GUIDANCE PAPER

July 2021

CORPORATE FAILURES AND LESSONS LEARNT

Governing body duty to act with due care and in best interest of the organisation

The duty of care on the governing body has become more complex and necessary, as the pace and magnitude of doing business is ever evolving. Because of this, governing bodies are placed under increased pressure to show meaningful growth in their businesses and whilst creating value in a sustainable manner through sound governance practices.

Governing bodies are required to act in the best interest of the organisation and it is becoming increasingly clear that acting in the best long term interest of the organisation requires considering the legitimate and reasonable needs and expectations of all material stakeholders, as required pursuant to the provisions of the King IV Code of Corporate Governance (the "**King Code**").

Despite the evolving world of doing business and governance frameworks, the South African financial markets have, over the few past years, experienced a range of corporate scandals. Accepting that corporate scandals are not unique to the South African financial markets, this guidance paper aims to identify the potential elements in the governance field which may have contributed to recent governance and business failures to understand whether there are any lessons to be learnt.

Ethical and effective (competent) leadership

The King Code defines "*corporate governance*" as the exercise of ethical and effective leadership by the governing body towards the achievement of the following governance outcomes: (i) ethical culture, (ii) good performance (iii) effective control and (iv) legitimacy. Ethical and effective leadership, as more fully set out below, should complement and reinforce each other:

- Ethical leadership is exemplified by integrity, competence, responsibility, accountability, fairness and transparency. It involves the anticipation and prevention, or otherwise amelioration, of the negative consequences of the organisation's activities and outputs on the economy, society and the environment and the capital that it uses and affects.[1]
- Effective leadership is results driven. It is about achieving strategic objectives and positive outcomes. Effective leadership includes, but goes beyond, an internal focus on effective and efficient execution.[2]

Failure of ethics as a common theme

When considering recent corporate failures in South Africa at face value and from public sources and literature available (*recognising that investigations in many of these corporate failures are still pending and no conclusions have yet been drawn*) certain key indicators or so-called "*red flags*" which have direct bearing on ethics, culture and values have been identified which appear to be consistently present where corporate failures arise.

One can only really claim that there is sound governance where there are ethics and good intent accompanied by effectiveness and results.[3] When considering the governance outcomes in the King Code, ethical culture speaks the closest to "*ethics and good intent*".

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[1] King IV: Report on Corporate Governance for South Africa 2016 at 20.
https://cdn.ymaws.com/www.iodsa.co.za/resource/collection/684B68A7-B768-465C-8214-E3A007F15A5A/IoDSA_King_IV_Report_-_WebVersion.pdf

[2] King IV: Report on Corporate Governance for South Africa 2016 at 20.

The King Code defines both "*ethics*" and "*culture*". Ethics means what is good and right for the self and for others, and can be expressed in terms of the golden rule, namely to treat others as you would like to be treated yourself. In the context of organisations, ethics refers to ethical values applied to decision-making, conduct, and the relationship between the organisation, its stakeholders and broader society.[4]

Culture in turn means the way in which members of an organisation relate to each other, their work and the outside world in comparison to other organisations and has been generally described as "*the way we do things around here, even when no one is watching*".[5]

Ethics further speaks directly to values, which is defined as convictions and beliefs about how the organisation and those who represent it should conduct themselves, how resources and stakeholders should be treated, what core the purpose and objectives the organisation should be, and how work duties should be performed. The ideal is that the values as articulated should find its way in how ethics is understood and lived by the organisation which in turn becomes habitual and part of the culture.

Governance red flags

A focused awareness must be created to optimise the governing body's focus on these red flags. In order to assist governing bodies with this journey, the relevant principles in the King Code will be highlighted to guide governing bodies to the applicable recommended practices in order to counter the red flags and improve their corporate governance practices. This document sets out certain red-flags but overall good corporate governance is anchored in all the principles of the King Code that must be considered and observed.

1. The deliberate downplay or neglect of ethics

As a pathfinder for this paper and when looking at the lessons that can be learnt from governance failures, it is important to understand that regulation, compliance and risk processes and structures can be introduced and applied ad nauseam by an organisation and the governing body, however these measures cannot address the fundamentals underlying corporate failures if (i) shortcomings in culture and values are not addressed or (ii) culture and values are not receiving the desired prominence in the organisation. Culture exists regardless and if left to its own devices, it shapes itself with the inherent risk that behaviours will not be those desired. Employees will then work out for themselves what is valued by the governing body to whom they report. Cultural ambiguity must be avoided by any governing body to ensure sound corporate practices based on the exercise of ethical and effective leadership.[6]

A culture which encourages exploration of ethical and moral dilemmas has a healthy respect for emotional expression. A culture which encourages open challenge to decisions that contradict the values of the organisation is a healthy culture. Cultures in which corruption ensues typically are those in which denial or suppression of values are found.[7]

A further important dimension of sound management is a commitment to ethical business practices which are based on values, not just rules. Values are deeply entrenched and highly personal belief systems

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[3] When doing nothing is unethical https://www.businesslive.co.za/fm/opinion/2021-05-10-ansie-ramalho-when-doing-nothing-is-unethical/, 10 May 2021

[4] King IV: Report on Corporate Governance for South Africa 2016 at 12.

[5] King IV: Report on Corporate Governance for South Africa 2016 at 11.

[6] Saltz Review – An independent review of Barclay's Business Practises April 2013 at 6.

[7] Saltz Review – An independent review of Barclay's Business Practises April 2013 at 194

which help people to distinguish between right and wrong and which therefore regulate their behaviour. Rules provide behavioural guidelines but are susceptible to being challenged, manipulated or ignored.[8]

It is strongly recommended that governing bodies appoint one of their members as champion for driving ethics, culture and values in the organisation and to ensure the continued prominence thereof within the organisation.

Relevant Principles in the King Report:

Principle 1: *The governing body should lead ethical and effectively.*

Principle 2: *The governing body should govern the ethics of an organisation in a way that supports the establishment of an ethical culture.*

Principle 3: *The governing body should ensure that the organisation is and is seen to be a responsible corporate citizen.*

As an example, Steinhoff appeared to comply with all legal requirements in its various jurisdictions. This created a (false) sense of security for both investors and other stakeholders. Yet it does point to the risks associated with '*tick-box'* compliance systems that are not underpinned by a commitment to ethics and to abide by relevant rules and regulations. It also raises the spectre of lip service merely being paid to the importance of compliance.

In its 2006 annual report, Steinhoff stated:

> *"All stakeholders and, more specifically, directors and employees are required to observe the Steinhoff Code of Ethics to ensure that business practices are conducted in a manner which is beyond reproach… This requires commitment by management to acknowledge and ensure that our long-term sustainability is based on delivery to all stakeholders."*

Yet the board's attempts to provide ethical and effective leadership, and more specifically to ensure that the company's ethical character is subject to close scrutiny, seem to have been ineffectual over the years.

For example, in the 2011 corporate governance report the following comment is made: *"Steinhoff has not established a formal process for obtaining assurance on ethical awareness and ethical compliance throughout the group"*. In the same report the chairman states that Steinhoff "*keeps its performance and core governance principles under constant review".* One would therefore expect to see some progress in this regard in the 2012 report. However, in the 2012 Integrated Report the following is simply restated: "*Steinhoff has not established a formal process for obtaining assurance on ethical awareness and ethical compliance throughout the group*" − this despite another expressed commitment to ongoing compliance and a preamble that states that the report presents "*progress being made towards compliance*".

Closer inspection has revealed that Steinhoff used the same comment relating to Principle 1.3 of the King Code[9] in all its company reports between 2011 and 2016. This raises questions about how serious the board was in trying to ensure that the company's ethical character remained unsullied. From the data it

[8] Business Perspective on the Steinhoff Saga – University of Stellenbosch Business School June 2018: Piet Naudé (Editor) at 34.

[9] The arrangements by which the members of the governing body are being held to account for ethical and effective leadership should be disclosed. These arrangements would include, but are not limited to, codes of conduct and performance evaluations of the governing body and its members.

would seem that there was a *laissez-faire* attitude towards the matter, with a no-change, cut-and-paste approach being routinely applied.[10]

Integrated or annual reports provide a periodic window into the activities of an organisation. In addition to providing insight into the strategy, performance and risks of the organisation, the report should explain how, and by whom, the organisation is governed. In reality, the governance reports very often do not accurately portray how the organisation is governed, with generic disclosures being the norm. This makes it very difficult for users to assess the extent to which the governance practices add value or risk to the organisation.

Governance disclosures should accurately portray how that entity is governed with entity specific examples provided to illustrate as opposed to a "*copy and paste*" approach. The annual report should convey to the shareholders and other stakeholders how the members of the governing body have executed their fiduciary duties to the organisation for the benefit of stakeholders.

Here, the role of the company secretary must be acknowledged and is critical as the gatekeeper of governance. The company secretary should receive the full support of the chair and the governing body at all times, and where appropriate the governing body should ensure access to professional and independent guidance on corporate governance. Governing bodies should further ensure that this role is allocated in such a manner so that sound governance practices remain paramount and that the role not be diminished where it is fulfilled by other executives as a "*part time role*", even for a short period of time.

Relevant Principles in the King Report:

Principle 1: *The governing body should lead ethical and effectively.*

Principle 2: *The governing body should govern the ethics of an organisation in a way that supports the establishment of an ethical culture.*

Principle 3: *The governing body should ensure that the organisation is and is seen to be a responsible corporate citizen.*

Principle 13: *The governing body should govern compliance with applicable laws and adopted, non-binding rules, codes and standards in a way that supports the organisation being ethical and good corporate citizens.*

2. Board dynamics & lack of board knowledge, skills, experience, diversity and independence

The interplay and dynamics between the members of the governing body is vital for any organisation, especially in relation to the exercise of authority, responsibility and strategy. However, when considering corporate failures, three prominent features in relation to board diversity has come to the fore of which governing bodies should be very mindful of in order to exercise ethical and effective leadership in line with the King Code principles and recommended practices. These features are:

- a charismatic CEO;
- inability of non-executive directors to maintain a professional arms-length relationship with management; and
- lack of industry knowledge and diverse expertise among non-executive directors.

[10] Business Perspective on the Steinhoff Saga – University of Stellenbosch Business School June 2018: Piet Naudé (Editor) at 16 & 17.

2.1 A charismatic CEO

A charismatic leader, especially with a strong entrepreneurial spirit is an important asset, but can become a risk if his/her power is not balanced.

> *"Many people believe that if an organisation is fortunate enough to have a charismatic leader, its chances of success improve dramatically. Charismatic leaders have the ability to engage people at all levels, speak their language, keep their attention and earn their respect, which is no mean feat in an age when authority is regularly questioned. Yet charismatic leaders are not always brimming with charm and goodwill. They can also be mesmerising in a frightening sort of way, extorting cooperation and loyalty through fear."*[11]

Charismatic leaders, who are typically intent on promoting self-enrichment and advancing the interests of their network, draw those close to them into a web of loyalty and submission. By surrounding themselves with admirers, such leaders acquire the latitude to act in certain ways and to conceal possible unethical behaviour without any critique or push-back from colleagues.[12]

A charismatic CEO should of course be recognised for the exceptional value he or she can bring to an organisation. The success of a business is often presumed to hinge on the qualities of the CEO, who through his or her actions and behaviour guides the performance of the business. The personality of a CEO, often regarded as a soft and inconsequential matter, is in fact a matter of paramount importance, with research demonstrating that a CEO's personality has a significant impact on the culture of an organisation, which in turn has a direct impact on the organisation's employees and its corresponding performance.[13]

However, recognising different leadership styles, governing bodies should be cautious that the features of a charismatic CEO may have personality traits that could lead to an environment where challenge by members of the governing body are not tolerated, where the view of the CEO dominates the discussions and risks are often down played as "*I have done this before, I know what I am doing or this is the way we do things here"*. This exposes the governing body to a "*one-way street*" view, where the view of the CEO dominates and directs discussions at most of the time or even worse all times. Allowing an environment where CEOs are able to indulge in these behaviours without due oversight or consequences from the chair and/or the collective of the non-executive members of the governing body, could lead to the following detrimental consequences -

- the required professional scepticism of the non-executive members of the governing body being diminished to fulfil their oversight role over the executive management;
- an approach of general agreement and harmony when it comes to decisions, with little debate or opposing views;
- a lack of a robust culture of asking difficult questions;
- lead to a culture where the governing body believes everything uttered by the CEO;
- the CEO believing he/she is above the governing body and therefore untouchable;
- the ability of the financial director being compromised to stand up against the CEO, as the CEO is untouchable and/or a larger than life figure; and
- the CEO being allowed to advocate a self-serving agenda or be encouraged in "empire building", where the CEO is overly concerned with expanding the business and increasing employee levels where this may not align with developing or creating shareholder value.[14]

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[11] Business Perspective on the Steinhoff Saga – University of Stellenbosch Business School June 2018: Piet Naudé (Editor) at 34

[12] Business Perspective on the Steinhoff Saga – University of Stellenbosch Business School June 2018: Piet Naudé (Editor) at 26

[13] PwC Report 2020 (13th edition): Non-Executive Directors: Practices and fees trends report (Feb 2020) at 12.

[14] PwC Report 2020 (13th edition): Non-Executive Directors: Practices and fees trends report (Feb 2020) at 13

As a reminder, various elements should be considered essential to creating an effective CEO-board relationship. On an individual level this means appointing non-executive members of the governing body who can do the following effectively and in a consistent manner:

- Examine in detail the CEO's recommendations provided and ask the tough questions when necessary;
- Ensure that the CEO advises and remains accountable to the governing body;
- Remain cognisant of the organisation's strategy and overarching succession plan to ensure alignment;
- Maintain independence and demonstrate a full commitment and engagement to the objectives of their terms of reference;
- Collaborate effectively with the CEO to establish expectations, agendas, processes and decision rules;
- Maintain ethical integrity in all instances;
- Proactively seek to build professional relationships with the management team; and
- Effectively communicate and facilitate both within the subcommittee of the governing body and the organisation as a whole.

2.2 Inability of Non-Executive Directors to Maintain a Professional Arms-Length Relationship with Management

The establishment of a professional and collegial relationship amongst members of the governing body is critical for the proper functioning of a governing body and should be encouraged. However, close friendships and selected social groupings within the governing body could compromise independent thinking and the ability to be sceptical at governing body level. A typical friendship scenario could be best illustrated by directors being "*golfing buddies*", especially where they have known each other for many years, where familiarity and alliances could be formed outside the confines of the meeting rooms of the governing body and then continue well into the meeting rooms of the governing body.

This could happen between the (i) CEO and financial director, (ii) the executive committee and non-executive member/s of the governing body and (iii) executive and non-executive member of the governing body. Members of the governing body should be reminded that, notwithstanding such social gatherings and groupings, each member is accountable in relation to his or her own fiduciary duties and duty of care owed to the organisation through common law and the statutory provisions of the Companies Act No.71 of 2008 (the "**Companies Act**").

An awareness should be created that, to the extent that there are social networking activities for member of the governing body, that these activities should be inclusive and diversity/transformation conscious taking into account attributes such as historical background, culture, age and gender. These activities must not in any way be seen to exclude any members of the governing body whether intentionally or not.

Where social networking activities are undertaken, without inclusivity and due regard for objectivity in professional dealings, the following detrimental consequences could arise -

- the responsibility "*lines*" between some of the executive and non-executive members of the governing body becoming clouded;
- non-executive members of the governing body being unduly influenced by the CEO based on the notion of being a "*group of friends*" or "*belonging to a club*";
- non-executive members of the governing body being compromised by not feeling the need to interrogate the executive members;

- non-executive members of the governing body feeling alienated and/or isolated;
- non-executive members of the governing body being put in a position of not to "*rock the boat*" by asking too many questions or being sceptical in nature; and
- non-executive members of the governing body themselves actively avoid not to "*rock the boat*", because they are the in the "*group of friends*" and even sit on the same governing bodies of other companies.

Incentives for members of the governing body requires separate consideration as well. It must be recognised that governing bodies do have effective off-site strategy sessions and that this indicator is not aimed to prohibit healthy corporate cultures, however "*extras*" such as bringing a spouse or partner along for an added weekend break (flights and accommodation) could raise concerns. Governing bodies should be cautious of out of the norm incentives for non-executive members of the governing body or often called "*perks*" which will encourage unhealthy social bonds, such as weekends away and any form of indirect financial benefit other than approved remuneration. Objective professional dealings with each other should be front in mind for any non-executive member of the governing body. Unhealthy social bonds and social networking opportunities between members of the governing body, other than related to meetings of the governing body, could potentially comprise the effectiveness of the governing body.

The relationship between the CEO and financial director also requires special mention. If the relationship is too close, an alliance can be formed where there is support for each other at all costs. However, if they are too far removed or maybe even hostile towards each other, this could significantly impact the trajectory and/or path of the organisation. A healthy relationship between the CEO and financial director is vital to ensure alignment with the organisation strategy and quality of reporting to the governing body.

2.3 Lack of Industry Knowledge and Diverse Expertise among Non-Executive Directors

All directors should be capable of seeing the organisation and its business issues in a broad perspective. Non-executive directors of the governing body are usually chosen because they have a wealth of experience, are of an appropriate calibre and have particular personal qualities. They should have the ability to see the "*blinds spots*" which the executives cannot see themselves. Additionally, they may have some specialist knowledge that will provide the board with valuable insights or, perhaps, key contacts in related industries. Of the utmost importance is their independence from management. This means they can bring a degree of objectivity to the deliberations of the governing body, and play a valuable role in monitoring executive management.[15]

There is a real risk when non-executive members of the governing body do not have the skills necessary to understand and oversee the business. It sounds obvious that leaders of a business should have the skills that are necessary to understand and run it, but some studies suggest that the leaders do not. Similarly, given that the role of non-executive member of the governing body is to provide independent oversight of the business, they need (at least collectively and arguably individually) sufficient skill and knowledge to ask all the right questions and to understand and evaluate the adequacy of answers they receive.[16] This risk is further exacerbated where non-executive members of the governing body do not have –

- a firm understanding of the business of the organisation;
- a basic understanding of their fiduciary duties pursuant to the provisions of the Companies Act and corporate governance pursuant to the King Code;

[15] https://www.iod.com/services/information-and-advice/resources-and-factsheets/details/What-is-the-role-of-the-NonExecutive-Director

[16] Road to Ruins the Analysis: A study of major risk events – their origins, impact and implications at 7.

- a basic understanding of law in general and the regulatory requirements relating to the industry in which the organisation operates; and
- have the ability to read and interpret financial statements.

These attributes are fundamental for the ongoing assessment of the organisation, and to establish compliance with basic laws, regulations and requirements. Where these attributes are lacking it creates a risk that the governing body and the non-executive members do not have effective oversight over the business of the organisation and allows important business decision of the CEO to go unchallenged.[17]

Members of governing bodies should further be wary of "*information dumping*" on the non-executive members by executive members as a tactic used to cloud or hide vital issues. The setting of information requirements is the responsibility of the governing body. It is only with a clear understanding of the role and responsibilities of being a non-executive member, that non-executive member of the governing body will be empowered to effectively challenge and interrogate the executive management.

Relevant Principles in the King Report:

Principle 6: *The governing body should serve as the focal point and custodian of corporate governance in the organisation.*

Principle 7: *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.*

Principle 10: *The governing body should ensure that the appointment of, and delegation to, management contribute to role clarity and the effective exercise of authority and responsibilities.*

Relevant Recommended Practises in the King Report:

Recommended Practice 6 (under Principle 7): *The governing body should assume responsibility for its composition by setting the direction and approving the processes for it to attain the appropriate balance of knowledge, skills, experience, diversity and independence to objectively and effectively discharge its governance role and responsibilities.*

Recommended Practice 7(f) (under Principle 7): *Diversity targets relating to the composition of the governing body should be a consideration.*

Recommended Practice 10 (under Principle 7): *The governing body should promote diversity in its membership across a variety of attributes relevant to promoting better decision-making and effective governance, including field of knowledge, skills and experience as well as age, culture, race and gender.*

General: Nominations committees should expand their horizons. Those in charge of new appointments should make a concerted and conscious effort to look beyond their usual circles to tap into a growing pool of diverse directorial talent. Board diversity is not an end in itself, and organisations that want to maximise board performance must understand the inner dynamics of diversity and what it seeks to achieve. Clearly, if a board is composed of the same type of people, with no diversity of thought, then chances are it will find itself constantly on the back foot – unable to think its way into the minds of its various stakeholders, its staff and, importantly, its competitors. Beyond individual non-executive members of the governing body, inclusive diversity and board diversity should be pursued, and requisite soft-skills training be introduced, to support and challenge critical thinking in order to avoid the social psychological

[17] Road to Ruins the Analysis: A study of major risk events – their origins, impact and implications at 6.

phenomenon of groupthink, in which the practice of thinking or making decisions as a group results in poor-quality decision making.[18]

Non-executive member of the governing body should be expected to improve their understanding of the business which would include being allowed to engage freely with executives and senior management. This will further empower non-executive members of the governing body to critically evaluate information provided by the executive members at meetings and to be able to ask the right questions. Non-executive members should further ensure that they are well read on news regarding the organisation, its industry and developments in the market place.

3. Executive incentives that encourage poor behaviour

Incentives, whether explicit or implicit, can distort culture and behaviour in ways that endanger the organisation. Governing bodies should be aware that the incentives they create or encourage can distort the outcomes they wish to achieve.[19] The remuneration policy should be designed to achieve the following objectives:

- To attract, motivate, reward and retain human capital;
- To promote the achievement of strategic objectives within the organisation's risk appetite;
- To promote positive outcomes; and
- To promote an ethical culture and responsible corporate citizenship.[20]

Incentives that allow the behaviour below may distort the culture and ethical behaviour of an issuer:

- Focus on short-term performance with little regard to how results were achieved;
- Focus on financial performance only where this may come at the cost of negatively impacting other capitals or stakeholders;
- High performers in the organisation are allowed to operate outside of established policies;
- Behaviours that are not consistent with the organisation's stated values/codes of conduct are rewarded;
- Frequent "*near misses*" of adherence to codes of conduct, risk appetite limits etc. or frequent requests for exceptions to these policies in order to meet performance targets; and
- No *malus* or clawback provisions are included in variable remuneration schemes.

The governing body and remuneration committee should review the organisation's recognition and reward system to ensure that they reinforce the desired culture and avoid unintended consequences that could undermine culture. [21]

Incentives should support the right behaviour and should not be used as a means to encourage behaviour to hit the target at all costs.

Further to the shift in thinking from short-termism to long term sustainability based on ethical principles, the King Code recommends that the governing should ensure that remuneration is used as a tool to ensure that the business creates value in a sustainable manner within the economic, social and

[18] PwC Report 2020 (13th edition): Non-Executive Directors: Practices and fees trends report (Feb 2020) at 14.

[19] Road to Ruins the Analysis: A study of major risk events – their origins, impact and implications at 17.

[20] King IV: Report on Corporate Governance for South Africa 2016 at 65 – Recommended Practice 28.

[21] Report of the NACD Blue Ribbon Commission on Culture as a Corporate Asset at 17.

environmental context in which the organisation operates. To this end, the governing body should establish a remuneration committee, the role of which is to recommend to the governing body a fair and responsible companywide remuneration policy that promotes the creation of value in a sustainable manner. [22]

Relevant Principles in the King Report:

Principle 14: *The governing body should ensure that the organisation remunerates fairly, responsibly and transparently so as to promote the achievement of strategic objectives and positive outcomes in the short, medium and long term.*

4. An ineffective chair

The primary role of a chair of a governing body is to provide leadership to the governing body of an organisation; set the tone for its performance and undertake the management thereof. The chair should play an active role in engaging governing body members and building upon their strengths and addressing /developing any weaknesses. The chair ensures focus is maintained by the governing body on what is best for the organisation; and that the tone for organisational success is set. The chair is accountable to the governing body. Working with fellow members of the governing body, the chair sets the direction and priorities for the execution of the duties by the governing body and acts as the communication channel for governing body decisions where appropriate.[23]

When considering the appointment of chair, often a key consideration is the status or brand of the name connected to that role without due regard to the valued attributes that would make a good chair.

The nominations committee should be cautious where the quality of brand name to the position of chair outweighs the recommended practices for a good chair. How the Chair carries out the role goes to the heart of the governing body's success. The chair needs to be capable of blending the skills of individuals into an effective leadership team. A governing body can become ineffective if the chair is too weak. It would be useful for the governing body to have clear guidelines, taking into account the recommended practices outlined in the King Code as it relates to the appointment of the chair.

Relevant Principles in the King Report:

Principle 9: *The governing body should ensure that the evaluation of its own performance and that of its committees, its chair and its individual members, support continued improvement in its performance and effectiveness.*

*The King IV Practice Note **The Role of the Chair and Lead Independent**, issued by the Institute of Directors should be considered.*

[22] https://www2.deloitte.com/content/dam/Deloitte/za/Documents/governance-risk-compliance/za_Deloitte_KingIV_Remuneration_Governance_01032017.pdf
[23] https://cdn.ymaws.com/www.iodsa.co.za/resource/collection/562ED5CF-02E8-4957-97C8-D3F0C66A7245/King_IV_Practice_Note_on_Role_of_Chair_and_LID.pdf

5. Too long tenure

Many factors that need to be considered in assessing whether the independent members of the governing body are truly independent. One of the factors that is often used as a guideline is tenure. The King Code (recommended practice 29) stipulates that a non-executive members of the governing body may continue to serve, in an independent capacity, for longer than nine years if, upon an assessment by the governing body conducted every year after nine years, it is concluded that the non-executive member exercises objective judgement and there is no interest, position, association or relationship which when judged from the perspective of a reasonable and informed third party, is likely to influence unduly or cause bias in decision-making.

It is generally accepted that "*independence of thought*" and "*care, skill and diligence*" are among the key capabilities that member of the governing body need to bring to the boardroom.[24] It is also accepted that increased tenure also brings valuable qualities to the governing body, such as experience and understanding the business of the organisation but the independence assessment of these members remain crucial. Tenure and independence assessments, preferably by third party evaluators, should receive the attention and thoroughness it rightly deserves. A statement on the independence of members of the governing body cannot be treated, as a compulsory "*tick the box*" statement for the annual report year and year.

As the purpose of having independent directors is to ensure that there is effective oversight of executives and diversity of views. Factors such as the length of time that executives have interacted with the same, or substantially the same independent members, the diversity of the backgrounds of the independent members and their individual contributions all need to be considered.

Another consideration is the tenure of the CEO. CEO tenure is one of the trickiest governance questions faced by governing bodies. CEO performance has a direct link to the organisation's performance, which is why best practice around appointing, overseeing and evaluating the CEO is contained in the King Code. Putting a CEO succession plan in place, and initiating it at the right time, are key strategic considerations a governing body must take. A key factor to be borne in mind is the rapid change in the business environment: even the most highly skilled CEO could find his or her skillsets inadequate as time goes by. In addition, CEOs can damage their own reputations by staying too long at one organisation as opposed to exiting on a high note. Governing bodies have to exercise their judgement, one can't just remove a CEO after a certain number of years, however governing bodies should look out for early warning signs:

- Flattening corporate performance: Falling revenues or market share could be one indicator, but other factors also need to be considered, such as the organisation's ability to retain and attract staff, particularly those with the skills and attitude to take the organisation forward.
- Complacency within the executive team: Annual, in-depth performance reviews are critical, as well as feedback from peers and staff. Additionally, feedback from external stakeholders such as clients and business partners would be valuable.
- Emergence of a CEOs court: Does the CEO surround him-or herself with weak executives? Members of the governing body need to develop ways for assessing the calibre of the people CEOs surrounds themselves with, monitoring new appointments to these roles carefully.
- Lack of innovation: The governing body should assess how many fresh initiatives originate within the executive team. Innovation quality is also important, so governing bodies will require the expertise to form an opinion as to how valuable this innovation is.
- Undesirable corporate culture or disquiet: Members of the governing body should find ways to interact spontaneously with employees to assess how the quality of leadership is perceived and

[24] Business Perspective on the Steinhoff Saga – University of Stellenbosch Business School June 2018: Piet Naudé (Editor) at 16

affecting the organisation as a whole. To do this, members of the governing body should develop networks within the organisation.[25]

Relevant Principles in the King Report:

Principle 7: *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.*

Principle 9: *The governing body should ensure that the evaluation of its own performance and that of its committees, its chair and its individual members, support continued improvement in its performance and effectiveness.*

6. Conclusion

It must be recognised that corporate failures have a wide variety of disguises and for that reason all of the role-players in the governance ecosystem must play their part in preventing corporate failures, the consequences of which are devastating to the market, investors, employees and creditors. These role players, acknowledging the general application of law and the King Code, include regulators, non-executive directors, audit committees, senior management, auditors, shareholders, analysts and financial journalists. Each role-player has a specific function that clearly interacts with those of the other role-players. Performance by each of the role-players of their specific functions provides the most effective chance of reducing corporate fraud and other non-compliance.[26]

The role of investors, particularly the institutional investor[27], in the governance ecosystem is often understated. Their role arises in at least three contexts:

- They elect directors. In doing so they should be vigilant in assessing the reputation and performance record of potential candidates;
- They should be conscientious in holding boards to account. The fundamental philosophy of regulation in this context in South Africa is regulation by disclosure – full and truthful disclosure in all documents, financial statements and circulars issued by companies. These should be carefully evaluated by investors and appropriate action taken, including recovery of damages by derivative action and removal of delinquent or non-performing directors; and
- They vote with their feet. They should consider, in appropriate cases, disinvestment from non-performing companies and those whose activities are inconsistent with socially acceptable conduct or prevailing public policy.[28]

[25] *CEO tenure: 5 warning signs for directors* https://www.iodsa.co.za/news/274002/CEO-tenure-5-warning-signs-for-directors.htm

[26] How the compliance ecosystem helps prevent corporate failure https://www.dailymaverick.co.za/opinionista/2020-12-01-how-the-compliance-ecosystem-helps-prevent-corporate-failure/

[27] Principle 17: The governing body of an institutional investor organisation should ensure that responsible investment is practised by the organisation to promote the good governance and the creation of value by the companies in which it invests

[28] How the compliance ecosystem helps prevent corporate failure https://www.dailymaverick.co.za/opinionista/2020-12-01-how-the-compliance-ecosystem-helps-prevent-corporate-failure/

The role-players in the governance ecosystem are the guardians of governance and must ensure that their review and disclosure processes are robust, and where applicable that independence and objectivity in professional dealings with companies is paramount. Only with the active and focussed participation of all the role players in the governance eco-system, will companies be responsible and moral corporate citizens to promote to the stability and integrity of the South African financial markets.

It may be useful to review the Issuer Regulation Guide to obtain an understating of the role-players involved with JSE listed companies.

Note: The indicators contained in this guidance paper are by no means an exhaustive list, but should be considered as a useful tool by governing bodies for (i) member induction training and (ii) ongoing member training.

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