Good corporate governance:
building stakeholder trust

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Effective corporate governance is at the heart of investor and stakeholder trust – particularly within the context of transitional societies and in countries with emerging economies.

"Don't kow-tow to CEOs." This is the advice given not by the US Security and Exchange Commission, but by Anand Panyarachun, the former prime minister of Thailand. Panyarachun, in his address on corporate governance to a conference of auditors and risk managers, predicted that "one-man show" CEOs will soon be a thing of the past.

As one of the Asian Tigers, Thailand and its former prime minister understand all too clearly that effective corporate governance is at the heart of investor and stakeholder trust – particularly within the contexts of transitional societies and emerging economies. Thailand has experienced first hand the consequences of a crisis in trust among its investors and stakeholders. An investor "no-confidence vote" has triggered a flight of capital out of the country, creating economic hardships of growth stagnation, inflation and a plummeting standard of living.

Recent scandals revealing misconduct at corporate giants like Enron, MCI, Barings, Bank of Credit and Commerce International (BCCI) and Vivendi serve to reinforce the notion that the USA and Europe are also vulnerable to the consequences of eroding investor confidence. For example, in the USA and most EU countries, unemployment rates are at "record highs" in over a decade.

In South Africa, we have had our own spate of scandals – who can forget the likes of Leisure Net and the pyramid schemes? However, such scandals are not new occurrences in business – we would argue that they are just more public due to global media and communication capability.

For instance, the Rolls Royce collapse in the 1960s and the financial scandals which occurred during the 1980s, such as Polly Peck and Maxwell, were viewed as failures of the UK system. But the root of these actions were spoken and written about as early as the 17th century when Sir Edward Coke in 1612 claimed that "corporations cannot commit treason, nor be outlawed, nor excommunicate, for they have no souls".

In 1887, Henry Ward Beecher made the point that "we have much to fear from great corporated, moneyed institutions. We are today more in danger from organised money than ever we were from slavery."

In 1985, in the House of Lords, Lord Denning added: "There is a veil of corporate personality which protects the individual from any personal liability at all. That is the fundamental principle of our company law."

All of the above quotes speak to **humans** and their **intent** – this is the underlying root, we believe, in South Africa (we constantly have to be questioning and interrogating the intent of individuals and corporations, and holding them accountable to the highest of principles – not accountable to rules to be followed).

- *What are the lessons for South African companies?*

If there is a lesson to learn, it is this: stakeholder and investor confidence requires vigilance in assuring that the principles of good governance are not only in place, but are embedded into the fabric of businesses, as well as into the moral fabric of individuals in leadership. Stakeholders and investors expect corporate boards and senior management teams to be guardians of trust by minimising nasty surprises and maximising transparency. Unlike the US model of corporate governance that is riveted to investor interests, the South African model of corporate governance addresses the interests of a community of stakeholders.

Good governance means a proper balance between enterprise and accountability, encompassing the two main dimensions of corporate governance:

The first dimension concerns active monitoring of management performance and ensuring accountability to the community of stakeholders (in the words of Khanya Motshabi, CEO of our National Empowerment Fund, the widest form of stewardship, demanded through personal and organisational excellence for the widest set of stakeholders and not just a selected set).

The second dimension, touched on recently in a presentation by

Table 1: Characteristics of good governance: from vision to action

Governance Characteristics	Checklist for action
Transparency: Accurate and timely availability of information to external stakeholders	**Disclosure:** Are processes in place for timely distribution of financial data such that senior management has adequate time to review reports? **Communication:** Does your corporate communication plan include clearly defined spokesperson roles (including board members), guidelines to protect competitively sensitive information, and a "needs-to-know" distribution list of key stakeholders, especially investors?
Independence: External board members are active rather than passive participants	**Board composition:** What is the criterion for board membership? Do your board members present a cross-section of your key external stakeholders? Are conflict-of-interest guidelines in place for board members? **Company expectations of board:** Do boards meet regularly? Are external board members active participants of key committees such as the auditing and compensation committees? **Risk management:** Are processes in place to delineate the risk of various key company strategies? Are there employees in place, acting as independent agents, to update and access the risk profile of the company?
Accountability: Role clarity at the board level driven by commitments to company and stakeholders	**Cascading accountability:** Can you map accountability from the board to functional managers in the firm, especially in areas of finance, human resources and marketing/sales? **Due diligence:** Are processes in place that encourage board members to know the business and industry? Is there an effective ombudsmen/ombudswomen process in place to protect whistle-blowers? Is the board a partner in selecting the external auditor? Can they request the external auditors to undertake an independent assessment on a specific area of the business?
Responsibility: Clearly defined responsibilities of the board, CEO and senior leadership team	**Board expectations of CEO and senior leadership team:** Are performance expectations of the CEO and senior leadership clearly delineated? Is compensation of the CEO and senior leadership team linked to performance outcomes? **Oversight by the board:** Are all board members active participants in developing the company's strategic framework? Is there agreement among board members and senior leadership as to the long-term performance indicators such as market share, profit margins, goal commitments to employees and goal commitments to stakeholder communities?
Fairness: Balance of differing interests of stakeholders	**Corporate values:** Is there a consensus between the board and the senior leadership team regarding what the core values of the firm are? **Conflict resolution:** When competing interests create unresolved tension, are there processes in place to resolve these tensions before they become contentious issues?
Social Responsibility: Awareness of external commitments to good corporate citizenship; maintaining ethical standards that build trust	**Commitment to ethical standards:** Is a standard of ethics that addresses the full array of stakeholder expectations in place? Do the processes for adherence to these standards motivate compliance or commitment? **Balance:** Are both the economic and social responsibilities treated with equal deference?

Source: King Committee Report on Corporate Governance: *Seven Characteristics of Good Corporate Governance*, March 2002

Finance Minister Trevor Manuel at a UCT Graduate School of Business function, emphasises how corporate governance structures and processes need to incorporate means for motivating managerial and board behaviour towards issues of enterprise and nation-building, and of increasing the wealth of the business and the country as a whole.

This makes the South African model more complex, but highly resilient to excesses of what is commonly called "corporate greed". As a template for effective corporate governance, the Institute of Directors in SA issued the King Report in 1994 and recently updated this report in March 2002. It is a comprehensive, cutting-edge, principle-based guide for what constitutes effective corporate governance.

The King Report outlines seven characteristics of good corporate governance. These characteristics constitute an excellent basis to initiate a reflective audit of companies' governance practices, and firmly set the foundation for the longevity and sustainability of companies in our context – a transitional society within an emerging market.

- *Corporate governance: How is your company doing?*

Corporate governance requires diligence on the part of boards and CEOs with their senior leadership teams to create a bond of trust between the company and its community of stakeholders. To prompt a healthy dialogue of how effective your company's current governance structure and practices are in promoting trust, the following discussion amplifies each of the seven characteristics. Table One summarises the governance characteristics with a checklist for action couched in a question format.

Corporate governance has become an issue of sustainable competitive advantage. Poor corporate governance is now a route to organisational failure. One bad decision, or a right decision poorly explained and communicated, can do untold damage to an organisation's reputation where, only a few years ago, it might have either gone unnoticed or been accepted unchallenged. The freedom of the wider community of stakeholders to challenge an organisation's decisions is a sign of a developed civil society – a necessary pillar of democracy.

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TRANSPARENCY. Stakeholders do not expect to be inundated with a volume of information from a company. What they do expect is pertinent information that will help them make informed assessments about their own risks. What stakeholders view as transparency translates to effective disclosure processes within companies. To meet regulatory requirements for financial reporting, corporations have maintained reporting processes aimed at meeting deadlines. A complaint often heard by board members is that financial reports don't reach them in time for adequate review or comment. If board members are to be engaged as active partners in ensuring the overall veracity and coherence of reported information, disclosure processes must build in reasonable time for review.

In addition, communication plans and their attendant processes should address how external releases are communicated so that stakeholders don't feel they are being manipulated by corporate spin doctors. Public relations and investor relations groups are most effective when they have maintained a list of key stakeholder contacts matched with established internal leaders and board members. Even more importantly, these PR and IR staffs provide an invaluable service by creating opportunities for dialogue between stakeholders and their corporate contacts. Efforts spent in advance cultivating stakeholder relationships pay dividends when unexpected bad news develops and must be communicated. In the US telecommunications industry, stakeholders often complained that the only time they heard from a company was when it was in trouble.

INDEPENDENCE. If a firm's culture is built upon a "hero" model in which the CEO is revered as a "star", board composition is likely to be made up of like-minded supporters. The Polly Peck and Maxwell scandals in the 1980s in the UK each represented a unique and often complex case. The common feature was widespread loss among company stakeholders as a result of the apparently unconstrained "entrepreneurial" activities of powerful individuals. Demands for improvements in control led to the establishment of the Cadbury Committee of the Financial Aspects of Corporate Governance which reported in 1992, producing the Cadbury Code in the UK, the first of a series of recommendations for company boards to follow, designed to improve corporate governance. Stakeholders today are becoming more insistent that boards act more autonomously, balancing the needs of both the business as well as their interests. In fact, a recent McKinsey survey shows that over two-thirds of investors would be willing to pay more for the shares of a well-governed company. Although it may be highly desirable to have board members who understand the firm's industry, finding board members who understand the industry raises questions concerning conflict of interest. The trade-off, or rather balance, here is between accountability and enterprise.

Some corporate governance academics argue for further investigation between accountability and enterprise/entrepreneurship. In countries such as South Africa and Singapore, where there are daily cries from the government and business for higher levels of entrepreneurship, accountability measures and controls, according to academics such as Laura Spira in the UK, need further investigation because it is believed that too much control and accountability impedes enterprise. In the USA, external board members are being recruited not so much for their industry knowledge as for their track records in facilitating effective audit and compensation committee capabilities. Perhaps the most vital contribution that external board members can offer is asking the tough questions about risk associated with undertaking certain strategies and corporate capital investments. One has to ask the question in South Africa whether our current cadre of board members possess the capabilities and "street-smarts" to ask the right, risk-related questions – and whether they fully understand the answers they are getting, when they do get answers.

In the USA, to assist the board, many corporations have created independent groups to assess risk. In regulated businesses, risks are frequently associated with legal compliance; therefore, corporate law staffs are often called upon for independent assessments of risks of certain strategies.

ACCOUNTABILITY. Board members and senior leaders of large global companies rely heavily on a structure of cascading accountability among all the company's managers. This means that directors need to have strategic, rather than operational, foci – they must therefore make the transition from technical expertise as being their basis of power to wider influencing skills to manage and motivate people over whom they have no line management authority. This cascading structure is also often only implied rather than overtly specified. For the board and the CEO to attest to the accuracy of reported information to stakeholders, this cascading structure requires an integrated mapping of accountability to build the confidence at the board level that their decisions on behalf of the company are based on accurate information. After the fiasco with Andersen, regarded before Enron as a highly respected auditing firm, many US policy-makers and investors are calling for external auditors to be engaged on fixed-term contracts, not exceeding five years. This type of requirement can place an undue hardship on a company because part of effective auditing of large companies is an intimate knowledge of the company and its industry. A feasible alternative is to ensure that the auditing firm is responsible to the board and, if necessary, the board can request specific audits on company practices or its subsidiaries. In order for a company's board members to be active participants, an important means of establishing accountability is to encourage an ombudsmen/women group who sets up a process to raise "minority" concerns, including whistle-blowing. Another means to support board members is for companies to create forums in which members get a better appreciation for what the company does and what employees think about the company.

RESPONSIBILITY. Evidence of a board's autonomy can be best seen through its active participation in establishing the senior executive compensation plans that are tied to performance indicators which represent wider stakeholder interests. In addition, many board compensation committees will often direct the HR departments to hire outside consultants who can benchmark pay in their industries. The goal of such efforts is to create compensation plans based upon evidence, rather than opinion. In order to execute their oversight responsibilities, external board members must be expected to engage in active consensual agreement on the long-term goals of the business. To support active board engagement, many companies are establishing offsite annual strategy meetings specifically designed to build consensus on corporate long-term goals and strategies. An important caution on board oversight is role clarity between the board and its CEO with his or her leadership team. A study on African entrepreneurship by Moses Kiggundu found that board members in some companies

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frequently interfered in the day-to-day running of corporations. In some cases, he also found that the level of trust between board members and the company's CEO was lacking; CEOs in these companies frequently withheld information from board members because they feared that such information could be "sold" by board members to competitors. Another, often unspoken and overlooked, responsibility of directors is achieving corporate transformation, ie, ongoing development and renewal of their organisation (maintaining the *status quo* – particularly in South Africa, where the *status quo* is not exactly desirable or needed – is not good enough and does not attest to leadership, but rather followership). We believe that in order to achieve corporate transformation, particularly within our South African context, directors have to learn to think and behave in totally new and exciting ways, relevant to the environment within which they operate and live. They need to embrace the need for personal transformation and ongoing learning (this possibly even requires the need for ongoing executive coaching, in addition to personal development education) so that board members can individually – and collectively – challenge their own limiting beliefs and preconceptions and daily justify their right to be in business and their positions.

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FAIRNESS. Fairness implies even-handedness in assessing the needs of multiple stakeholder interests. A shared understanding of the company's values among external board members, the CEO and the senior leadership team often gives the board a common frame of reference when an issue becomes contentious. As the board composition for many companies changes to one of autonomous external members, representing diverse stakeholder interests, many critics fear that boards will become dysfunctional and paralysed in taking necessary action. Board member capabilities to resolve competing interests can be effectively enhanced through conflict resolution skills. It might be prudent for the CEO to consider building conflict resolution capabilities among his or her board members before, not during, an onset of a particularly contentious issue.

SOCIAL RESPONSIBILITY. At the core of good corporate governance is adherence to a code of ethics and morality, built on a commitment to corporate citizenship and designed to engender trust. Many companies do have codes of ethics, usually included in its codes of conduct. A board alone cannot "be ethical" if the company for which it provides governance is not also comitted to ethical standards that are "lived through action", not just declared on pieces of paper. In South Africa, this is further complicated by the pressing demands for necessary change within our business and societal structures – and we would argue that boards of directors are failing their shareholders, the wider public and themselves if they continue to resist change. Many have not recognised how significantly the role of the director has changed in complexity. Those who have, would appear not to know what to do about it. There seems to be a deficiency in directing in the vast majority of organisations – that is, providing vision and leadership – in our unusually complex, and unique, society. The challenge, as our present government often claims, is to carve out new pathways, to set new standards and approaches for our transitional society, to take head-on our responsibility for leadership in shaping and creating our country's future (as opposed to reacting to the future). Many hard choices are presented to the board to act wisely in determining a course of action that balances the company's commitments to profitability and its overall social responsibilities. It requires the board, the company's CEO and senior leadership team to step back from short-terminism and the "sickness of quarterly results", and take a longer-term view of profitability and sustainability. For example, Merck, the pharmaceutical company, in line with its core value that medicine is for patients, not profits, decided to give away a drug called Mectizan which cures river blindness. Unfortunately, many companies, driven almost exclusively by share-owner interests (as opposed to the interests of the wider community of stakeholders), are losing sight of their core values.

- *Summary*

Effective corporate governance requires a healthy board composed of capable external members and attention to the needs of the broader community of stakeholders. Directors and boards need to address their own, ongoing personal development and that of their boards to create effective, performing teams.

The critical aim of governance practices is to build trust between a company and its wider community of stakeholders.

As Charles Handy observed: "Trust, too, is fragile. Like a piece of china, once cracked it is never quite the same." ■