OVERVIEW

New broom in governance

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

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

● In the recent past SA has been rocked by a spate of scandals among corporate entities both in the private and public sector – Steinhoff, Resilient, 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 delinquency 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 investment officer of asset manager Futuregrowth, which in August 2016 controversially suspended further funding of certain state-owned enterprises (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 subvert the nation! We have just witnessed the near-death of SA's young and legitimate democracy.

"Only the combined efforts of well-intentioned individuals – genuine national heroes – in politics; agencies; SOEs and the judiciary; alongside participants in civil society, such as the press; academia; the public; and financiers, have allowed the darkness to come to light."

Cyril Ramaphosa's rise to the presidency of SA and his appointment of Pravin Gordhan as minister of public enterprises represents a sea of change in this regard. The appointment of a new board at Eskom and more recently the appointment of a new interim board at arms manufacturer Denel, as well as the appointment of a commission of inquiry into state capture and the announcement that the Special Investigating Unit is to investigate the goings-on at Eskom and Transnet, are clear signs that things are changing for the better.

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 present, individuals and companies will seek to act in the right way – even when nobody is looking – because they understand that to do so makes good business sense and reduces risk," says Parmi Natesan, executive at the Centre for Corporate Governance of the Institute for Directors in Southern Africa.

"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 4'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 the 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

Freddy Mavunda

Johan Erasmus: Ethical performance is more important than mere conformance

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

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." x

Freddy Mavunda

Stephen Sadie: King reports are globally recognised governance mechanisms

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 outstanding large SOEs – Eskom and Transnet – have been at the centre of serious allegations and these continue to be investigated through various parliamentary and judicial processes," Canter says. "But we are highly encouraged by the appointment of Pravin Gordhan (one of the more credible politicians in SA) to oversee those two troubled entities as the new public enterprises minister. Also, our analysts continue to engage in direct discussions with both Transnet and Eskom on governance and improved disclosure, and are finding those conversations co-operative. To date, however, we have not recommenced lending to Eskom or Transnet."

Pravin Gordhan: New life for state entities that were ravaged by mismanagement

Among the stated objectives of the King 4 report was that it should be broadly applicable to all types of organisations, including SOEs.

"Specifically, the King committee was requested by many entities outside the private sector to draft King 4 in such a way as to make it more easily applicable to all organisations, public and private, large and small, for-profit and not-for-profit," writes committee chairman Mervyn King in the report's foreword.

This resulted in the inclusion of sector supplements for SOEs, retirement funds, municipalities, SMEs and nonprofit organisations in the report.

These supplements are intended "to help organisations across a variety of sectors and organisational types to interpret and implement King 4 as is suited to their particular circumstances".

The terminology used in the report has also been adapted to reflect this broader focus. For instance, the substitution of "board" by "governing body".

Specifically in the case of SOEs, the governing body is the "accounting authority" as defined in the Public Finance Management Act. In cases where SOEs are established in terms of specific legislation, King 4 defers to the prescriptions of such legislation.

Following their engagement 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.
- Boards and subcommittees. All corporate governance begins with the board of directors, so its composition and operations must be appropriate.
- 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. x

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