverage or a low equity/asset ratio mitigates the agency costs of outside equity and increases firm value by limiting or motivating executives to act in congruent with the interests of shareholders. After the seminal paper by Jensen and Meckling in 1976, more research findings on such agency-theoretic explanations of capital structure is evolving (Harris and Raviv, 1991 and Myers, 2001). It is expected that higher financial leverage may affect executives and mitigate agency costs through the threat of liquidation, which causes personal losses to executives of salaries, reputation and perquisites (Grossman and Hart 1982, Williams 1987), and through pressure to generate cash flow to pay interest expenses (Jensen 1986). Higher leverage can lessen conflicts between shareholders and managers concerning the choice of investment (Myers, 1977), the amount of risk to undertake (Jensen and Meckling 1976, Williams 1987), the conditions under which the firm is liquidated (Harris and Raviv 1990), and dividend policy (Stulz, 1990).

2.7 AGENCY PROBLEM AND RECENT DEVELOPMENTS

Agency costs can manifest in various forms, including self-serving mannerism by company agents pre-occupied by personal objectives, too much perquisite utilisation, unsound project appraisals or inappropriate accounting practices or corporate scandals (Jensen, 1976). The adverse effects of such undertakings are often felt through destruction of firm value and other effects on the wider stakeholder community. The noticing of the results of agency problems have triggered advocacy for free competitive markets for executive labour and corporate control as oversight mechanisms designed to constrain conflict of interest between agents and principals, the importance of institutional shareholders as proxy agency instruments and the development and enforcement of corporate codes to enable executive oversight and build the

desired motivational structures in companies (Morris, 2011). The most notable of such codes includes the Cadbury Committee Report (UK, 1992), the UK Combined Code (2002 and 2006), the OECD Principles of Corporate Governance (1999 and 2003), the CACG Principles of Corporate Governance in the Commonwealth (1999) and the Sarbanes-Oxley Act (USA, 2002). South Africa has responded by coming up with King Report (1994, 2002 and 2009) while Zimbabwe launched The National Code on Corporate Governance (2014) on 9 April 2015 that provides a framework for corporate conduct for both the public and private sector. However, the Zimbabwean code remains a voluntary code whose enforcement is on a “comply or explain” basis. Among some of the key elements of the Zimbabwean code are a critical evaluation of issues of corruption, corporate disclosure, communication and mechanisms for creating trust between shareholders, boards, management and employees as a reaction to the inadequacies in the regulatory framework such as the Companies Act which is now outdated having been enacted in 1951. Additionally, Zimbabwe has also enacted the Public Finance Management Act (Chapter 22:19) to bring about better governance. Unfortunately, research on the importance of corporate governance in reducing agency cost and thus promote firm performance is very limited. Despite this, literature suggests that agency costs can be minimised by internal governance mechanisms as shall be explained in the discussion below. Therefore, conceptually, agency costs should be lower where there is strict observance of corporate governance and this should result in higher firm performance.

2.8 THE IMPACT OF CORPORATE GOVERNANCE ON ORGANISATIONAL PERFORMANCE

Board Size

According to Singh and Davidson (2003), board size is the number of people in the Board of directors comprising of both independent and executive directors (Mir and Nishat, 2004). Veliyath (1999) noted that the board serves as a bridge between owners and managers; its duty is to safeguard shareholders’ interests. It takes responsibility for managing and supervising the board, monitoring managers’ behaviour for shareholders’ interests, making important decisions, employing management teams and supervising organisations in complying with the law consistent with the stewardship theory. The stewardship theory is not new at all in terms of literature in explaining the nature of corporate governance in firms. De

Ste Croix (1956, p38) states that the purpose of Greek and Roman accounting was to disclose any “loss due to dishonesty or negligency” of subordinates (agents). The idea that the purpose of accounting is to check the honesty and reliability of agency is called the stewardship concept in accounting literature. It has been used to explain, inter alia, feudal accounting in England (Littleton and Zimmern, 1962,p.23 and Yamey,1962,p15) and the financial reporting provisions of the British Companies Act of 1847 (Littleton and Zimmern, 1962,p.84). Thus the idea that agency relationship can explain accounting practice is not new at all. This theory works well where there is less mandatory regulation and more self-regulation. However, it is very unlikely that managers act as true stewards of companies as they are rational beings motivated by self interest and thus the theory is less likely to explain why managers behave the way they do in the same manner as the agency theory since the stewardship theory may be in conflict with the agency theory.

Jensen (1993) noted that directors in a large board have diverse opinions and consensus is difficult to reach. Therefore, the efficiency may be lower and control could deteriorate if directors increase (Lipton and Lorsch, 1992). Yermack (1996), Eisenberg, Sundgren and Wells (1998) and Singh and Davidson (2003) also noted that board size is negatively correlated to corporate performance. Nevertheless, Bacon (1973) holds an opposite opinion that larger board implies members with diverse background and viewpoints, which should be helpful for the quality of decisions. Additionally, a wide array of their interests may neutralize decisions. Zahra and Pearce (1989) and Kiel and Nicholson (2003) concurs with this line of argument and concluded that board size is positively correlated to corporate performance. The differences in findings may be due to heterogeneity in sampled firms used in the different studies in terms of the level of development in the evolution to sound corporate governance.

Research also shows that small boards are less powerful and effective as compared to large boards (Pearce and Zahra, 1991). Singh and Davidson III (2003) support this argument by asserting that the relationship between board size and asset utilisation ratio is positive and statistically significant. Furthermore, they concluded that agency cost will be lower as the asset utilization ratio grows. However, Florackis and Ozkan (2004) in a study during 1999-2003 on a sample of UK public listed companies, noted that board size negatively influence agency costs as proxied by asset turnover, meaning that the higher the board size ,the higher will be the agency costs due to reduced efficiency. In the same vein, Beiner *et al.* in 2004 and

Eisenberg *et al.*, in 1998 vindicates the findings of Florackis and Ozkans in 2004 suggesting that board size is negatively related to asset turnover. Large Boards of directors may have challenges in communicating with each other, which may reduce firm performance. Yermack (1996), Eisenberg *et al.* (1998) and Singh and Davidson (2003) also proved that board size has a negative relationship with firm performance. This suggests that there is no consensus yet on an ideal board size. The differences in lines of arguments may emanate from disparities in sample firms in terms of, for example, capital structure and financial arrangements (outside or inside financing).

Board Independence

Bhagat and Black (2002) defined board independence as the degree to which the board is involved in the daily operations or management of an organisation. Literature suggests that board includes internal and external directors. For example, Fama and Jensen (1983) revealed that internal directors, by virtue of their positions, are likely to possess much more information and thus likely to collude with managers and make decisions against shareholders. On the other hand, external directors are in neutral position, acting as supervisor and are good for eliminating principal-agency problem. Additionally, Beasley (1996) investigated the relation between board composition and financial scandals, revealing that the ratio of independent directors in the firms with no scandals is higher than the firms which have been caught manipulating financial reports. However, Bhagat and Black (2002) took the ratio of independent directors minus the ratio of inside directors as a proxy, and the result disclosed that board independence, significantly and negatively, correlates with short-term performance, but board independence makes no difference in improving corporate performance.

In relation to board independence and firm performance, if outside directors are independent and have professional ability, they could be more objective to make decisions and monitor managers. Empirical research by Weisbach (1988), Rosenstein and Wyatt (1997) and Huson *et al.* (2001) corroborate that the higher the ratio of independent directors for boards, the better firm performance could be.

Literature also suggests that larger board independence is construed as a monitory mechanism to constrain or control the agency problem. This implies that independent directors are

expected to work for the shareholders interest (Byrd and Hickman, (1992), Brickley *et al.*, (1994), Westphal and Zaiac,(1995) and Borokkhovich et al (1996). The same findings were found by McKnight and Mira (2003) and Henry (2004) who concluded that agency costs are expected to be less as the number of independent directors on the board increases. Conversely, Hermalin and Weisbach (1991) and Agrawal and Knoeber (1996) suggest that board independence is not all that important in reducing agency costs. This is supported by Ang *et al.* (2000) and Agrawal and Knoeber (1996). The differences in the impact of board independence on performance suggest that no one size fit all as firms are heterogeneous in nature.

CEO/Chair Duality

Previous research strongly suggests that segregating the CEO and chairperson position is expected to improve firm performance as well as helping to reduce agency costs. However, according to the agency theory as espoused by Fama and Jensen (1983), to reduce agency cost, the leadership composition cannot be segregated. It is suggested that CEO/Chair duality is not all that vital in explaining incurrence of agency costs (McKnight and Mira, 2003 and Florackis and Ozkan, 2004). In their study on UK public listed firms, Mcknight and Weir (2008) also find that duality is not all that vital in reducing agency cost. However, as the chairman serves as the executive, serving roles of decision-maker and supervisor simultaneously, the board is likely to lose its independence and monitoring power, consequently performing a weak function in mitigating costs. Daliy and Dalton (1993), Dahya *et al.* (1996) attest to that CEO duality seems to deteriorate firm performance.

In terms of Agency Theory, when a chairman assume the role of CEO and thus acting as decision maker and supervisor at the same time, the role of the board to mitigate agency cost could be weakened drastically; in the end, corporate performance is likely to drop (Jensen and Meckling, 1976;Fama and Jensen, 1983; Patton and Baker, 1987). Past studies by Daliy and Dalton (1993) and Dahya, Lonie and Power (1996) also revealed that CEO duality could bring about negative effects for corporate performance. Nevertheless, according to stewardship theory, executives' responsibility may neutralize self-interest behaviours derived from CEO-Chair duality, and they are even much more devoted to advance corporate performance. To this end, Boyd (1995) agrees to that CEO duality may bring in positive effects for corporate performance like motivation and a sense of responsibility.

Remuneration Structure

Darren Henry (2006) defined board remuneration as the sum total of annual benefits paid to all board members. In this paper, the remuneration structure variable is going to be measured by calculating natural log of the total annual benefits paid to all members of the board. In previous literature, it is predicted that the high director remuneration reduces the agency cost because these incentives will motivate managers to work in shareholder's interest to perpetuate receipt of those benefits and to protect job security (Mcknight and Weir, 2008). Contrary to this, Darren Henry (2006) however found that the role and impact of remuneration structure on agency cost measured by asset utilization ratio is negative, suggesting that high director remuneration does not reduce agency cost. Darren Henry (2006) further found that remuneration structure has an inverse relationship with asset liquidity ratio implying that remuneration structure reduces agency cost.

Prior studies by Core *et al.* (2001) and Murphy (1999) suggest that compensation contracts, whose use has been increased dramatically during the 90's, can motivate managers to take actions that maximise shareholders' value. Specifically, Core *et al.* (2001) posits that if shareholders could directly observe the firm's growth opportunities and executives' actions, no incentives would be necessary. This result may be consistent with the governance system prevailing in the UK market given the fact that UK legislation encourages non-executive directors to be active since it does impose fiduciary obligations on them. Also, UK boards are dominated by executive directors, which have less monitoring power (Core *et al.* 2001). Franks *et al.* (2001) confirm this view by providing evidence on a non-disciplinary role of non-executive directors in the UK.

However, due to asymmetric information between managers and shareholders, both equity and compensation related incentives are required. For example, an increase in executive compensation may reduce managerial agency costs in the sense that satisfied managers will be less likely, *ceteris paribus*, to exert insufficient effort, perform expropriation behaviour and, hence, risk the loss of their job. Despite the central importance of the issue, only a few empirical studies examine the impact of managerial compensation components on corporate performance. For example, Jensen and Murphy (1990) find a statistically significant relationship between the level of remuneration and performance. Murphy (1995) finds that the form, rather than the level, of compensation is what motivates managers to increase firm

value. Specifically, he argues that firm performance is positively related to the percentage of executive compensation that is equity based. In 2004, Hutchinson and Gul (2004) analysed whether or not managers' compensation can moderate the negative association between growth opportunities and firm value. The results of this study indicated that corporate governance mechanisms such as managerial remuneration, managerial ownership and non-executive directors possibly affect the linkages between organisational environmental factors (like growth opportunities) and firm performance. Finally, Chen (2003) analysed the link between equity value and employees' bonus. The findings suggested that the annual stock bonus is strongly associated with the firm's contemporaneous but not future performance.

From the above discussion, managerial compensation remains a debated component of corporate governance. From the findings reviewed, despite its potentially positive impact on firm value, compensation may also work as an "infectious greed" which creates a good environment for abuse, especially at significantly high levels. For instance, remuneration packages usually include extreme benefits for managers such as the use of private jet, golf club membership, entertainment and other expenses and apartment purchases. Benefits of this nature are usually associated with severe agency conflicts between managers and shareholders as shareholders may view them as not in tandem with firm performance.

On the other side, the majority of the studies in literature reverse the causation and examine the impact of performance changes on executive or CEO compensation (Rayton, 2003). Concerns about excessive compensation packages and their negative impact on corporate performance have led to the establishment of basic recommendations in the form of "best practises" in which firms should comply to limit the problems of excessive compensation. In the case of the UK market, one of the basic recommendations of the Cadbury (1992) report was the establishment of an independent compensation committee. Additionally, in the Greenbury (1995) report, specific propositions about remuneration issues were made including the rate of increase in managerial compensation. In the case of the US market, the set of "best practises" includes the establishment of a compensation committee to ensure transparency and disclosure (same practise as in the UK) and the substitution of stock options as compensation components with other tools that promote the long-term value of the company.

Managerial Ownership

According to Darren Henry (2006), director/ managerial ownership is a measure of the percentage of total company equity capital held by all company directors. Agency costs are expected to be lower where higher managerial ownership exists since higher managerial ownership is associated with the convergence of interests between company agents (company managers) and principals (shareholders) as suggested by Jensen and Meckling (1976) in the agency theory. Complementing this, Singh and Davidson (2003) vindicates the prediction of agency theory. However, the predictions give weak collaborating evidence that the agency problem can be reduced by increasing managerial ownership in companies. Jensen and Meckling (1976, p.335) also noted that there are agency costs in debt financing too. In the absence of monitoring and bonding contracts, an owner manager would increase his wealth at the expense of bondholders by first selling bonds with low variance of return and by then investing in a project with same systematic risk but with a higher variance of return (Jensen and Meckling, 1976). It is also argued that if the equity market is competitive, and makes unbiased estimates of the effects of monitoring and bonding expenditures, when the owner manager bears the total wealth effect of the expected agency costs of creating outside equity (Jensen and Meckling, 1976). Thus the manager has an incentive to reduce expected agency costs as long as the marginal benefits of those contracts (in terms of reduction in residual loss) are greater than the marginal costs (direct costs of the covenants and utility of the perquisites foregone).

From related literature, Berle and Means (1932) posits that ownership dispersion implies management is separated from ownership, which, as Jensen and Meckling (1976) stresses, may contribute to agency problems between managers and shareholders or shareholders and debtors. On the other hand, Shleifer and Vishny (1986) and Morck, Shleifer and Vishny (1988) revealed the phenomenon of ownership concentration. La Porta *et al.* (1999) and Claessens *et al.* (2000) usher in the conception of ultimate controller; they define firm ownership as voting rights, unearthing that many controlling shareholders of listed firms predominate firms by means of pyramid structure and cross holding, which could result in central agency problem. Kao, Chiou and Chen (2004) reveal that financially distressed firms are closely related to high ratio of the shares pledged by directors, causing concern about the agency problem resulting from the pledge of corporation shares. Chiou, Hsiung and Kao (2002) indicate that, directors and supervisors could fund by the collateralised shares and

further purchase more firm stocks to manipulate stock price or enhance their power. Therefore, Directors' and supervisors' financial stress, because of the collateralised shares, is likely to be closely related to share price. As share price slump, the value of the collateralised shares depreciates and may drop below the standard of the required margin; correspondingly, collateralising shareholders will be requested to collateralise more shares, while debtors fail to afford more shares as collaterals, financial institutions as creditors will close the position of collateralised shares. As a result, collateralising shareholders, making use of their position, may feed on small shareholders or embezzle company funds.

Institutional Ownership

According to Darren Henry (2006), institutional ownership is calculated by finding the total percentage shareholding of all institutional shareholders. Such shareholders are critical in reducing the agency problem because they are expected to closely monitor company performance through oversight on the action of managers. In this way, they can influence managerial decision making (Pound, 1988). Additionally, institutional shareholders as noted by Brickley, Lease, and Smith (1988) are likely to vote more actively on anti-takeover amendments and work in the best interest of shareholders. According to Pound (1988), institutional investors when compared to private investors who are expected to be less informed are likely to monitor executive performance at a reduced cost owing to expected greater expertise and resources. Henry (2004) also vindicates the findings of Pound (1988). However, Doukas *et al* in 2000, and Mcknight and Weir in 2008, revealed that agency cost is not impacted by institutional ownership. Basing on the work of Singh and Davidson in 2003, outside block ownership do not appear to have an important influence on agency costs. The reason may be that they are normally less informed of the practical realities in firms and their knowledge is often general. The differences in lines of argument may be due to differing perspectives under which the researches were carried out.

External Ownership

The seventh explanatory variable in this research is external ownership which is a measure of the percentage sum total of all individual shareholdings except managerial and institutional shareholdings (Darren Henry, 2006). As predicted on institutional shareholders, other external substantial shareholders may also maximise their value by monitoring company performance, which may reduce the agency costs. In line with Darren Henry's argument (2006), there is a

negative correlation between the dependent variable and asset utilization ratio, but this association does not appear to be statistically material. The same result was found by Singh and Davidson III in 2003 in a United States study, revealing that external shareholding does not have an important impact on agency costs when it is measured in terms of discretionary expense ratio and asset utilisation ratio. In line with arguments by Singh and Davidson III (2003), the small association between external ownership and agency cost proxies may be explained by the fact that those agency variables may not fully capture the performance metrics that are evaluated by the outside shareholders when appraising company performance. In terms of convergence of interest hypothesis, higher insider share ownership could help to reconcile executives' and outside shareholders' interests, which should reduce agency problems. Empirical results by Kesner (1987), Oswald and Jahera (1991), Eng and Mak (2003) reveal evidence that insider ownership has a positive relation with firm performance.

2.9 HYPOTHESIS

Based on the above discussion concerning the role of corporate governance mechanisms in enhancing performance, the following shall be the hypothesis for the purposes of this study:

H1: Agency costs will be lower when public sector companies have boards that are small in size.

H2: Public sector companies will face lower agency costs when they have higher board independence

H3: Agency costs will be lower when public sector companies have two different persons acting as a CEO and chairperson.

H4: Agency costs decreases with increasing pay and bonuses of management.

H5: At higher level of managerial ownership, firm will have lower agency costs.

H6: At higher level of institutional ownership, agency costs will be lower.

H7: Higher external ownership mitigates the agency problem.

2.10 PUBLIC SECTOR MANAGEMENT AND THE AGENCY PROBLEM

The agency problem within the public sector often involves the citizens (principals) and governing elites (agents), or the citizens (principals) and bureaucrats (agents) (Jensen, 1983). In an ideal world, public office holders would have a genuine interest in serving the public. In

such an ideal setting, minimal incentives are required to motivate public office holders. In reality, at least some public office holders consider politics as a career to earn their living. After all, significant time and capital is invested to get elected, and once elected they may try to apply whatever means they can to reap profit through abuse of office. Since it is often not possible for the principal to identify in advance the agent who may be susceptible to agency problems, corporations generally rely on material incentives and impose monitoring mechanisms to better align the interest of the principal and the agent (Jensen, 1983).

The concept of public choice, as put forward by James Buchanan, Gordon Tullock (1962) and William Niskanen(1971), recognises the agency problem in the public sector. In their seminal works, Buchanan and Tullock (1962) and Niskanen (1971, 1991) described politicians as self-interested individuals, just like anyone else, who may be interested in maximising their personal interest rather than that of the public, which they supposedly represent. The problem is worsened, as citizens are usually unwilling to monitor public sector managers. This is because most citizens perceive their individual voice to be insignificant in initiating change and are therefore disinclined to seek costly information. Therefore, corruption arising due to the agency problem can be observed in both public and private sectors. For example, managers of private as well as public sector enterprises may expropriate and abuse company funds. In the same vein, nepotism and bribery equally affect both the public and private corporations.

2.11 THEORY OF CORPORATE GOVERNANCE

From a review of related literature, the World Bank (1999) highlighted that corporate governance encompasses two mechanisms, internal and external corporate governance. Internal corporate governance, emphasising shareholders' interest, operates on the board of directors to monitor top management. Contrary to this, external corporate governance monitors and controls managers' behaviours by means of external regulations in force, in which many stakeholders are involved, such as suppliers, debtors (stakeholders), accountants, lawyers, providers of credit ratings and investment bank (professional institutions). This suggests that corporate governance is all about setting up structures and behaviours to regulate internal and external relationships and interactions with stakeholders. In the case of government regulators, an important aspect of this is the balance between independence and

government control, between transparency and accountability, on the one hand, and the need to respect privacy and commercial confidentiality on the other hand.

Literature also tells us that the subject has two views namely the narrow view and the broad view (Poitras, 1994). In the narrow sense, corporate governance refers to the relationship between the shareholders and managers. This is supported by the shareholder wealth maximisation theory. This theory holds that, originally, financial statements as a corporate governance tool were meant to give a report to shareholders who provided funds for investment and were regarded as true owners of the company. Prior to industrialisation, it was more of sole traders and hence there was no need for accounts to control ones' self. It is however not likely that shareholder wealth will ever be maximised due to the agency problem in today's corporations where there is separation of ownership from control (Poitras, 1994). The broad view relates to several interrelationships between enterprises and its stakeholders like clients, creditors and employees as suggested in terms of the stakeholder theory. Specifically, this theory recognises the wide range of affected parties due to the operations of an enterprise other than just zeroing in on shareholders and managers only which would conflict with the shareholder wealth maximisation theory.

Closely related to the stakeholder theory are the Legitimacy Theory and the Political Economy Theory. The legitimacy theory recognises that organisations seek to ensure they operate within the bounds and norms of their respective societies and their activities must be perceived legitimate. Specifically, the theory posits that for a corporation to continue to exist, it must act in congruence with society's values and norms (Dowling and Pfeffer, 1975). The idea is to promote corporate social responsibility. Companies must therefore be responsive to the ever changing bounds and norms since they have to abide by this social contract, that is, the implicit and explicit expectations that the society has about how the organisation should conduct its operations. The political economy theory reinforces the legitimacy and stakeholder theory. A political economy is the social, political and economic framework within which human life takes place. Corporate reports are therefore not considered neutral, but a product of the interchange between the corporation and its environment. The legitimacy theory and stakeholder theory can therefore be applied to explain why an entity might elect to make particular voluntary disclosures (Keech, 1995).

Literature also suggests that the narrow view is the traditional finance paradigm expressed in the agency theory while the broad view follows the stakeholder theory (Yatim, 2006). Complementing the above, Carcello *et. al* (2002) and Yatim et al (2006) argue that literature on corporate governance shows that most of the work done in this field was done in developed countries and very little in developing countries because developing countries corporate governance mechanisms are still evolving. For example, UK corporate governance was addressed by the 1992 Cadbury Report and its Code of Best Practice and the 1995 Greenbury Report. Illustrated below is what Johnson (2005) regard as the guides for proper governance in the public sector:

2.12 GOOD GOVERNANCE GUIDE FOR PUBLIC SECTOR ENTITIES

Effective agencies focus on achieving good governance to enhance firm performance and thus reduce agency costs through:

- strategy – involves planning and structures, such as strategic and operational planning, organisational structure and having defined and appropriate roles and responsibilities;
- culture – relates to leadership and integrity, demonstrated in leadership structures and behaviours, executive oversight of strategic decisions, embodiment of leadership principles, conduct and values, employee engagement and commitment to service delivery;
- relations – refers to communication and reputation, shown in internal and external communication and relationships, striving for a reputation for excellence, working effectively across organisational boundaries;
- performance - relates to effectiveness and efficiency, through performance monitoring and evaluation systems and process, both at an individual and organisational level, as well as performance reporting and
- compliance and accountability – this involves meeting statutory and other obligations, through audit, delegation of authority, and having policies, processes and plans to manage finances, risk, human resources, as well as ethical, equal opportunity, occupational health and safety and record keeping obligations.

2.12.1 The Elements of Good Governance

The word "governance" may mean different things to different people. As the ethos, experience and interests of people change, so too, do their perceptions of what constitutes good governance. Of the many definitions of "governance" that exist, the one that appears the most appropriate from ACAG's standpoint (1999) is "the manner in which power is exercised in the management of the State's affairs". Four basic elements of good governance are accountability, participation, predictability and transparency.

2.12.1.1 Accountability: means the imperative to make public officials answerable for their behaviour and responsive to the entity from which they derive their authority. Accountability also entails establishing criteria to measure the performance of public officials, as well as oversight mechanisms to ensure that standards are met. In an ideal situation, all public sector organisations are expected to be transparent, responsive and accountable for their work. The public should be adequately informed as to whether public resources are utilised effectively, efficiently and economically. Additionally, regular reports of performance and publication of results are paramount to record milestones and exert pressure for improvement. Transparency is important as a guarantee that public bodies are fully accountable and thus is pivotal to good corporate governance. A new aspect in corporate governance is the evolving nature of accountability with the greater involvement of the private sector in the provision of services to the public sector.

In the public sector where private enterprises are active, the issue becomes that of making reasonable sacrifices when, unavoidably in a public sector context, the perceived desire for being answerable has a potential to impact adversely on the economy and efficiency. A similar observation relate to effectiveness, especially where that idea does not include accountability concerns such as transparency, equity of treatment and probity of public resources, including the application of public service values and codes of conduct. This trade-off has long been discussed by, for example, Professor Richard Mulgan (2008 and 2013) of the Australian National University in numerous articles and seminars who noted that:

“Contracting out inevitably involves some reduction in accountability through the removal of direct departmental and Ministerial control over the day-to-day actions of contractors and their staff. Indeed, the removal of such control is essential to the rationale for contracting out

because the main increases in efficiency come from the greater freedom allowed to contracting providers.”

Another comment on the perceived trade-off has been provided by the Canadian Auditor General, Denis Desautels who noted that:

“The emphasis should not be solely on greater efficiency or on meeting accountability requirements.”

Additionally, commenting on the need to maintain scrutiny of government operations in June 2014, Senator Hogg (a Member of the Joint Committee of Public Accounts and Audit (JCPAA)), for instance, noted that:

“Public funds are not for the private purse of the government nor the bureaucrats to do what they like with. They are public funds for public purposes and should stand the test of public scrutiny by the Parliament.....”

This is however largely normative, that is, as it should be. It can however be argued that accountability of public sector operations is a function of providing the representatives of the Zimbabwean people—that is, Parliament— with all information on the operations of government entities and on the functions performed therein.

2.12.1.2 Participation: Participation is often related to accountability and, in representative democracies where citizens participate in government through the electoral process, public officials are accountable ultimately to the electorate Johnson (2005). At the grass roots level, participation implies that government structures are flexible enough to offer beneficiaries, and others affected, the opportunity to improve the design and implementation of public programs and projects. At a different level, the effectiveness of policies and institutions impinging on the State as a whole may require broad support and co-operation of the major stakeholders Johnson (2005).

2.12.1.3 Predictability: Predictability refers to the existence of laws, regulations and policies to regulate activities and their fair and consistent application. It requires the State and its agencies to be as much bound by, and answerable to, the legal system as are private individuals and enterprises. Predictability can be enhanced also through institutional

arrangements to ensure an appropriate degree of autonomy for those agencies which ought to be insulated from political pressures.

2.12.1.4 Transparency: Transparency refers to the availability of information to the general public and clarity about government rules, regulations and decisions.

2.13 IMPORTANCE OF GOOD CORPORATE GOVERNANCE

According to The Chartered Secretary Official Magazine (Issue3/2015), the Vice President Emmerson Mnangagwa stressed the importance of good corporate governance by summarising Zimbabwe's corporate terrain as characterised by powerful owners and managers, weak levels of accountability, lack of respect for shareholders, inactive markets for capital control and poor regard for the extended stakeholders. In his key note address to Secretaries attending the Institute of Chartered Secretaries and Administrators in Zimbabwe annual dinner, the Vice President noted that corporate governance issues in Zimbabwe revolves around resolving conflict of interest and balancing the sharing of power and wealth between owners and managers, poor accountability, short termism and unsustainable processes where workers, customers, suppliers, society in general and the environment have been the major victims. It is suggested in his address that good corporate governance is not only beneficial for individual companies but also for enhancing credibility, stability and competitiveness of Zimbabwe's economy by reducing country risk. This is particularly so if one notes that the country has negative experiences from its recent past on the effect of poor corporate governance on the economy (say the banking crisis where poor governance resulted in collapse of several banks while more recently, we had the salarygate scandal, where Chief Executive Officers and senior managers of some state enterprises and parastatals milked their entities through awarding themselves exorbitant and unsustainable salaries and allowances) (Newsday,15 October, 2015). To this end, the Vice President suggested that good governance should not be about compliance with rules as a box ticking approach.

2.14 PUBLIC SECTOR CORPORATE GOVERNANCE AND THE CONFORMANCE/PERFORMANCE DEBATE

According to Tricker (1994), there are two aspects of corporate governance namely conformance and performance. Conformance consists of two elements, that is, monitoring and supervising executive performance; and maintaining accountability. Performance consists of strategy formulation and policy making. In private sector, more emphasis is given to conformance aspect, but in the public sector, performance aspect is as important as conformance aspect (Hodges *et al.*, 1996). Therefore, public sector corporate governance is essentially concerned with structures and processes for decision-making and with the controls and behaviour that support effective accountability for performance outcomes (Barrett, 1998).

In the past, the tendency in the public sector has been to focus mainly on ensuring conformance with legal and procedural (including budgetary and financial) requirements, with attention to program outcomes and improved performance being a secondary consideration. As a result, there has been reasonable administrative control processes put in place for the implementation of government policies and procedures over many years. Public servants have been particularly concerned with ensuring that the requirements of relevant legislation were met and there has also been more emphasis on fraud control and probity concerns. In contrast, there has not been effectiveness in constructing robust control structures aimed at assuring that public sector employees achieve defined outputs and outcomes, nor in providing efficient client-oriented services. Attention is now being given to addressing government programs/services directly to public sector clients, as citizens.

Concern has however been expressed, in both the public and private sectors, that there has been more emphasis on the form rather than the substance of good corporate governance.

Recently, a prominent Chairman of three major Australian corporate boards challenged boards' 'obsession' with conformance rather than performance and their predisposition to be risk averse. His comment was as follows:

“..... there's just been too much concentration in recent times on the conformance, the governance, the ticking of the boxes, who comes to meetings and I think it's far from clear that that adds value, improves the performance of companies, delivers benefits for

shareholders. And ... having lots of due diligence and advisors around you when you're making decisions doesn't necessarily make the best decision."

Such criticism needs to be addressed holistically while realising that there is always an optimum balance to be struck for maximum effectiveness, for instance in relation to Board independence. As a recent Australian survey suggested, the independence itself is no guarantee of success. More convincingly, many would agree with the following year 2000 quote attributed to Ian Horton, Principal of Boardroom Partners, that:

"Independence in itself is no substitute for quality on a board. There is no reason why you can't have both, but you need quality more than independence".

In my opinion, the critical issue for establishing a sound corporate governance framework is not limited to creating appropriate Board and/or committee structures or determining the way in which they work. The critical challenge is also not simply to ensure that all the elements of corporate governance are effectively in place, but more fundamentally, that its purposes are fully understood and integrated as a coherent and comprehensive organisational strategy focussed on being accountable.

Speaking at a public sector seminar in year 2000, Mr Sitesh Bhojani (Commissioner, Australian Competition and Consumer Commission) responded to the question as to what are the objectives of good corporate governance by highlighting that the following are still apposite:

- Enhance corporate performance;
- Simplify and reduce directors' duties and liabilities;
- Protect reputation of directors and the enterprise;
- Minimise government interventions; and
- Enhance public acceptance of the corporate sector.
- The question would realistically appear to be one of achieving a balance.

While there is no need to re-emphasise the advantages of legal compliance to this group, the language of a compliance program with its emphasis on a culture of compliance, starting from the top, leadership, shared vision, ongoing commitment, effective mechanisms, continuous improvement, performance, transparency, and accountability, is also that of corporate

governance. Indeed, Professor Allan Fels (2001) has rightfully observed about the value of an effective compliance program that:

“It is good corporate governance reduces litigation risks and, if there is litigation, will help reduce penalties”.

Justice Alan H Goldberg (Federal Court of Australia) (2001) suggested that:

“It (compliance) goes on to the agenda for every periodic board meeting and every periodic management meeting where the state of the organisation is overseen”.

Justice Goldberg goes on to say that:

“Every director and every executive, indeed all staff, must be evaluating their conduct by reference to compliance principles.”

Perhaps, no less should be said of the public sector. It could be argued that compliance programs have been a feature of bureaucracies in the past as part of their close association with legislation. The pertinent question is however, whether public sector organisations are sufficiently aware, and equipped, to put such programs in place now, having regard to the Australian Standard on Compliance AS3806. However, this was not discussed in this report as it does not form a central point in this research. For those interested, the latest Australasian Risk Management publication (Vol. 11, No. 2, March 2001) includes a “compliance compendium” on ways to increase the effectiveness of compliance systems.

As in the private sector, there is undoubtedly greater interest in the performance of boards. At this time, any assessment is likely to be more at board, rather than at individual level. Nevertheless, some board chairs are interested in developing a suitable appraisal mechanism for individual board members. It can be noticed that, in the recent Annual Report of Chartered Secretaries Australia, the board stated that its corporate governance practices should be indicative of best practice for an organisation of its type, and, as far as possible, for corporations generally. This was under the heading of ‘Board Performance and Management Appraisal’. It is no doubt that professional organisations of this kind will require good leadership in establishing suitable board performance and management appraisal systems.

2.15 ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) GUIDELINES ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES

By way of background, the OECD is a special organisation comprising of the governments of 30 countries working together to address the economic, social and environmental issues brought by globalisation (Johnson, 2005). It was set up to understand and to assist governments address problems related to new areas of concern in member countries, like corporate governance, the information economy and the challenges of population growth. This special forum gives an interactive platform for governments to share policy experiences, proffer solutions to similar problems, identify good practice and work to synchronise domestic and international policies.

The recent OECD Guidelines on the Corporate Governance of government Enterprises provide a globally agreed benchmark to assist governments appraise and improve the way they exercise their ownership functions in government enterprises (Johnson, 2005). They rely on experience from a large pool of OECD and non-OECD countries around the globe and gives advice on corporate governance challenges that need to be addressed where the state is a corporate owner (Johnson, 2005). Of late, sound corporate governance of government enterprises is becoming a reform priority in many countries. Improved efficiency and better transparency in the public sector will result in substantial economic gains especially in countries where government ownership is essential. Additionally, creating a fair ground for private and government enterprises to compete will help to drive a vibrant and competitive business sector. The OECD thus gives an important mechanism towards national and international efforts to improve corporate governance of government enterprises (Johnson, 2005).

2.16 CORPORATE GOVERNANCE AND VOLUNTARY DISCLOSURE

The demand for corporate disclosure may arise from information asymmetry problem and agency conflicts between management and outside investors (Healy and Palepu, 2001). Therefore, enhanced corporate disclosure mitigates these problems through reducing uncertainty surrounding future corporate performance and facilitates the trading of shares

(Hassian *et al*, 2009). Lang et al (2003) contend that enhanced disclosure can create value for the firm through its effect on firm's cost of capital, cash flows that accrue to shareholders or both. It is therefore argued that higher disclosure provides information to investors and thus reduces the cost of capital; and increasing the demand for companies' securities which will be positively reflected in firm value (Hassian *et al*, 2009). Moreover, higher disclosure is associated with governance reforms which affect firm value through cash flow effects by reducing agency costs. Leuz and Verrecchia (2001) and Healy et al (1999) however argue that managers voluntarily disclose information to increase firm value, lessen information asymmetry and reduce agency costs that they bear. Literature also suggests that firms will voluntarily disclose information as long as the information increases firm value (Lo, 2003; Einhorn, 2007 and Al-Akra and Ali, 2012).

From related studies, Bauhwende and Willekens (2008) used the agency theory to investigate corporate governance disclosures in the European Union and found out that their results vindicated the theoretical arguments about companies disclosing corporate governance information in order to reduce information asymmetry and agency costs. Henry (2010) proposed that corporate governance disclosure would reduce the agency conflicts and thus results into a reduction in agency costs. Kent and Stewart (2008) based their research on the premise that properly governed companies would increase their disclosures to reduce agency problems.

Closely related to the concept of voluntary disclosure is the Signalling Theory also known as the Information Hypothesis. This theory suggests that financial statements should provide useful information to investors for investment decision making (monitoring and bonding information). In his 1973 seminal article, Michael Spence argued that the problem of information asymmetry can be solved where one part deliberately signals some piece of information. Thus, the theory is a voluntary mechanism by management to inform the market by giving an indication of management's thinking and motivation. It emphasises on voluntary disclosure and there is a potential for political and market pressure which may force or penalise corporations for non-disclosure. However, there seems to be a contradiction in emphasis in accounting literature on the information function of financial statements as a corporate governance mechanism especially when one realises that financial statements are a result of actions of individuals and a political process through laws and other regulatory agencies. In terms of the capture theory, the regulators are coming from the regulated

industries and their motivations are already captured. Therefore, it remains debatable whether the information hypothesis has as much potential as the agency cost hypothesis in explaining the impact of corporate governance on performance or in explaining why managers behave the way they do. Signalling has been investigated and proposed as a potential means to address asymmetric information in the markets for Lemons (Akerloff, 1970). Recently, signalling theory has been employed in second hand cars market such as eBay Motors. For instance, Lewis (2011) investigated the role of information access and noted that the voluntarily disclosing private information increases the prices of used cars on eBay. Moreover, Dimoka *et al.* (2012) analysed information from eBay Motors pertaining to the importance of signalling to reduce product uncertainty. Adding to existing information asymmetry research in consumer behaviour literature from the agent (seller) to the product, academics came up with theories and supported the nature and scope of product uncertainty, which is different from, yet shaped by seller uncertainty.

In addition, literature also suggests that financial reporting forms a critical link in enabling financiers to appraise actions by directors (Eng and Mak, 2003). Imperfect financial reporting therefore inevitably causes unsound corporate governance systems. The continued existence of creative accounting is a reflection that financial reporting is not meeting its proper role. Under normal circumstance, the external auditing process should rectify this anomaly, but absence of auditor independence may hamper this. Therefore, criticisms of financial accounting and auditing are closely related to the corporate governance concept and this is not astonishing given the fact that accounting bodies were involved in the establishment of the Cadbury Committee.

Eng and Mak (2003) also argue that state ownership would lead to higher agency costs and weak governance. They find a positive association between state ownership and voluntary disclosure. On the other hand, Jung-wha –Zhang(2011) found out that agency problems between state ownership and minority shareholders cause an increase in administrative costs and a decrease in firm values. Land et al (2003) argue that institutional investors are more professional and financially literate hence anticipate that their presence is associated with higher levels of voluntary disclosure. They are expected to closely monitor managers hence reducing agency costs. However, Mckinnon and Dalimnthe (1993) and Bauwhede and Willekens (2008) found that the extent of voluntary disclosure is higher for companies with individual ownership for fear that government might end up imposing mandatory regulation.

Also, Jung-Wha and Zhang (2011) argue that when shares are widely dispersed, monitoring of management costs increases due to communication breakdowns and coordination problems hence firm value decreases.

2.17 THE SARBANES-OXLEY ACT (2002)

Other related reviews include the Sarbanes and Oxley Act of 2002 (SOX) which requires companies to report on compliance to corporate governance to reduce agency costs. It is further asserted that software vendors that market Enterprise Resource Planning systems (ERP) have taken advantage of this new focus on corporate governance and internal controls by emphasising that the key feature to ERP system is the use of “built it” control in the firm’s infrastructure (Morris,2011). Alchain and Demetz (1972) and Fama and Jensen (1983) concluded that an audit committee is one way to reduce poor governance in corporations. Core *et al* (1999) supports this idea by concluding that companies will face high problems of agency costs when they have weak structures of corporate governance.

The Sarbanes–Oxley (SOX) was named after U.S. Senator Paul Sarbanes and U.S. Representative Michael Oxley, the sponsors of the Act. Consequent to provisions of SOX, executives must individually certify the accuracy of financial information and penalties for fraudulent financial activity are much more severe. Additionally, SOX increased the board oversight duty and auditors independence. The bill was enacted in response to numerous cases of major corporate and accounting scandals, chief among them being those which rocked Enron, Tyco International, Aldephia, Peregrine Systems, and WorldCom. The said scandals cost investors billions of dollars when the share prices of those companies fell, and shook public confidence in the securities market. In addition, the Act established the Public Company Accounting Oversight Board or PCAOB, mandated to oversee, regulate, inspect, and discipline accounting firms in their roles as auditors of public companies. It also covers issues such as auditor independence, corporate governance, internal control assessment, and enhanced financial disclosure.

2.18 THE CADBURY REPORT

The Cadbury Report in the UK (1992) identified three critical principles of corporate Governance namely openness, integrity and accountability. This Cadbury Report is a report to

Cadbury Committee, a formal committee which was set up to address financial aspects of UK private sector corporate governance. The report was used as basis for the first public sector corporate governance framework developed by British Chartered Institute of Public Finance and Accountancy in 1995 (Percy, 1994; Whiteoak, 1994). One of the weakness of this framework is that it is based on broad principles (openness, integrity and accountability) instead of the detailed one.

2.19 THE COMMITTEE OF SPONSORING ORGANISATIONS (COSO)

During the 1980s, several high profile audit failures led to the creation of the Committee of Sponsoring Organisations of Treadway Commission (COSO) (Simmons, 1999). The COSO of the Treadways Commission released its report, Internal Control- Integrated Framework in September 1992 as a result of the Commission's recommendation that its sponsoring organisations work together to develop needed internal control guidance. It was reported that:

“Donald H. Chapin, an assistant comptroller general in the General Accounting Office (GAO) sent Robert L. May, COSO's chairman, a blistering letter that concluded the COSO report in effect calls for a retreat from public interest” (Kelly,1993). Kelly (1993) further asserts that the apparent underlying motive for GAO's action was its long held and often stated preposition that there is a pressing need for public reporting on internal controls, including internal controls that go beyond financial reporting matters and encompass certain operations and compliance. Complementing this, El-Nafabi (2009), in his study of the role of the public sector audit and financial controls in Sudan, found out that audit , accounting systems and internal controls are paramount in ensuring accountability for public funds and safeguarding limited public resources against corruption and other misappropriation and unlawful practices.

2.20 CORPORATE GOVERNANCE AND CORRUPTION

The issue of corruption is central to any discussion related to corporate governance since corruption is associated with poor governance in most cases. Unfortunately, the word corruption has several meanings depending on the context in which it takes place, either in the public or private sector. Transparency International (2010) defined it as “dishonest or fraudulent conduct by those in power...” while an international anti-graft organization, Global

Organisation of Parliamentarians Against Corruption (2003), described corruption in public service as “the misuse of public power (by elected or appointed civil servants) for private gain”. Simply put, corruption in the public sector involves the misuse of public office for personal gains. It has become an internationally condemned scourge whose catastrophic effects have been detrimental to many countries. So big is the threat of corruption that various international organisations have been set up to combat it, while locally, institutions have also been put in place to investigate allegations of corruption and prosecute offenders, as well as to report publicly on the issue to discourage its practice. Local institutions established to fight graft include the constitutionally established Zimbabwe Anti-Corruption Commission (ZACC), and civil society organizations set up to act as a public sector corruption watchdog, such as Transparency International Zimbabwe (TI-Z) and the Coalition Against Corruption.

According to the European Union’s Anti-Corruption Report of February 2014, corruption practice: “harms the economy and society as a whole...hampers economic development, undermines democracy, and damages social justice and the rule of law. It impinges on good governance, sound management of public money, and competitive markets. In extreme cases, it undermines the trust of citizens in democratic institutions and processes”. Samundra PuaDEL (2010), a Nepalese anti-corruption activist, explains why corruption continues to exist despite concerted efforts to fight it. In his blog: “Voices Against Corruption” (2010) he says: “the roots of corruption are often grounded in a country’s social and cultural history, political and economic development, bureaucratic traditions and policies. Corruption tends to thrive when institutions are weak and economic policies distort the marketplace.” PuaDEL (2010) further elaborated: “As a single transaction, corruption occurs where there is a meeting of opportunity and inclination. The extent of corruption depends on the amount of monopoly power and discretionary power that an official exercises”

At national level, corruption has become prevalent in Zimbabwe with the country ranking among the most corrupt countries in the world. Specifically, in a Corruption Perception Index (CPI), a tool developed and used by Transparency International (TI) “to rank countries and territories in accordance with the perceived levels of corruption in the public sector”, Zimbabwe scored just 21 points out of a possible 100 in 2013. Additionally, of the 177 countries included in the Index, Zimbabwe ranked as number 157 thereby rendering the nation

as the most corrupt country in the SADC region. The Index is presented on a scale of 0 (highly corrupt) to 100 (no corruption).

In addition to the above, the year 2000 Transparency International Zimbabwe survey revealed that Zimbabwean citizens are of the opinion that the public sector is the most corrupt sector in the Zimbabwe (Newsday, 15 October, 2015). In the survey, respondents suggested that the police are the most corrupt followed by political parties, parliament/legislature, public officials/civil servants and the judiciary. Moreover, in 2008, a Transparency International director announced that Zimbabwe loses US\$5 million to corruption every day. Additionally, in 2011, the then Finance Minister Tendai Biti claimed that at least US\$1 billion in diamond-related revenue owed to the national treasury remains unaccounted for due to corruption, misappropriation and a lack of transparency on diamonds sales and the failure to recover losses. In an address to parliament, the Minister then was worried because there was no correlation between diamond exports made by Zimbabwe and the revenues derived thereof.

2.21 APPROACHES TO CORRUPTION

There is wide literature on corruption and several approaches to the corruption subject abound. A very rudimentary taxonomy would include crime, including the international approach to crime; public sector management and change; governance and ethics; elimination and control of corruption and economic theory. Much of the available literature, especially in the economics discipline, makes implicit references to agency and agency cost theories. It has been suggested in Friedmann's Nobel lecture in 1968 that the tradition of the literature dates back to GS Becker. Fjeldstd's (2003) study of the experience of Tanzanian tax administration services suggests that corrupt practices cannot be eradicated merely by paying higher salaries. Deininger and Mpuga (2005) suggest that greater accountability mitigate the incidence of corruption, but Sarte (2001) associates oversight costs with reduced public sector monitoring, and consequential increases in the rent seeking activities of public sector agencies. Bishop and Sampford (2003) promote a multidisciplinary approach by looking at management organisation in the public sector from the perspective of law, ethics and governance. It is not astonishing that the available literature vindicates the proposition that the incidents and persistence of corruption will increase as the number of corrupt agents in the economy increases.

2.22 THE CORRUPTION THEORY

Several explanations are given for the persistence of corruption. Inadequate initiatives, inappropriate incentives, lack of political will, and the lack of adequate political competition are just a few of the potential explanations (Mishra, 2006). It is argued that corruption makes for dysfunctional administrative systems but it seems equally true that corruption does not completely prevail even in the most corrupt systems (Mishra, 2006). Indeed, no society is completely corrupt especially when referring to states that have made some attempt to institute organised public administration. This discussion, however, ignores what S Rose-Akerman (1999) calls the ‘purely kleptocratic or “vampire” states where there is no distinction between state management and private affairs and where the dominant oligarchs capture as much of the country’s resources as they wish. Therefore, for the purposes of this presentation, my interest is on Zimbabwe as one of the vulnerable states. Vulnerable states are states in which the public bureaucracies are at risk from capture or corrupt influence. It is arguable that all states, in which the distinction is made between state management and private affairs, are vulnerable states. Mishra (2006) interprets the fact that corruption does not completely prevail to mean that all societies will over time try to curb corrupt behaviour. This might rather be a little optimistic because others could equally argue that no society can be completely free of corruption. Mishra’s view (2006) represents the thesis that individual and societal values will develop and change over time. The proposition also acknowledges the fact that some societies have substantially managed to contain corruption in significant ways.

2.23 CORRUPTION AND LEVELS OF ECONOMIC DEVELOPMENT

Literature suggests that corruption is often discussed in developmental terms, with greater corruption associated with lower levels of development. This is what the data from Transparency International’s perception indices (2000, 2002 and 2008) suggest. However, it is not necessarily true that there is an inverse relationship between corruption and economic development. To this effect, Mishra (2006) concludes that societies with relatively same levels of development, judicial machinery, and politico-legal structures can exhibit varying degrees of “illegal (pre)occupation” like corruption, tax evasion, and other regulatory non-compliance. Mishra (2006) further notes that the expectation of corruption in a society is a

multiplier factor; if people expect others to be corrupt, then increasingly more will be. In addition, the more pervasive is corruption, the more persistent it is likely to be.

However, it may be argued that these phenomena are not fully understood. It may well be true that, as Sullivan (2002) argues, that poverty cannot be studied without addressing corruption and the political system that distributes society's surplus wealth, and both categories remain empty and static without addressing banality, the unhealthy and commodified leisure culture under capitalism that distracts rich and poor alike from realising their freedom. But does it necessarily hold that the opposite is always true; that corruption cannot be studied without addressing poverty? If Transparency International's corruption perception indices (1999, 2000, 2008, 2010, 2012, and 2014) are used to representing the existing data, and one concedes that both the methodology and the data from those indices are a little suspect, they clearly show a strong negative correlation between development and corruption. Transparency International's corruption perception indices show that rich countries are less corrupt and poor countries are more corrupt. On the other hand, the Transparency International corruption perception indices do not demonstrate the nature of relationship; is it the presence of corruption that impedes economic development, or is it the existence of economic development that reduces instances of corruption? In the same way we associate high levels of economic development with low levels of corruption, so well developed political systems are similarly associated with low levels of corruption. Rose-Akerman (1999) is one of the principal proponents of this latter view, but certainly not the only one. Mishra (2006), among others, also associate inadequate political competition with the causes of corruption. So, the protection of civil liberties, democratic elections and transparent government are regarded as defences to corruption, while non-democratic states are more susceptible to corrupt influences. However, it seems this is perhaps an oversimplification of the issue. There is certainly an association between weakly developed democratic institutions and corruption, but some highly competitive political systems are also corrupt and have been so for a long time.

2.24 CAN CORRUPTION BE ELIMINATED?

Much of the literature address the elimination or control of corruption, suggesting that corruption of the public bureaucracy can be eliminated or reduced by one or any combination

of the following: increasing penalties for corrupt activities, increasing the probability of conviction for corruption offences, and paying efficient wages to public agents (Damania, Fredriksson and Mani, 2006). But whereas the question most often put in the literature deals with eliminating and controlling corruption, there is an additional, interesting but most unusual question put by Damania, Fredriksson and Mani in 2006, that is, not why does corruption exist, and why is it so difficult to eliminate it? Why does corruption persist? It is the World Bank's position that while much is known about the proximate causes and consequences of corruption, little is known about the factors underlying its persistence (Damania, Fredriksson and Mani, 2006). Damania, Fredriksson and Mani (2006) have advanced a theory that deals with the persistence of corruption. Their assertion is that there is positive correlation between political instability and the persistence of corruption. Several arguments why such a correlation should exist abound but the most persuasive is that which suggest that unstable governments, faced with an ordeal of prospects of losing power, will place relatively lower weight on the welfare consequences of its future actions and more weight on those actions with current or contemporary utility; corruption becomes more self-sustaining, more persistent, in politically unstable regimes. However, to say that there is a correlation between political instability and the persistence of corruption is not synonymous to saying that there is a correlation between political instability and the creation of corruption, but Damania, Fredriksson and Mani (2006) assert that there is an indirect relationship. They insist that political instability result in less effective judicial and administrative institutions and this in turn increases the incentives to give and accept bribes and the argument can be extended to regulatory compliance. To the extent that the contemporary literature on bribery corruption addresses the issue from the perspective of corruption theory, it has been suggested that the theory focuses on the problems of inefficiency and incentives in a corrupt organisation.

2.25 MEDIA AND THE EXTENT OF ZIMBABWE'S CORRUPTION

Local media have always been doing a good job of exposing corrupt and fraudulent activity in state-owned enterprises, parastatals and municipalities. For instance, in the so called 'Salarygate Scandal', the media reported that heads of government-controlled enterprises were abusing public funds by awarding themselves unsustainable salaries and allowances. The institutions that were widely reported as having fallen victim of these scandals included the

Zimbabwe Broadcasting Cooperation (ZBC), municipal councils governing the affairs of Harare and Chitungwiza, the Grain Marketing Board (GMB), the Zimbabwe Revenue Authority (ZIMRA) and Premier Service Medical Aid Society (PSMAS) (Anti-Corruption Trust of Southern Africa, 2014). Those accessed for comment expressed outrage over the fact that while senior management at these institutions were awarding themselves hefty salaries and allowances, majority of workers at these state enterprises and councils were wallowing in abject poverty because they were poorly paid and or often went for several months without pay. In other instances, the media also exposed “shady” links between government officials running public institutions, high ranking politicians, some crooked local and foreign businessmen and syndicates who were accused of conducting corrupt deals in sectors such as mining, airline services, energy, road and infrastructural development (Anti-Corruption Trust of Southern Africa, 2014). These activities involved the deliberate manipulation of tenders and other forms of fraudulent activity. The most prominent cases in this class included the arrest of Air Zimbabwe’s senior management and their accomplices on allegations of swindling the national airline of more than €5 million and US\$2 million involving an airline insurance scam; the delay in the sealing of the Zisco Steel deal between government and Indian conglomerate, Essar Holdings, as some government officials with vested interests in the project allegedly tried to scuttle it; and that of a Ghanaian businessman William Atto Essien, who stand accused of master-minding a US\$6 million bribery scandal that initially implicated the former Zimbabwe Mining Development Corporation (ZMDC) chairman Goodwills Masimirembwa, who was eventually exonerated by President Mugabe during an interview on his 90th birthday (Daily News and NewsDay, 8/1 and 25 and 26/2). Additionally, there were also reports about the alleged involvement of members of the police force in corrupt activities, especially at roadblocks, bus terminuses and in Harare’s CBD. The Herald (17/1) reported senior police spokesperson, Assistant Commissioner Charity Charamba, saying that as part of measures to eradicate this, at least 33 traffic police officers at Avondale Police Station were transferred to other bases allegedly because of the “intolerable corruption levels”. The media also quoted senior police officials including Police Commissioner-General Augustine Chihuri warning, “corrupt police officers to expect the full wrath of the law as the organisation embarks on measures to stamp out graft in the force” (ZTV, 1/2, 8pm).

The critical issue with the above media reports however, is that the media appeared to accept this punishment as adequate retribution for those police officers involved in corrupt activities.

To the general public, bribery and blackmail are criminal offences and offenders are prosecuted and often jailed. Thus, to ordinary civilian observers, simply transferring corrupt officers from one area to another gives the impression that while the police authorities recognise corruption gives the force a bad reputation, they appear to be actually condoning the activity by not prosecuting the offenders or discharging them from service. Additionally, the media also appeared to be condoning this “preferential” treatment by failing to demand some explanation from the police authorities about why these alleged petty criminals in the police force have escaped prosecution.

2.26 THE FIGHT AGAINST CORRUPTION IN ZIMBABWE

Several efforts have been made in Zimbabwe to fight corruption. Such efforts are regulated by the following pieces of legislation:

- The Prevention of Corruption Act (1983);
- Public Service Act (1995);
- The Ombudsperson Amendment Act (1997);
- Anti-Corruption Commission Bill (2004);
- The Criminal law (Codification and Reform) Act (2004);
- Bank Use Promotion and Suppression of Money Laundering Act (2004);
- Criminal Procedure and Evidence Amendment Act (2004); and
- Criminal Law (Codification and Reform) Act of 2006

The Zimbabwean Anti-Corruption Commission (ACC) was set up after the passing of the Anti-Corruption Commission Bill in June 2004. This Commission is part to the Southern Africa Development Community (SADC) Protocol as well as the African Union (AU) and United Nations Convention on Anti-Corruption. It is however deplorable that, according to a 2009 report by Global Integrity, the Commission is regarded inefficient as very little authority was given to it to take vigorous strides to fight corruption in Zimbabwe. For example, it was reported that out of 147 corruption cases referred and attended to by the Commission in year 2006, only four of them were finalised.

2.27 CONCLUSION

This chapter covered a review of related literature and the conceptual framework on aspects related to the role of corporate governance in mitigating agency costs and thus to enhance firm performance. To guide the research, seven hypotheses corresponding to the seven corporate governance mechanisms (explanatory variables) were generated. In addition, issues covered also include a review of the agency theory, the corporate governance theory, the public sector management theory, the contracting theory, guide for proper public sector governance and other related theories like the signalling theory, shareholder wealth maximisation theory, stewardship theory, legitimacy theory, political economy theory, the efficient market hypothesis, and the stakeholder theory. A review was also done of the nature of relationship between corporate governance and product market competition, capital structure and voluntary disclosure. The chapter went on to discuss what constitute corruption and its link to corporate governance, the levels of corruption in Zimbabwe and the role of media. Lastly the chapter reviewed what the Government of Zimbabwe has done so far to fight corruption. In the next chapter, this researcher shall discuss the methodology, the research philosophy, data and operationalisation of variables, model specification as well as the way data is going to be analysed.

CHAPTER THREE: METHODOLOGY

3.1 INTRODUCTION

The previous chapter covered literature review and the conceptual framework where a number of theories were also linked to the topic under study. In this chapter, the researcher shall describe in detail how this research was carried out in terms of the methodology, research design and instruments, research philosophy, model specification and operationalisation of variables. The researcher shall attempt to justify the research instruments and methodology used by contrasting with other instruments or variables not used in this current study.

3.2 RESEARCH DESIGN AND INSTRUMENTS

This research mostly employs a descriptive research design. The researcher conducted the study on the basis of literature survey and secondary information by consulting various journals, research papers and other articles following a similar approach by Islam *et al* (2010) where the method was deemed appropriate for such studies. Questionnaires were administered to public sector managers while interviews were carried out to get the views regarding the nature of interaction between corporate governance, public sector performance and agency costs within the public sector consistent with studies by Mulyadi *et al* (2012) on a similar study. Questionnaires allow for respondents to take their time to give the correct information while interviews allow for the researcher to explore greater details by probing the interviewee to get clarity on any vague answers that may be filled in questionnaires. So, in essence, the data collection instruments were complementary to get the most reliable information in the circumstances.

In this study, agency costs are taken as a proxy for performance. Good performance implies less agency costs while the reverse holds (Mulyadi *et al*, 2012). The study also adopted descriptive research design because such a design allows simultaneous description of views, perceptions and beliefs of the respondents at any single point in time (Islam *et al*, 2010). Structured questionnaires and personal interviews were used to collect the data because this ensured confidentiality of the information given by the respondents. The determination of

validity and reliability of the instruments were done before collection of data for the main study. The instruments were deemed reliable with Cronbach's alpha above 0.7 (that is, $\alpha = 0.7$). A Cronbach's alpha is a measure of internal consistence of a set of items and often used in statistics to estimate the reliability of a psychometric test. Descriptive statistics was used to summarise the data through percentages and frequency tables as well as measures of central tendencies and dispersion consistent with similar studies by Islam *et al* (2010). The data was further subjected to inferential analysis through Pearson's correlation analysis to show the direction and strength of association between agency costs and corporate governance. The method used for detecting multicollinearity is through employing of a correlation matrix. A high correlation exists when it exceeds 0.80 or 0.90 in line with studies by Kennedy (1998). Brayman and Cramer (2001) complements this by asserting that when the correlation between any two variables is 0.80 or higher, then they will have the problem of multicollinearity while a 0.70 correlation is used as a benchmark by Anderson *et al.* (1999) for what should be regarded as a serious correlation.

3.3 RESEARCH PHILOSOPHY

This research follows positivism based on the idea that science is the only way to learn about the truth. Positivism belongs to epistemology which can be specified as a philosophy of knowing (Crowther and Lancaster, 2008). As a philosophy, it follows the view that only "factual" knowledge gained through observation (the senses), including measurement, is trustworthy. The researcher is therefore limited to data collection and interpretation through an objective approach and the research findings are observable and quantifiable leading to statistical analysis. As a research philosophy, positivism follows the empiricist view that knowledge is derived from human experience. Thus, the researcher is assumed to be independent from the study and there are limited provisions for human interests within the study. Crowther and Lancaster (2008) assert that as a general rule, positivist studies usually adopt deductive approach. Therefore, as this research follows a positivist paradigm, it is factual and considers the world to be external and objective.

3.4 DATA AND VARIABLES OPERATIONALISATION

This study used a sample of thirty-six public sector companies chosen on the basis that all the needed information is available and also that they are the biggest in terms of market capitalisation (they constitute 80% of the public sector capital). However, the names of those companies shall not be revealed in this report following an agreement with the company executives of those companies to observe high levels of confidentiality since soft copies of the final report of this study are expected to be sent to all who participated in this study. Consequently, the companies shall be coded on data analysis to preserve the anonymity of data from those companies. The enterprises were chosen on the basis that all information is available on all variables. In any case, they also constitute the pillars of the public sector in terms of capitalisation. The period of the study consist of 4 years from 2011-2014. The information was extracted mainly from the company audited annual reports or from companies' official websites. The researcher considered the audited annual financial accounts of all the companies during 2011-2014 in calculating financial variables. The research also employed fixed effect multivariate regression analysis to examine the role of governance and ownership influences in reducing the agency problem and agency costs.

3.5 OPERATIONALISATION OF VARIABLES

Dependent Variable

In this study, the dependent variable is agency cost, which is measured by using the proxy asset utilization ratio. This ratio is used after noting the acceptable results from a similar approach in a similar study by Ang, Cole and Wuh Lin in 2000 and Singh and Davidson 2003. A relatively higher asset utilisation ratio show that companies are making unsound investment decisions or that companies are investing their funds in sub-optimal projects which are unproductive. The formula is as follows:

Asset utilization ratio = total revenue/total assets

Although in studies by Rajan and Zingales (1995) and Ozkan and Ozkan (2004), the dependent variable is measured at some time t, while for the independent variables used

average-past values, this research uses averages for both variables. Using averages to construct variables helps in mitigating potential problems that may arise due to short-term fluctuations and extreme values in our data. Also, using past values reduces the likelihood of observed relations reflecting the effects of asset utilisation ratio on firm specific factors. Specifically, the variables are measured in years 2011-2014. Given that equity ownership characteristics in the country were relatively unstable over the period in question, it would be expected that measuring them in a single year would render the results biased (see also La Porta *et al.*, 2002).

An alternative proxy for agency costs between managers and shareholders, which is not used in our paper though, is the interaction of company's growth opportunities with its free cash flow (see Doukas *et al.*, 2002). This approach has however not been found to be suitable in the public sector and there has been advocacy for Return on Investment as an alternative measure.

As decisions are being made to allocate funds to initiatives, there needs to be a process implemented to evaluate them with a focus on results. Although the interest in return on investment has increased as an alternative method to measure performance, the understanding and determination of ROI (Return on Investment) as developed by Dr Jack Phillips, is still a matter that challenges even the most sophisticated public sector agencies. Some argue that it is not possible to calculate the ROI for any type of improvement initiative or program, while others are proceeding to develop meaningful measures and ROI calculations. Both proponents suggest that, eventually, they will need to show a return on investment or funding may be reduced and the initiative or program may be eliminated. The public service today faces this challenge; not only is there increased emphasis on understanding the efficiency of delivery and implementation, but also a new emphasis on the outcomes of programs. All types of public sector organisations are using ROI evaluation as a way to meet these challenges.

The types of programs suitable for ROI evaluation vary; some appropriate programs include:

- performance improvement programs
- training and learning programs
- change initiatives
- technology implementation or improvements;
- Human Resources programs and

- Organisational development initiatives.

The arguments for not using ROI as the dependent variable in this study are:

- Absence of revenues and profits- Most government agencies don't generate profits. ROI value can only be calculated when there are profits and revenues. However, others argue that this is far from the truth. The numerator in the ROI formula equation represents net benefits derived from either profits or cost savings. Monetary benefits based on cost savings is the majority in case studies. When productivity is improved, quality is enhanced, rework time is reduced; the result is a cost savings – a direct bottom line contribution.
- Absence of hard data-There is an argument that hard data is not available in government agencies; only intangible soft data is available. However others argue that this is not the case. In all government agencies, there is output, quality, cost and time – the four major categories of hard data.
- Government services are essential and, therefore, shouldn't have this level of evaluation. Many government services are essential and must be delivered, regardless of the accountability or contribution. Many critical government support services cannot be easily changed. This argument as others see it often create the illusion that government services should not be evaluated.

In reality, many of these programs should be subjected to detailed evaluation, at least for major programs with high investment. The effectiveness of the program can be changed, even if the program itself cannot be altered.

- Restricted range of options to correct problems-The range of options that are available to the private sector to correct problems within programs including discontinuing the program may not be available in the public sector. However, others argue that on the positive side, many options are often available to improve the program in terms of efficiency, effectiveness and its connection to the desired results.

Independent Variables

The explanatory variables in this research are potential determinants of agency cost levels which are grouped as representing ownership influences and corporate governance mechanisms.

3.6 MODEL SPECIFICATION

The method employed in this study to examine the link between governance and agency cost proxies is fixed effects multivariate regression analysis. This method is deemed satisfactory since it removes omitted variable bias and allows for controlling unobserved heterogeneity across the sample firms. The specifications of this model are as follows:

$$\text{Agency cost at } it = \beta_0 (\mathbf{a}) + \beta_1 (\text{CEO- chair duality } it) + \beta_2 (\text{Board independence } it) + \beta_3 (\text{Board size } it) + \beta_4 (\text{Board remuneration } it) + \beta_5 (\text{Institutional ownership } it) + \beta_6 (\text{External ownership } it) + \beta_7 (\text{Director Ownership } it) + \mathbf{d}_i + \mathbf{e}_{it}$$

Where: **Agency cost it** = the dependent variable of the study, it represent asset utilization ratio for firm **i** at period **t**.

a = Intercept, **d** = Firm-specific fixed effect, and **ei** = Error term **it**

3.7 CONCLUSION

In this chapter, the researcher discussed the methodology, the research philosophy, data and operationalisation of variables, model specification as well as the way data is going to be analysed. Justifications were proffered on the choice of research design, data collection instruments, sampling techniques and statistical tests. The next chapter shall deal with data analysis and results of the study. The findings from questionnaires and other data sources shall be analysed using R statistical and computing environment under sub-themes descriptive statistics, correlation matrix, regression analysis, pairwise correlation, multicollinearity and multivariate linear regression analysis. To help on data analysis Mean, median, max, mini and standard deviation shall be used.

CHAPTER FOUR: DATA ANALYSIS

4.1 INTRODUCTION

The previous chapter presented an overview of the research design and methodology used. A positivistic approach was adopted, and the data collection method used was a survey. This was meant to acquire knowledge or information about and to solve the research problem.

In this chapter, the results from the survey are described and or presented in the form of tables and bar graphs for easy interpretation of data. The results are presented in almost the same sequence as they appear in the questionnaire. The findings from the questionnaires are analyzed using the **R** statistical and computing environment. Different statistical analysis methods such as percentage frequencies, mean, and standard deviation are used in interpreting findings.

4.1.1 Descriptive Statistics

In this chapter, the researcher shall give the descriptive data and or statistics for all the seven explanatory variables and agency cost proxy asset utilisation ratio. The descriptive data and or statistics shall include the mean, median, standard deviation, minimum and maximum values. The study uses data from a sample of thirty-six public sector companies for the period spanning 2011 to 2014. The data is derived from company's audited annual reports.

4.1.2 Correlation Matrix

The Pearson's co-efficient of correlation and Spearman's rank correlation coefficient (a nonparametric measure of statistical dependence between two variables which assesses how well the relationship between two variables can be described using a monotonic function) are employed in order to investigate whether multicollinearity exist among the regressors or not. The method for detecting multicollinearity is through the employment of a correlation matrix. A correlation is classified as high if it exceeds 0.80 or 0.90 in line with the 1998 studies by Kennedy. Additionally, Brayman and Cramer in 2001 asserted that the correlation between any two variables of 0.80 or higher should be presumed to have the problem of multicollinearity whereas 0.70 should be used to benchmark serious correlations (Anderson *et*

al, 1999). For the purposes of this study, information for the whole study sample is used to detect correlations among explanatory variables using Pearson’s co-efficient of correlation.

4.1.3 Regression Results

The results of fixed effect multivariate regression analysis shall herein be presented in a table with asset utilisation ratio as the dependent variable. The model as a whole shall be significant in explaining variation in the dependent variable.

4.2.0 VARIABLE DEFINITION AND SOURCES

The general model regarding the relationship between agency costs and corporate governance mechanisms including source of each of the variable used is shown in the description given below:

$$Au = \beta_0 + \beta_1 CEO + \beta_2 Boi + \beta_3 Boz + \beta_4 Bor + \beta_5 Inso + \beta_6 Eo + \beta_7 Dos + \varepsilon_{it}$$

.....

(1)

Variable	Description	Data sources
<i>Au</i>	Asset utilisation	Public sector company reports
<i>CEO</i>	CEO/ chair duality	Public sector company reports
<i>Boi</i>	Board independence	Public sector company reports
<i>Boz</i>	Board size	Public sector company reports
<i>Bor</i>	Board remuneration	Public sector company reports
<i>Inso</i>	Institutional ownership	Public sector company reports
<i>Eo</i>	External ownership	Public sector company reports
<i>Dos</i>	Director ownership	Public sector company reports
$\beta_1 - \beta_7$	Coefficient of the predictor variables	
ε_{it}	Error term	

4.2.1 Response Rate of the Survey

Forty (40) questionnaires were administered to the respondents in the target population comprising of top management and middle managers in the surveyed quasi-government

departments like ZESA, ZUPCO, ZINARA, NSSA, POSB, TelOne and CMED as illustrated in **Table 1**. The responses from the sample of top management and middle management officials from the aforementioned organizations gave an overall 90% response rate as illustrated in **Table 2** arising from a return rate of thirty six (36) out of a total of forty administered questionnaires. Further details regarding the response rates of the different strata are presented in **Table 2**.

Table 1: Response rate of the survey

Population	Target group	Distributed	Returned	Response rate	% Response rate
Public sector	Top management	20	16	0.80	80
	Middle managers	20	20	1.00	100
Σx		40	36	1.80	180
\bar{X}		20	18	0.9	90

Source: Sampling survey, 2016

The results of the study therefore relied on the thirty six returned questionnaires that comprised the middle and top managers in the thirty-six parastatals as shown in **Table 2** and these were taken as the final participants of the study. This subsequently formed the sample size upon which data analysis for this study was based. The study of Shaheed (2011) on the effects of CEO and Directors powers on corporate governance in Japan using small and medium enterprise organizations established a response rate of 66%. According to Employee Survey Solution (2011), the response rate generally varies, and a response rate less than 65 percent is considered too low while a response rate of more than 75 percent is considered good. The present research therefore represents a reasonably high response rate to warrant a valid conclusion based on the findings of the research.

4.3.0 DEMOGRAPHIC INFORMATION

Demographic data regarding working experience and educational background of the surveyed respondents in the public sector of Zimbabwe was obtained through a questionnaire survey. An empirical overview of the demographic variables in the study sample is presented in the ensuing paragraphs. An analysis regarding the demographic trends in the study

population was done in order to provide insights that could be of interest to the research questions of the study at hand. Consequently, the analysis provided a platform on which to further develop the perceptions of the research questions earlier on formulated in the study.

4.3.1 Working Experience

A greater proportion of the middle manager respondents (56%) have work experience ranging from 5-10 years whilst top management in the public sector (58.5%) have work experience ranging from 15-20 years as illustrated in **figure1**. An insignificant proportion of the top management respondents (2.5%) have work experience of 0-5 years whilst a sizeable proportion of the employees (20.5%) have work experience ranging from 5-10 years. These results are consistent with existing trends in the public sector in that top management in parastatals is deemed highly experienced and knowledgeable in comparison to their junior counterparts. As such, appointments into senior positions of responsibility requires one to have served the organisation for a reasonable period of time and to command a certain level of education. On the other hand, it is common to see the less experienced staff of an organisation in the low ranking positions as illustrated below.



Figure 1: Work experience

4.3.2 Academic Background

60.5% of the surveyed top management respondents hold at least a post graduate qualification whilst 58.8% of the middle management category holds at least a degree qualification as illustrated in **Figure 2** below.

As expected, the top management category has an insignificant proportion (2.5%) of employees with a diploma qualification. On the other hand, a sizeable proportion of the middle management employee respondents (40%) hold at least a diploma qualification. As such, the most educated staff members in the surveyed organizations are found in high ranking and senior positions whilst the less educated staff members are found in the junior and less experienced staff. Hence, the results depicted in **Figure 2** are consistent with the prevailing situation in the Zimbabwean public sector, that is, the quasi-government and governmental departments.

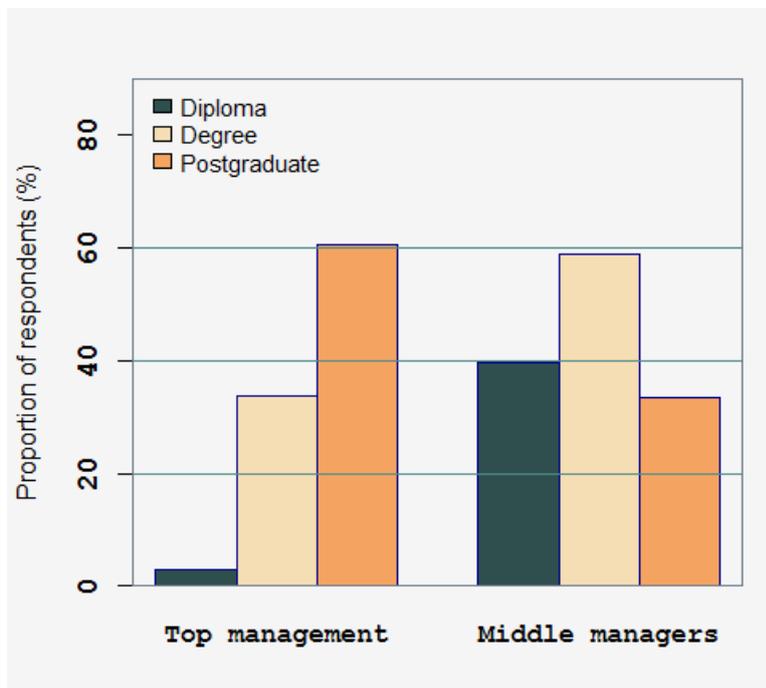


Figure 2: Education level

4.4.0 SUMMARY FINDINGS, STATISTICS AND ANALYSIS

A presentation of descriptive statistics coming from an exploratory analysis of the public sector data is illustrated in **Appendix AA**. The descriptive statistics for the proxy of agency costs, asset utilisation, alongside the seven predictor variables of asset utilisation are given in **Table 3**. The data or statistics computed in this research include the mean, median, standard deviation, minimum and maximum values. The study sample comprises of 36 public sector companies in Zimbabwe that have been in existence for a period of at least 10 years. Statistics regarding the variables in question were compiled from the annual reports of the various companies sampled in Harare.

The results show that the mean asset utilisation ratio is 0.695, with a standard deviation of 0.5879. As far as corporate governance and ownership characteristics are concerned, the variable independent director has a mean value of 0.861, which indicate that the percentage of independent directors in company board of directors is 86.1%. The mean board size stood at 9 members with a standard deviation of 1.65, whereas duality has a mean value of 0.182 which means that sample companies in which CEO is also the chairperson of the board is less than 20%. The number of shares held by company directors and institutions is 2.37% and 1.95% respectively of total equity capital. The average value of external ownership is 5.86% with a standard deviation of 2.64.

Table 2: Descriptive statistics for the response and potential predictor variables. MEAN- mean, STDV- standard deviation, MED- median, MIN- minimum, MAX- maximum, SKEW- skewness, KURT- kurtosis.

	Response variable			Predictors				
	Au	BOI	BOR(US\$000)	BOZ	CEO	Dos	Eo	Inso
Mean	0.69	0.86	9368	9	0.18	2.37	1.95	5.86
STDV	0.58	0.24	4568	2.35	0.35	0.28	0.18	2.64
MED	0.36	0.23	2365	5.62	0	0.009	0.12	0.25
MIN	0	0	1023	4.1	0	0	0	0
MAX	1	1	12368	19	1	0.79	0.86	0.68
SKEW	0.87	0.36	2568	8.69	0.02	0.25	0.45	0.14
KURT	0.68	0.77	926.23	11.36	0.11	0.04	0.66	0.69

NB: Au=Asset utilization ratio, BOI=Board independence, BOR=Board remuneration, BOZ=Board size, CEO=Chair duality, Dos=Director Ownership, EO=External ownership, Inso=Institutional ownership

4.4.1 Pairwise Correlation and Multicollinearity

The predictor variables were tested for inter-correlations as an exploratory data analysis through pairwise regression analysis. Pairwise regression analysis of the independent variables give pairwise correlations between predictors and any pairwise correlations exceeding 0.7 would invite investigation for multicollinearity. Consistent with the suggestions of Brayman and Cramer (2001), there should be an investigation for multicollinearity when the pairwise correlation between any two predictor variables is at least 0.80. On the other hand, Anderson *et al.* (1999) regards any pairwise correlations above 0.7 as cause for serious correlation. In our case, Pearson's correlation coefficient is used to establish the correlations for the entire sample from the public sector entities as illustrated in **Table 4**. As evident from the presentation shown in **Table 4**, the data does not show serious inter-correlations between variables.

The results illustrated in **Table 4** below indicate asset utilisation to be positively related to board independence. Since asset utilisation is taken as a proxy for agency costs, this implies that agency costs will be lower when the board does not interfere in the business affairs and running of the company and as such, the agents will work in the best interest of the shareholders.

Table 3: Corporate governance mechanisms pairwise correlation

	Au	BOI	BOR	BOZ	CEO	Dos	Eo	Inso
Au	1							
BOI	0.231	1						
BOR	0.35	-0.219	1					
BOZ	*-0.4014	*0.134	0.2831	1				
CEO	0.043	0.001	0.1025	-0.0512	1			
Dos	-0.122	0.1827	-0.296	-0.1725	0.4371	1		
Eo	0.4953	*-0.5094	-0.1913	** -0.4423	-0.0495	-0.0273	1	
Inso	0.0084	-0.0344	0.1257	0.1732	-0.168	*-0.1319	-0.0365	1

NB: ***, ** and * denote significance at the 1%, 5% and 10% levels respectively.

There is also a positive association between board independence and asset utilisation (agency costs) and high board remuneration greatly reduces agency costs. This makes intuitive sense as the remuneration forms a source of motivation for delivering quality service to external stakeholders of the firm. On the other hand, poorly remunerated boards result in low morale

amongst the directors and ultimately, mediocre service to the stakeholders. There is a positive relationship between director ownership and CEO-chair duality, implying that companies or firms with higher director ownership will have CEOs working as chairperson of the board. To add on, institutional ownership is less common in public sector entities where the majority of shares is held by company directors and hence, a negative relationship between institutional ownership and director ownership (**Table 4**). As a result, this scenario makes the likelihood of the agency problem to become high. Again, institutional ownership is unpopular in public sector entities where the majority of shares are held by company directors or external shareholders, therefore such firms are exposed to higher agency problems.

4.4.2 Multivariate Linear Regression

Asset utilisation ratio is used as the response variable in the multivariate regression analysis with corporate governance mechanisms. In general, the model is significant in explaining variation in the outcome variable at 5% level of significance. Due to the large number of explanatory variables in the model, an adjusted R^2 value is used instead of the simple coefficient of determination, R^2 . As such, the results illustrated in **Table 5** show that 39% of the variation in agency costs can be explained by independent variables of corporate governance mechanisms, leaving 61% to be explained by other factors.

Company-specific fixed effects are also highly significant, indicating considerable firm heterogeneity across sample firms. The result also shows that the variable director ownership and asset utilisation ratio have a weak negative correlation. Such results are similar to the findings of Singh and Davidson III (2003) who asserted that director ownership is inversely related to asset utilisation ratio. However, when measuring agency cost as discretionary expense ratio, the result becomes statistically insignificant. On the other hand, Mustapha and Ahmad in 2001 noted that higher director ownership mitigates the extent of agency costs. Therefore, the hypothesis that higher director ownership reduces agency costs is hereby rejected.

Institutional ownership was found to have no significant influence on asset utilisation ratio. Ideally, Institutional investors are expected to closely monitor the decision making and performance of the company and effective monitoring should align the interest of agents with

that of the owners, resulting in reduction in agency costs. However effective monitoring mechanisms in Zimbabwean public sector are impaired due to unfavourable indigenisation legislation and government policies. As such, the hypothesis that higher institutional shareholding will reduce agency cost is rejected. This finding agrees with Doukas *et al.* in year 2000 and Mcknight and Weir in 2008 which demonstrated that agency cost is not affected by institutional ownership. Despite this, Henry (2004) found that agency costs will be lower when institutional shareholdings is higher. The same result was found by Darren Henry in 2006 while taking asset utilisation ratio as the dependent variable. The work of Singh and Davidson III (2003) also do not show any significant impact on agency cost when it is measured using the discretionary expense ratio and asset utilisation ratio.

Additionally, corporate governance related variables are significant in the model in explaining interactions between asset utilisation ratio and corporate governance mechanisms. For instance, asset utilisation ratio is significantly enhanced by increasing the number of independent directors on the board and with smaller size of boards. The reasoning for the negative association between the explanatory variable board size and the asset utilisation ratio may be that, smaller sized boards, in making decisions, are more effective and organisationally functional as compared to larger boards. Furthermore, it is rather easier for top management, for example, Chief Executive Officer to control smaller board of directors. Hence, smaller sized boards have lower agency costs. This position is similar to the findings of Ibrahim and Abdul Samad (2006), who established that smaller board size are critical in reducing agency costs. On the contrary, Pearce and Zahra (1991) and Florackis and Ozkan (2004) established that larger boards reduce agency costs as compared to smaller boards.

Public sector entities with more independent directors are expected to have lower agency costs since independent directors should have more influence on the performance of the company. As such, independent directors should not only safeguard shareholders' interests but also more closely monitor decision making of company's executive. For that reason, the hypothesis proffered earlier on that agency cost decreases with smaller boards and increasing the number of independent directors is hereby accepted.

Table 4: Significance of the predictor variables with respect to the response agency cost

Predictor	Coefficient	Standard deviation	t-value	Pr. (> t , $\alpha = 0.05$)
Intercept	1.038	0.121	0.81	0.003***
Board independence	0.901	0.039	0.45	0.035**
Board remuneration	1.059	0.011	1.81	0.0411**
Board size	-0.1284	0.0948	-1.355	0.01864**
CEO-Chair duality	-2.25	0.0194	2.356	0.0012*
Director ownership	0.0673	1.936	2.698	0.79
External ownership	0.011	1.5097	0.0354	0.4992
Instit. Ownership	-0.0243	0.0516	-0.685	0.638
Adjusted R² value	0.391			
P-value	0.0345*			

*** Significant at 1%, ** Significant at 5%, *Significant at 10%

Similar findings were found by McKnight and Mira in 2003 and Henry in 2004 who noted that board independence reduces agency costs. From information taken from Malaysian family and non-family owned companies, Ibrahim and Abdul Samad in 2006 also concluded that there is no significant correlation between agency cost and independent directors for companies from family ownership; instead, independent directors reduces agency costs in non-family ownership. The work of Hermalin and Weisbach (1991), Agrawal and Knoeber (1996), Ang et al. (2000) and Singh and Davidson III (2003) is also instructive who found out that independent directors do not influence agency costs.

The relationship of the CEO/Chair duality variable with asset utilisation ratio is negative and statistically significant. This implies that companies with the same person acting as both a CEO and Chairperson will have higher chances that that person dominates on the decision making of the board, resulting in a higher agency problem. To this effect, the separation proposition earlier on posed that the post of CEO and chairperson will lower agency costs is supported. According to Ibrahim and Abdul Samad (2006), it was found that in family ownership firms, agency cost decreases when CEO/Chair duality exists. However, agency costs can also rise when duality role exists in non-family ownership. It was further noted that CEO/Chair duality does not influence agency costs (McKnight and Mira, (2003), Florackis

and Ozkan (2004) and Mcknight and Weir (2008)). Consistent with previous literature, board remuneration has a positive association with asset utilisation ratio, implying that higher pay to executives results in rising firm performance and reducing agency cost. Thus, our asserted hypothesis is hereby accepted. It is evident from the results shown in **Table 5** that not all corporate governance related variables are statistically significant in the model with asset utilisation and as such, the model for asset utilisation existing in the public sector entities in Zimbabwe can be represented as illustrated in Equation 2 below.

$$Au = 1.038 + -2.25 CEO + 0.9 Boi - 0.128 Boz + 1.05 Bor \dots\dots\dots (2)$$

4.4.3 Public Sector Performance

A time series analysis for the sampled public sector entities for the past four years shows the average asset utilisation ratio of the majority of the companies to be 26% (**Figure 3**). A relatively low asset utilisation ratio shows that the public sector has been making investments in productive projects, which ultimately increased the share value of the shareholders.

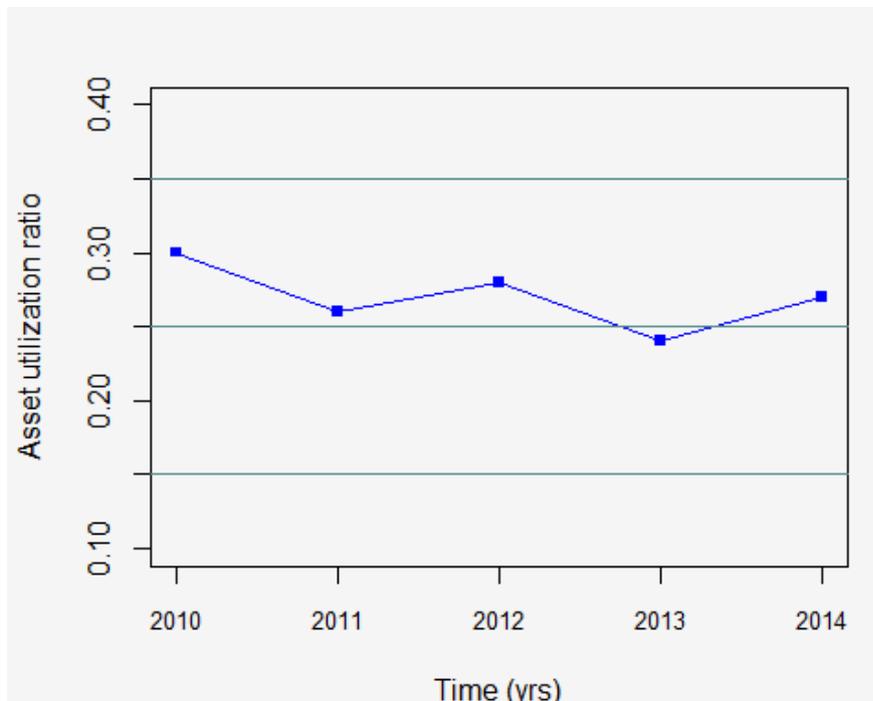


Figure 3: Asset utilisation ratio

4.4.4 Impact of Corporate Governance on Firm Performance

The results of the investigation of the impact of corporate governance factors on firm performance on the public sector institutions in Zimbabwe using views from the industry's top management and middle managers show that most of the respondents in the top management, 50.7% (mean=4.1, s.d.=0.9) and middle management, 60% (mean=4.4, s.d.=0.89) respectively, agree that board remuneration influences firm performance as illustrated in **Figure 4**. However, a sizeable proportion of the respondents in the middle management category (30.5%) chose to remain neutral on whether board remuneration impact firm performance in the public sector, an indication that various managers of the public sector may not share the same opinions regarding the exact factors that might be affecting public sector performance.

These findings are consistent with evidence documented in past research, including Roberts (1994) and Royer and Russell (2006) who observed board remuneration to be influential in the public sector industry of most developing countries, including China and Nigeria. The level of competition on the local market is seen by most business practitioners as a manifestation of a lack of sensitisation on how corporates should reward their boards and largely on the part of policy makers to regulate the industry properly.

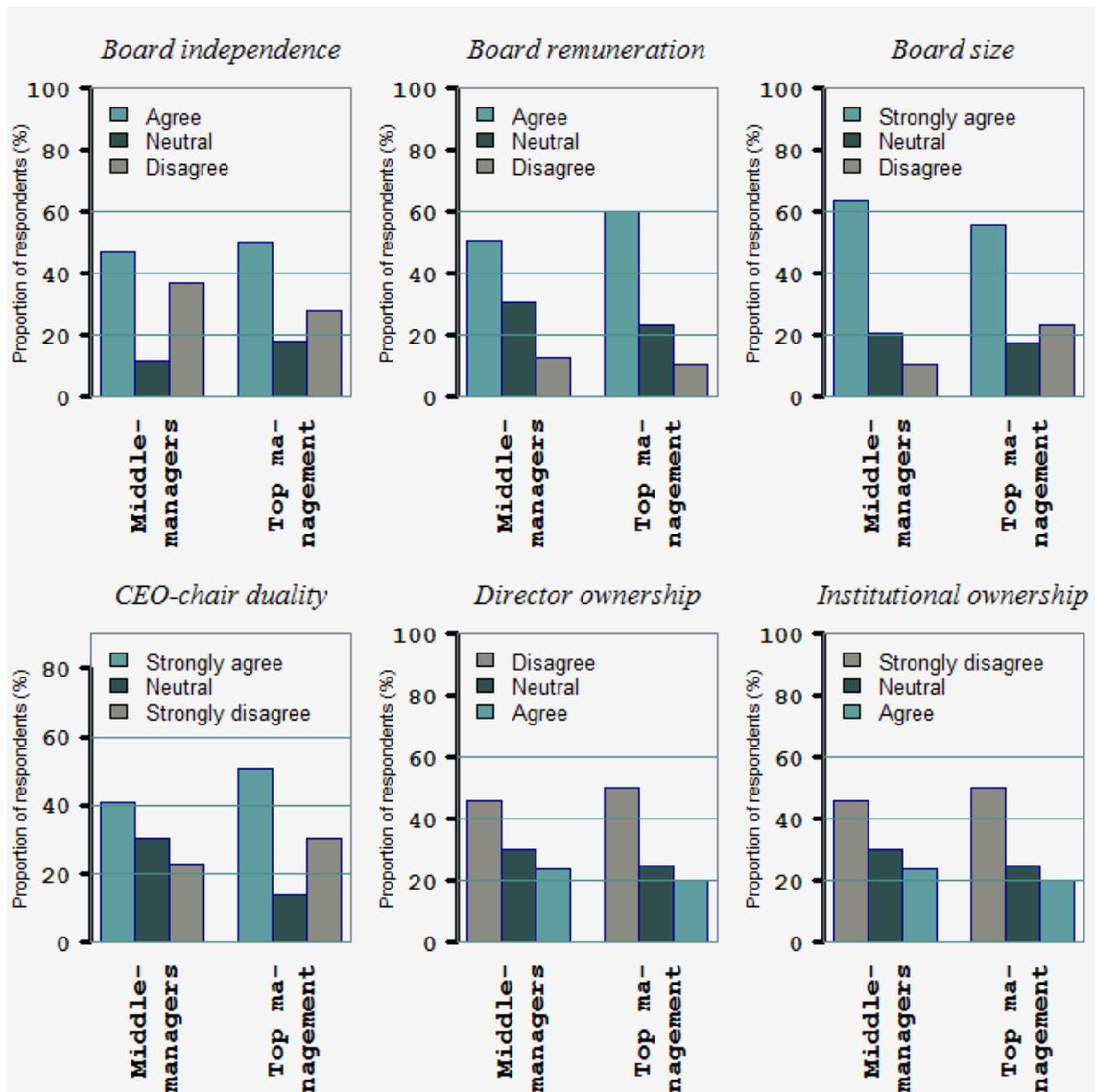


Figure 4: Firm performance and corporate governance

Most of the surveyed respondents do regard board independence as an important factor impacting firm performance in the public sector in Zimbabwe. This fact is supported by the results illustrated in **Figure 4** above showing 47.7% (mean=1.3, s.d.=1.4) of the middle management respondents regarding as important the fact that board independence has an effect on firm performance in the public sector industry. As **Figure 4** above illustrates, 47.7% (mean=4.5, s.d.=1.0) and 50.9% (mean=3.9, s.d.=4.1) of the middle managers and top management employee respondents respectively, both agree that board independence has a bearing on firm performance.

It is evident that the board size in the public sector industry will either boost the prospects of better business performance and ultimately organisational growth or destroy the prospects of better firm performance. This position is held by the results shown in **Figure 4**, indicating 60.7% (mean=3.8, s.d=1.5) and 58% (mean=3.9, s.d=1.1) of the top management and middle management respondents respectively, strongly agreeing that board size strongly influences firm performance. A quantitative approach for the determination of whether smaller sized boards are favourable or unfavourable to firm performance is illustrated in **Equation 2**.

From the analysis, there is need to separate the roles of the board chairperson and CEO. As such, 40.7% (mean=4.2, s.d=1.3) and 50.1% (mean=1.3, s.d=0.9) of the middle management top management employee respondents strongly agree that CEO-chair duality impacts firm performance in the public sector in Zimbabwe. However, because organisation staff retain the right to think differently and independently, a sizeable 30.8% (mean=3.9, s.d=2) of the surveyed top management employee respondents do not share the sentiments of their top managers and hence, strongly disagree with the fact that CEO-chair duality impact corporate governance, **Figure 4**.

In relation to board independence and firm performance, if outside directors are independent and have professional ability, they could be more objective to make decisions and monitor managers. Empirical research by Weisbach (1988), Rosenstein and Wyatt (1997) and Huson et al. (2001) corroborate that the higher the ratio of independent directors on boards, the better firm performance could be.

Literature also suggests that larger board independence is construed as a monitoring device which should play a critical role in constraining or mitigating the agency problem. This implies independent directors are expected to work in the best interest of the shareholders (Byrd and Hickman, 1992; Brickley *et al.*, 1994; Westphal and Zaiac, 1995 and Borokkhovich et al 1996). The same findings were noted by McKnight and Mira (2003) and Henry (2004) who asserted that agency costs will be lower if the number of independent directors on the board increases. Conversely, the findings of Hermalin and Weisbach (1991) and Agrawal and Knoeber (1996) seem to indicate that board independence does not have an important bearing in reducing agency costs. Supporting this, Ang *et at al.* (2000) also vindicates the argument of Hermalin and Weisbach (1991) and Agrawal and Knoeber (1996).

On the other hand, director ownership is found not to be an important corporate governance mechanism that can impact firm performance in the public sector. This fact is held by the results illustrated in Figure 4, indicating 42% (mean=1.3, s.d=1.4) and 55.8% (mean=1.2, s.d=2.0) of the interviewed middle management and top management respondents disagreeing that director ownership of the various public sector entities do not impact firm performance.

Similarly, institutional ownership is regarded as irrelevant in influencing firm performance. It is therefore clear from the results of the survey that very few public sector companies have institutions as their shareholders. With respect to the results shown in Figure 4, 55% (mean=1.01, s.d=1.6) and 45.3% (mean=1.4, s.d=1.6) of the middle and top management public sector respondents, strongly disagree that institutional ownership is a corporate governance factor that impact firm performance.

4.5 RELIABILITY AND VALIDITY TEST

The determination of validity and reliability of the instruments were done before collection of data for the main study. The instruments were deemed reliable with Cronbach's alpha above 0.7 (that is, $\alpha = 0.7$). A Cronbach's alpha is a measure of internal consistence of a set of items and often used in statistics to estimate the reliability of a psychometric test.

4.6 CONCLUSION

Chapter four dealt with data analysis and results of the study. The findings from questionnaires and other data sources were analysed using R statistical and computing environment under sub-themes descriptive statistics, correlation matrix, regression analysis, pairwise correlation, multicollinearity and multivariate linear regression analysis. Mean, median, maximum, minimum and standard deviation were used to aid analysis. The next chapter deals with conclusions and recommendations to strengthen the system of corporate governance and thus improve firm performance while at the same time reducing the agency problem within the public sector in Zimbabwe, limitations of the study and suggestions for future research.

CHAPTER FIVE: CONCLUSIONS AND RECOMMENDATIONS

5.1 CONCLUSIONS

This research examined the role of corporate governance in mitigating agency cost on a sample of thirty-six selected public sector companies in Zimbabwe during the period 2011-2014. It uses the asset utilisation as a proxy to measure agency cost. Multivariate fixed effect regression was employed on data analysis. The independent variables comprises of governance and ownership related influences namely director ownership, external ownership, and institutional ownership, size of board of directors, CEO/Chair duality, and remuneration structure and board independence. The information and or data used in this study was collected using different methods like questionnaires validated through inferential data from published company accounts and interviews with selected respondents. The data was analysed using **R** statistical and computing environment. The results of data analysis suggest that asset utilisation has a positive association with board independence and board remuneration. There is also a positive relationship between director ownership and CEO-Chair duality while institutional and external ownership was less common within the public sector in Zimbabwe. Additionally, institutional ownership was found to be negatively related to director ownership while the later also has no influence on asset utilisation ratio. There is also a negative association between asset utilisation ratio and CEO-Chair duality while board remuneration and board independence positively influences performance. However, from multivariate linear regression analysis, company specific fixed effects are also highly significant, implying considerable firm heterogeneity across sample firms. Moreover, 39% of variation in agency costs is explained by independent variables of corporate governance mechanisms while 61% is left to be explained by other factors implying corporate governance remains critical but certainly not the sole driver for agency costs and performance in public sector entities in Zimbabwe. Basing on results from this study, a number of recommendations to improve corporate governance and thus firm performance by reducing the agency problem within the public sector in Zimbabwe are herein suggested as shall be explained on **5.2**.

5.2 RECOMMENDATIONS

1. Strengthening the Effectiveness of the Legal and Regulatory Framework for Public Sector Entities

The legal and regulatory framework within which public sector entities in Zimbabwe operate is often complex. An inconsistent and illogical framework may prompt expensive market distortions and compromise the accountability of both management and the state as an owner. Segregation of responsibilities among authorities, a streamlining of legal forms in addition to developing a coherent and consistent legal framework is expected to improve corporate governance and thus firm performance in public sector entities in Zimbabwe as shall explained below.

- ✓ The government's ownership function should be different from related complementary government functions that may impact on the conditions for government enterprises, especially with respect to market regulation.

The government has a dual role of market regulator and owner of public sector entities with commercial operations. Under such circumstances, the government becomes both a significant market player and a regulator. Segregation of such responsibilities of ownership and market regulation may be important for creating a level playing field for public sector entities and private companies and for avoiding distortion of competition to promote efficiency in performance.

Additionally, when public sector entities are employed to construct an industrial policy, there may be chaos between industrial policy and the ownership functions of the state, especially where the responsibility for industrial policy and the ownership functions are placed in the same ministries.

- ✓ The government should simplify and streamline its operational practices and the legal form under which public sector entities functions. Their legal form should allow third parties to put their claims and to initiate insolvency procedures.
- ✓ Responsibilities and Obligations that public sector entities carryout in terms of public services beyond the generally accepted norm should be backed by laws or regulations

in addition to the fact that such responsibilities and obligations should be disclosed to all stakeholders (particularly the general public) and related costs be covered in an open manner.

- ✓ Public sector entities must not be protected from complying with general laws and regulations. All concerned should be guaranteed of efficient redress and a fair ruling when they consider that their rights have been violated.
- ✓ There should be enough flexibility for adjustments in the capital structure of public sector entities when this is necessary for achieving company objectives. An example may be the alteration of capital structure to meet company objectives.
- ✓ Public sector entities must also be exposed to competitive conditions when borrowing funds. Their business transactions with government-owned banks, financial institutions and other related companies must be based on purely commercial grounds.

2. The Government Being the Sole Shareholder

The government should be active and informed, put in place an elaborate ownership policy to ensure government entities carry out their business transparently while maintaining effectiveness.

- ✓ The government should not be involved in the daily management of public sector entities.
- ✓ The government should respect board independence.

3. Stakeholder Relations

The government's ownership policy should recognise the government-owned enterprises' primary responsibilities towards the wider stakeholder community and require that they disclose their relations with stakeholders.

4. Transparency and Disclosure

Government-owned enterprises should be highly transparent.

- ✓ Public sector entities should be subjected to the same high quality accounting and auditing standards just like listed companies. They should disclose financial and non-financial information according to high quality internationally recognised standards.
- ✓ Public sector entities should disclose material information on all matters related to areas of significant concern for the state as an owner and the general public.

5. The Responsibilities of the Public Sector Entities Boards

The boards should have enough power and authority, knowledge, skills and objectivity to execute their mandate in strategically guiding and monitoring of management. They should act ethically and be held answerable for their actions.

6. OTHER CONSIDERATIONS

- ✓ The board should be sufficient in terms of size and mix of skills and it should not run without a substantive chairperson as this may result in less bold decisions and short-termism.
- ✓ The country should improve on country risk to attract capital injection into the country to improve public sector performance.
- ✓ The country should channel more effort and resources to fight corruption and unjust enrichment, improve risk monitoring mechanisms as well as to eradicate power centric type of leadership. This can be achieved through setting up of anti-corruption committees, protection and encouragement of whistle blowing, proper accountability of resources and rapid empowerment drive to reduce motivation for corruption.
- ✓ The country can prevent conflicts of interest by legislating corporate governance.
- ✓ There should be broad media coverage and public debates on performance and governance issues within parastatals and those on wrong side should be named and shamed.
- ✓ Adequate integrity and accountability can be achieved through proper training of the board and through appropriate board selection.

- ✓ Politics should not be too excessive when making business decisions to avoid too many adhoc directives for political mileage. Additionally, appointments to the board should be on merit and not on political affiliation.
- ✓ There should be prior project evaluation for each expenditure proposal and value for money should be consistently observed where all investment should be bankable.
- ✓ The punishment for those convicted should be deterrent enough.
- ✓ Voluntary disclosure should be encouraged in accounts to improve governance and thus improve performance. This can be achieved through offer of incentives or increasing the scope of mandatory disclosure requirements.
- ✓ There should be a cultural change on the part of the public through appreciation that nothing is for free. People have to pay for services for firms to improve performance.
- ✓ There should be independence of the judiciary and all the three tiers of government should be effective unlike the currently obtaining situation where results of audits are sent to the same corrupt directors and managers with no counter measures from the said three tiers of government.
- ✓ Boards should be fairly remunerated since remuneration can be a source of motivation.
- ✓ There is need to limit on director ownership given the fact that it is positively related to CEO-Chair duality and negatively related to board independence and asset utilisation ratio.
- ✓ Given that 39% of variation in agency costs is explained by independent variables of corporate governance mechanisms while 61% is explained by other factors, it implies corporate governance remains very critical although definitely not the sole driver for performance. Therefore, public sector entities should frequently re-look into their operations and institutional arrangements to determine which factors have a bearing on reducing agency costs and thus responsible for unlocking shareholder value. In other words, it should be appreciated that no one size fits all.
- ✓ The indigenisation law should be streamlined to allow for Foreign Direct Investment (FDI) and promote institutional investors which are necessary drivers for board independence and performance.

5.3 RESEARCH LIMITATIONS

The following are the research limitations:

- 1) It was necessary to do a pre-board selection tests and an accreditation system that would give a reasonable assurance of some fundamental levels of skill, knowledge and experience although this researcher did not do this.
- 2) This research only uses data from thirty-six Zimbabwean public sector companies, for the four years 2011 to 2014 hence the findings do not represent time period beyond this cut-off point.
- 3) The research only looked at thirty-six public sector companies in Zimbabwe and therefore does not represent private sector companies.

5.4 SUGGESTIONS FOR FUTURE RESEARCH

The following recommendations can be made for future research basing on the above limitations to this research:

- 1) It may be necessary to find out the association of agency cost with some other types of ownership structure like family ownership and non-family ownership.
- 2) More years of data can be increased in order to extend the study and increase reliability of results.
- 3) Future researchers should increase more control variables such as leverage, growth, risk and size of the firm to find out their importance in reducing agency cost.
- 4) It may be necessary in future to investigate whether agency costs are influenced by the prevalence of non-linear ownership and the researchers in corporate finance subject needs to re-estimate the model used in this study after including squared terms for the external and director ownership variables.

6.0 ACTION PLAN

DUE DATES	TASK TO BE DONE
AUGUST – SEPTEMBER 2015	DISSERTATION PROPOSAL
OCTOBER 2015	CHAPTER1
NOVEMBER 2015	CHAPTER2
DECEMBER 2015	CHAPTER3
JANUARY 2016	CHAPTER4
FEBRUARY TO MARCH 2016	CHAPTER 5 AND SUBMISSION

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8.0 APPENDIX AA: PUBLIC SECTOR DATA

Entity	Agcs	CEO	BOR	Inso	BOZ	Dos	BOI	Eo
1	0.12	1	4.7	0.1	0.8	0.001	0.83	0.005
2	0.09	1	4.6	0.77	0.8	0.002	0.56	0.006
3	0.15	1	3.2	0.98	0.56	0.98	0.6	0.007
4	0.005	1	3.5	0.45	0.77	0.36	0.86	0.01
5	0.06	0	3.1	0.65	0.56	0.45	0.45	0.025
6	0.15	0	3.6	0.25	0.21	0.88	0.88	0
7	0.089	1	3.8	0.44	0.65	0.25	0.25	0
8	0.0004	1	3.8	0.65	0.44	0.02	0.65	0
9	0.25	1	2.2	0.78	0.56	0.88	0.88	0
10	0.198	1	2.6	0.0002	0.87	0.001	0.89	0
11	0.266	0	3.14	0.25	0.41	0.65	0.75	0
12	0.36	1	3.28	0	0.65	0.01	0.74	0
13	0.29	0	1.2	0.00001	0.12	0.99	0.66	0.05
14	0.33	1	2.1	0.00006	0.44	0.03	0.12	0.06
15	0.007	1	1.6	0.0005	0.63	0.78	0.65	0.01
16	0.007	1	1.5	0.00004	0.25	0.63	0.86	0
17	0.007	1	1.5	0.001	0.65	0.25	0.86	0
18	0.008	1	1.6	0.00002	0.81	0.65	0.87	0
19	0.008	1	1	8E-07	0.83	0.81	0.78	0
20	0.008	0	2.3	0.00002	0.81	0.83	0.98	0
21	0.008	0	3.25	0.003	0.79	0.81	0.65	0
22	0.008	0	0.02	0.3	0.74	0.79	0.88	0
23	0.009	0	0.03	0.007	0.76	0.74	0.21	0
24	0.009	1	0.01	0.6	0.78	0.007	0.66	0
25	0.009	1	0.02	0.4	0.76	0.006	0.77	0
26	0.01	1	0.03	0.05	0.77	0.77	0.84	0
27	0.02	0	0.44	0.18	0.77	0.77	0.86	0
28	0.025	0	0.66	0.09	0.78	0.78	0.87	0
29	0.03	0	0.23	0.011	0.79	0.79	0.86	0
30	0.05	1	0.14	0.023	0.58	0.58	0.84	0
31	0.06	0	1.3	0	0.8	0.0001	0.85	0
32	0.06	1	0.66	0	0.56	0.56	0.86	0.01
33	0.07	1	0.48	1.3	0.35	0.35	0.86	0.005
34	0.08	1	1.36	2.3	0.36	0.36	0.84	0.004
35	0.08	1	0.28	0	0.88	0.88	0.88	0
36	0.089	1	1.99	0.02	0.85	0.0002	0.86	0

9.0 APPENDIX BB: RESEARCH INSTRUMENT (QUESTIONNAIRE SPECIMEN)

UNIVERSITY OF ZIMBABWE



TO WHOM IT MAY CONCERN

DEAR SIR

RE: QUESTIONNAIRE

My name is Taona Bhande, a Masters in Accountancy candidate at the University of Zimbabwe. I am carrying out a research entitled: ***“AGENCY COSTS: AN ANALYSIS OF THE IMPACT OF CORPORATE GOVERNANCE ON THE PERFORMANCE OF PUBLIC SECTOR ENTITIES IN ZIMBABWE”***

I kindly seek your assistance in answering the following few questions below basing on information relating to your firm over the past four years (2011-2014). The responses that you give will be kept confidential and the information will be used for academic purposes only.

SECTION A: DEMOGRAPHIC DATA

1. Gender

Male	Female
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2. Age Range

<20 Years	21-30 Years	31-40 Years	41-50 Years	51-60 Years	>Over 60 Years
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3. Highest Level of Education

Below O' Level	O' Level	A' Level	Certificate	Diploma	Undergraduate	Postgraduate
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4. Marital Status

Single	Married	Widowed	Divorced
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5. Type of Suburb of Residence

Low Density	Medium Density	High Density
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6.0 Work Experience

MANAGEMENT LEVEL	NUMBER OF YEARS
MIDDLE	
HIGH/TOP	

SECTION B: IMPACT OF GOVERNANCE FACTORS ON FIRM PERFORMANCE

1. To what extent do you agree or disagree that each of the factors below negatively affected Public Sector performance in Zimbabwe over the past four years (2011-2014)?

FACTOR	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
CEO- chair duality					
Board independence					
Board size					
Board remuneration					
Institutional ownership					
External ownership					
Director Ownership					

2. Which of these factors do you think had the greatest effect and why?

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3. What do you think are the social and economical problems associated with firm performance in public sector entities in Zimbabwe?

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4. What do you think are the solutions to these problems?

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SECTION C: IMPACT OF OWNERSHIP INFLUENCES AND CORPORATE GOVERNANCE MECHANISMS

1. To what extent do you agree or disagree that each of the following factors negatively affected corporate governance within the public sector in Zimbabwe?

FACTOR	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
CEO- chair duality					
Board independence					
Board size					
Board remuneration					
Institutional ownership					
External ownership					
Director Ownership					

2. Which of these factors do you think had the most effect and why?

.....

.....

.....

.....

3. What do you think are the social and economical problems associated with corporate governance in public sector entities in Zimbabwe?

.....

.....

.....

.....

4. What do you think are the solutions to these problems?

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SECTION D: IMPACT OF CORPORATE GOVERNANCE FACTORS ON AGENCY COSTS

1. To what extent do you agree or disagree that each of the factors below are causes of agency problem in the public sector in Zimbabwe?

FACTOR	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
CEO- chair duality					
Board independence					
Board size					
Board remuneration					
Institutional ownership					
External ownership					
Director Ownership					

2. What do you think are the agency problems associated with public sector entities in Zimbabwe?

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3. What do you think are the solutions to these problems?

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SECTION E: OWNERSHIP AND CORPORATE GOVERNANCE RELATED VARIABLES

1. Using the **KEY** underneath as a guide, can you please complete the following table below?

VARIABLE	YEAR 2011	YEAR 2012	YEAR 2013	YEAR201 4	AVERAGE
CEO-CHAIR DUALITY					
INDEPENDENT DIRECTORS					
BOARD SIZE					
BOARD REMUNERATION					
INSTITUTIONAL OWNERSHIP					
EXTERNAL OWNERSHIP					
DIRECTOR OWNERSHIP					
TOTAL REVENUE					
TOTAL ASSETS					
ASSET UTILISATION					

KEY:

CEO-Chair Duality: In line with studies by Mcknight and Weir (2004) CEO- Chair duality is becomes a dummy variable with a value of 1 if the CEO is also the chairperson of the board of directors and 0 if the reverse holds.

Independent Directors: In line with Darren Henry (2006), it is a measure of the percentage of independent directors on the board in relation to total number of board members.

Board Size: In line with Mir and Nishat (2004), board size is found by taking natural log of all board members.

Board Remuneration: This researcher measured this variable by taking natural log of the sum total of all annual benefits paid to all members of the board.

Institutional Ownership: In line with Darren Henry (2006), it is determined by calculating the total percentage shareholding of all institutional shareholders.

External Ownership: In line with Darren Henry (2006), it is defined as the sum percentage of all individual non- institutional and non-director shareholdings relative to total shareholdings of the company.

Director Ownership: In line with Darren Henry (2006), it is measured by taking the percentage of total firm equity capital held by all company directors.

Asset utilization ratio = total revenue/total assets

END OF QUESTIONNAIRE

THANK YOU FOR TAKING TIME IN ANSWERING THE QUESTIONNAIRE