CHAPTER 2.

CORPORATE GOVERNANCE.

“CORPORATE GOVERNANCE IS CONCERNED WITH HOLDING THE BALANCE BETWEEN ECONOMIC AND SOCIAL GOALS AND BETWEEN INDIVIDUAL AND COMMUNAL GOALS… THE AIM IS TO ALIGN AS NEARLY AS POSSIBLE THE INTERESTS OF INDIVIDUALS, CORPORATIONS AND SOCIETY.

Sir Adrian Cadbury
Corporate Governance Overview, 1999
World Bank Report

The many corporate collapses caused by fraud, misrepresentation, suppression of information and corruption which resulted in huge losses for investors and decimated trust and confidence in business and financial markets have brought increased regulation, e.g. the 2002 Sarbanes-Oxley Act in the US and corporate governance guidelines, e.g., the King Report on Corporate Governance for South Africa 2002 (King II). These regulations and guidelines aim at restoring public confidence in corporations, capital markets and the various operators in these markets. Investors and other relevant stakeholders need to be supplied with truthful, complete and transparent information so that they are enabled to take reasoned decisions. Only under such full disclosure conditions can capital markets function optimally, ensuring fair corporate market
valuations and encourage corporations to comply with their moral duty to respect the dignity of others.

The key to good corporate citizenship is to find the right balance between performance and conformance (50. King, 2002: 2). While ethics needs to help business find the right answers to the often difficult questions about the correct moral way and to develop and implement institutions, corporate governance is more an issue of controlling compliance with the agreed institutions, values and purpose of the business. I believe that Sir Adrian Cadbury’s definition as quoted at the head of this chapter is too wide.

For the business’s strategies, goals and policies to be successful, it is obviously necessary that the purpose of the business is clearly defined. The values by which it wishes to live and the institutions that are to govern it need to be agreed, clearly outlined and communicated to all stakeholders identified as relevant to the business. Compliance with these policies must be monitored and enforced through an appropriate corporate governance set of rules.

Poor corporate governance will encourage fraud, corruption, mistrust and generally unethical behaviour resulting in waste, loss of reputation, flight of capital and honest, capable employees and stakeholders. Well governed companies are significantly higher valued than companies with similar profit records but that are poorly governed (36. Holliday, 2002: 38). Generally, investors are prepared to pay an “ethical premium” for shares in companies that have strong, stakeholder accepted ethical and governance policies by which they live and through which they enjoy a good reputation gained from stakeholder’s perceptions of the relevant company’s integrity, competence, honesty, and social and environmental responsibility. Ethical behaviour and good corporate governance are significant not only for the particular business, but also for the development of national and international financial markets.

Due to the increasing multinationalism of business, its role in global governance matters is growing. Consequently, there is a greater demand by society for the private sector to
manage its affairs in such a manner that it adds value to the economic, social and environmental development.

Corporate governance can be effective only if suitable remedies and sanctions are in place to redress and (where necessary) enforce compliance with the relevant institutions. It is the duty of the owners or the board of directors and management to ensure that a stakeholder-agreed ethical code of conduct and corporate governance policies are in place and complied with. In the United States the US Federal Sentencing Guidelines explicitly refer to the “realization and active use of ethics programmes”.

The owners of a business are ultimately responsible for appointing and removing the members of a company’s board of directors. This needs to be done in compliance with the legal requirements and as far as possible in line with corporate governance guidelines (in South Africa, King II). Usually the board plays a major role in the selection of new board members, the appointment of the CEO, executive succession and in the proper constitution of the board. Great care needs to be taken in the election (which should be formal and transparent) of board members so that the board as a whole represents a body of well qualified people with diverse but relevant interests, vision, courage, good ethics and communication skills.

The board is also responsible for vetting and monitoring the achievement of the company’s strategic plans and goals, ensuring effective external and internal auditing and compliance by the business with all statutory requirements.

Because of its diverse duties and powers, the board should establish committees such as remuneration and nomination, audit, and ethics committees to assist the board in its controlling duties and decision making process. The audit committee should be responsible, inter alia, for corporate governance, risk management and fraud prevention.

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24 The US Federal Sentencing Guidelines, including the “Corporate” Sentencing Guidelines mandate more uniform and more severe penalties for corporations convicted of criminal misconduct.
The remuneration and nomination committee determines the terms and conditions of employment and the pay structure. Particular care needs to be taken by this committee that incentives, be they for the CEO, the sales team or any other employee, will promote ethical behaviour as laid down in the business’s code of ethics. The committee will also recommend nominations to the board and institute succession planning.

Auditors must in the first instance report to the audit committee but need to have board approved channels of communications direct to the chairman of the board and any other relevant stakeholder.

The company’s ethics policy (including its culture and values) must carry the approval of the entire board and should be managed, monitored and treated as a living document by the ethics committee. The committee and the board must ensure that the policy is not merely a piece of paper but that the company and all its relevant stakeholders live by it, and the board should adjudicate any difficult ethical question or dilemma. (For more on this issue refer to chapter 19 “Implementation and Management of a Code of Ethics”).

The corporate governance policy must ensure open, transparent and complete reporting (financial, social and environmental) in line with the Financial Reporting Bill (in South Africa), the International Federation of Accountants and the South African Institute of Chartered Accountants guidelines, the company’s ethics policy and other relevant statutes.

The board also has the duty to see to it that the directors and managers of the company are aware of their legal, fiduciary and ethical responsibilities.

Credit insurers have certain additional issues that need to be taken care of within their corporate governance policy, e.g.:
1. Their reserving policy – see page 173.
2. The solvency margin and/or asset ratio.
3. Risk management, other than underwriting risks, e.g.: Investment risks; money market and foreign currency risks; operational risks and reinsurance risks.

4. For companies in South Africa: The Employment Equity and Skills Development plans, the provisions of the Financial Sector Charter and other applicable legal stipulations.

5. For companies operating in countries additional to their home market: The relevant statutory requirements prescribed by the authorities in the respective countries.

All the regulations and corporate governance guidelines in the world cannot entirely prevent corporate misconduct, scandals and the resulting misery for many, mostly innocent people, but such policies can assist in keeping misdeeds to a minimum.