New broom in governance

The new King 4 code places much emphasis on creating an ethical culture and mindset.

In the recent past SA has been rocked by a spate of scandals among corporate entities both in the private and public sector – Steinhoff, Eskom and SAA to name a few. Firms providing professional services, such as KPMG, have also been drawn into the fray.

This rash of corporate deficiencies unquestionably represents a failure of corporate governance. This despite SA having what is widely regarded as among the best corporate governance codes in the world.

Corporate governance is essentially a system of checks and balances for the proper exercise of power in an organisation. Why then, with such an exemplary corporate governance regime in place, did the system spin out of control? The political climate certainly was one area of blame.

As Andrew Canter, chief invest¬ment officer of asset manager Futuregrowth, which in August 2016 controversially suspended further funding of certain state¬owned entities (SOEs), writes in his foreword to a report titled “SOE Governance Unmasked” – “In recent years, SA has faced an alarming decay of governance in its government departments and its SOEs. It is now clear that there has been a systematic programme to capture and pillage the nation for personal financial gain. Worse, the plundered wealth of the people was actively used to substantiate the notion that we have just witnessed the near-death of SA’s young and legitimate democracy.”

This despite SA having what is widely regarded as among the best corporate governance codes in the world.

What it means:
Corporate governance is set to be overhauled by new leadership guided by globally respected King reports.

The latest of the King reports on corporate governance – King 4 – came into effect in April last year.

“The King reports are highly regarded worldwide and have even been praised by Sir Adrian Cadbury, author of the Cadbury Report which was the first corporate governance report,” says Stephen Sadie, CEO of the Chartered Secretaries Southern Africa.

“The first of the King reports was published in 1994 so, at this stage, ignorance is no excuse for transgressions.”

It should be remembered, however, that King 4, like its predecessors, is a voluntary code and not a law.

“Both laws and codes can quite easily be circumvented by people who wish to do so. or who are concerned only with not being caught. It is for this reason that King 4 places so much emphasis on creating an ethical culture and mindset. When this mindset is properly understood, individuals and companies will seek to act in the right way – even when nobody is watching – because they understand that to do so makes good business sense and reduces risk,” says Parmi Natesan, executive at the Centre for Corporate Governance and Regulatory at Deloitte.

“Because it is not trying to be a law, and because it recognises that ethical behaviour is ultimately a matter of choice, King is a voluntary code. King’s ‘apply and explain’ approach reflects this ethos, and prompts the governing body to apply its mind to achieving the principles, rather than simply following a set of rules blindly.”

The 75 principles of King 3 have been reduced to 17 basic principles in King 4 (of which one applies only to institutional investors).

“Sixteen of these principles can be applied by any organisation, and all are required to substantiate a claim that good governance is being practised. The required explanation allows stakeholders to make an informed decision as to whether the organisation is achieving the four good governance outcomes required by King 4,” Natesan says.

“King 4 has adopted an outcomes-based approach, where the four desired governance outcomes – ethical culture, good performance, effective control and legitimacy – are seen as adding value to the organisation, thus enhancing its ability to satisfy its various stakeholders.”

Johan Erasmus, director of governance and regulatory at Deloitte, sums it up by saying that King 4 focuses on performance as opposed to conformance”.

“While he concedes that compiling an integrated report (the hefty report which JSE-listed companies are required to produce annually) is a challenge, he believes that, if it is done correctly, it can be a valuable exercise which also provides comfort to stakeholders.”

“In the past companies tended to use a tick-box approach in demonstrating compliance with the 75 principles of King 3. Under King 4, however, disclosures have to be much more mindful.

Parmi Natesan: Ethical behaviour is ultimately a choice that makes good business sense and reduces risk.

Andrew Canter: Recent political changes bring hope of ethics in corporate governance in SA.
special report corporate governance

The governing body and relevant committees have to dig deeply into the motivation for, and outcomes of their actions. “They must explain what the focus of their actions was during the past year, what was done to achieve the desired outcomes and the intended focus for the year ahead. It, therefore, becomes a long-term planning process leading to continuous improvement.”

He agrees with the code’s strong emphasis on the composition of the governing body. “Gone are the days when being a director was often nothing more than a status symbol. In today’s complex business world, what is needed is skilled people on the board who are familiar with the industry in which the business operates and are able to provide useful input.”

The 7th principle of the code states: “The governing body should comprise the appropriate balance of knowledge, skills, experience, diversity and independence for it to discharge its governance role and responsibilities objectively and effectively.”

GOVERNANCE

Lifeline for SOEs with new leadership

The new minister of public enterprises brings much needed improvement in the governance of SOEs

It is no secret that state-owned enterprises (SOEs) were among the worst offenders as far as corporate malfeasance during the past few years is concerned, much of this linked to the Gupta family.

The deterioration in governance within SOEs caused asset manager Futuregrowth to suspend funding of certain SOEs in August 2016.

However, according to chief investment officer Andrew Canter, after engaging with the six largest SOEs on issues of governance structures and practices, the asset managers resumed lending pension funds to four of them – subject to certain governance changes (and, in one instance proposed legislative change).

The terminology used in the report has also been adapted to reflect this broader focus.

King 4 defers to the pre-existing regulations in SA with the six SOEs, Futuregrowth produced a report titled “SOE Governance Unmasked”. In his foreword to this report Canter identified a number of broad areas for governance improvements, such as:

- The “who” matters. “An organisation can have all the trappings of governance such as board committees and policies. But if it has corrupt or ill-intentioned shareholders or leaders, then policies and practices are all at risk,” he says.
- Governance policies. These should be in place and cover the major business areas, such as procurement and lending as well as key risk areas (such as remuneration).
- Internal watchdogs. “There is a raft of existing regulations in SA concerning whistleblowers, and yet those who are in the know are evidently not empowered to reveal the truth. Fear rules. Change is necessary,” Canter says.

Special Report compiled by David van Biljon Advertising executive: Debbie Montanari