Corporate Governance Failures: Is it the End of Governance as we Know it?
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Abstract: In the recent past there have been a plethora of corporate governance failures in South Africa, both in private and public sector. The poor corporate governance failures are causing immeasurable damage to South Africa’s reputation when it comes to corporate governance matters. These failures happen despite the recent publication of King IV code of good practice. Corporate governance failures were experienced at Eskom which is a state-owned enterprise and Steinhoff International which is a private sector which is dual listed entity both in South Africa and in Germany. These corporate governance failures are not the first, as there were high profile collapses in the pasts which included the likes of Enron, WorldCom in the United States of America and Saambou and Fidentia in South Africa. In the accounting and auditing fields, there have been lapses in ethics and governance, this includes in companies like KPMG about the work done at SARS and Deloitte with regards to the work done at Steinhoff and this has made these professions to be ethically suspects (Lane, 2016:229). Corporate governance embodies the processes and the systems by which the entities are directed, controlled and how they should be held accountable (Khurama, 2016:3592). There are legislative requirements that are based on companies Act in the case of private sector and Public Finance Management Act in the case of public sector and all these are also solidified by the principles contained in the King code, which is currently King IV. It is now also evident in the Companies Act 71 of 2008 that the matters of corporate governance are no longer just regulated in the codes of best practice but they are now part of the legislation as contained in section 76(3) (b) of the Act, while section 72(4) provides that there should be committee that will deal with social and ethics. This paper will show how corporate failures come about. Is the subscription to principles of good corporate governance helpful, if that is the case, why then did they fail? Does the drafting and publication of code of good governance make companies and organisations that subscribe to them healthier and sustainable? Will such subscriptions reduce the amount of failures or collapses of companies? Is the failure caused by the box ticking mentality?

Keywords: Board of Directors, Corporate Governance, King Code IV, Shareholders

1. Introduction

Corporate governance has become increasingly important over the last decades, both in South Africa and internationally (ACCG, 2016:70-79; Malherbe & Segal, 2001:7). With so much said about corporate governance and defined in various ways, why should there be concern about it, and what relevance does it have for South Africa (ACCG, 2016:70-79; van Hooij, 2014:6-7). This article will outline the reasons why corporate governance has risen to prominence in the first decade of the new century and discusses South Africa’s role in the international movement and the ultimate failures of corporate governance. Corporate governance covers a wide array of concepts and issues, and therefore means different things to different people (Mahajani, 2016:29; McGregor, 2008:2). This section defines corporate governance and outline the core principles of which it is based and set out the scope and limits. There are several definitions of corporate governance, the most important of which is outlined here (Mahajani, 2016:29; Cuong, 2011:586-588). Naidoo (2002:1) provides succinct initial point for defining what corporate governance is, and defines it as follows: "Corporate governance is the practice by which companies are managed and controlled."

It can therefore be inferred that the practice that is used by companies in managing and controlling them that is what constitute corporate governance. A broad definition of corporate governance is found in King II report (2002:5), and is defined as follows: "Corporate governance is a participative, system of enterprise with integrity in the interests of a wide range of stakeholders having regard to the fundamental principles of good financial, social, ethical and environmental practice."
According to Sir Adrian Cadbury, who is the father of Corporate Governance in the United Kingdom extends this concept in a report on corporate governance for the World Bank as follows:

"Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of the resources. The aim is to align as nearly as possible the interests of individuals, corporations and society."

A company once registered is a citizen of South Africa, but is totally incapacitated and the agency theory can in this case be invoked (Lame, 2016:11; ACCG, 2016:70-79). According to Moritz-Rabson in Lame (2016:11), the agency theory "explains how best to organise relationships while the other party does the work in this relationship, the principal hires an agent to do the work, or to perform a task the principal is unable or unwilling to do" in which one party determines the work. It can therefore be inferred that from the day a company is created lifeless and the managers and directors give it life. The board of directors are therefore the ones that become the head, mind and soul and they assume the same common law responsibilities toward a company (Buys & Cronje, 2016:120-122; Lame, 2016:11; Moloi, 2008:14-15).

It can further be inferred that, that is the reason why communities demand that the company take cognisance and behave as a decent citizen so that the company becomes a decent citizen.

At the core of corporate governance is the legally established principle that a company is a separate juristic person with all of the rights and responsibilities of natural person (Mahajani, 2016:29; ACCG, 2016:70-79; van Hooij, 2014:6-7). It is directors and through their managers, who determine the character, abilities and of the company (McGregor, 2008:6; Wilson, 2015:5; van Hooij, 2014:6-7). Out of this principle come the concept of good corporate governance, how a company's behaviour is controlled for best positive effect and good corporate citizenship has on its surroundings as a legally recognised, useful member of society (ACCG, 2016:70-79; Mahajani, 2016:29; van Hooij, 2014:6-7; Moloi, 2008:14-15). It can therefore be argued that, if a company can be compared to a person, then it is a separate person in law, therefore companies, like another natural person, cannot be owned and therefore shareholders cannot have direct interest in the property, business or assets of a company however the shareholders have a right to vote and to share dividends in return for their investment. The inference of this is that shareholders cannot expect director to run companies in their sole interest, as has happened in the past.

2. Changing Roles of Business

Legally and philosophically it is no longer acceptable for businesses to concentrate only on generating returns without giving consideration to the environment in which they operate, therefore corporate social responsibility is also an important element (ACCG, 2016:70-79; Buys & Cronje, 2016:122-123; van Hooij, 2014:12-14). Companies are now also expecting to act as good corporate citizens (Mahajani, 2016:29; Buys & Cronje, 2016:122-123).

In addition to generating financial returns, how such returns are generated and the direct and indirect effects of doing business inside and outside the company are now ranked alongside financial performance (van Hooij, 2014:12-14; Bris, 2010:2-7). Emanating from the visibility and impact on the others, companies are required to adhere to higher standard of ethical practice than individuals (van Hooij, 2014:12-14; Bris, 2010:2-7). It can therefore be inferred that, it has now become legitimate expectation of communities that when businesses carry out business in their areas, they will ensure that the needs of the community are also factored in their practice.

3. Evolution of the Corporate Governance Paradigm

The corporate governance of business behaviour has developed out of a long history of other, less balanced business paradigms (ACCG, 2016:70-79; Mahajani, 2016:29). This section provides a cursory overview of the most important of these. Family run businesses dominated the growth of companies during the industrial revolution as such largest companies were started, owned by, and or obtained governance investments from a single family (ACCG, 2016:70-79). This implied that controls on corporate governance behaviour were less strict in their works as these were their own businesses and any stealing from such would have been stealing from themselves (ACCG, 2016:70-79). The next century saw the rise of institutional investors in companies and it was therefore necessary to institute checks
and balances that provided for the protection of institution's money (ACCG, 2016:70-79). This situation led to an inevitability, which resulted in a shareholder dominated business paradigm that protected the right of investors over those of other stakeholders as the agency relationship developed (Lame, 2016:11; ACCG, 2016:70-79). It can therefore be argued that in the past, the power vested in management and shareholders, this meant that companies were controlled and manipulated by almost unchecked management teams and this resulted in management dominant business paradigm that was pervasive.

4. South African Corporate Governance

The governance of corporations' can be on statutory basis or as a code of principles and practices or a combination of the two (ACCG, 2016:70-79; Malherbe & Segal, 2001:7-8). The United States of America has chosen to codify a significant part of its governance in an act of congress known as the Sarbanes-Oxley Act (SOX) (Moloi, 2008:35-36). In SOX, the statutory regime was known as comply or else, in other words, there are legal sanctions for non-compliance (Moloi, 2008:35-36). There is an important argument against the comply or else regime because one size fits all approach cannot logically be suitable as different types of business carried out by companies vary to a large degree (ACCG,2016:70-79). The cost of compliance is burdensome, measure both in terms of time and direct cost. Further the danger is that the board and management may become focused on compliance at the expense of enterprise (ACCG,2016:70-79). The board of directors must ensure that they act in the best interests of the company as an overriding factor, and they also must deal with the legitimate interest and expectation of all the company's stakeholders (ACCG, 2016:70-79; Buys & Cronje, 2016:120-122; Wilson, 2015:5).

The total cost to the American Economy of complying with SOX is considered to amount to more than total write off for Enron, World Com and Tyco combined (Cuong, 2011:586-588; Moloi, 2008:35-36). Some argue that the companies compliant with SOX are more highly valued and that perhaps another Enron debacle has been avoided (Dibra, 2016:284-285; Cuong, 2011:586-588; Moloi, 2008:35-36). SOX's corporate governance provision was ill conceived. Other nations, such as the members of the European Union who have been revising their corporation codes, would be well advised to avoid Congress's policy blunder (Dibra, 2016:284-285; Cuong, 2011:586-588; Moloi, 2008:35-36). It is unlikely that hasty, crash induced regulation like SOX can be far sighted enough to protect against further problems particularly in light of the debatable efficiency of SOX's response to current market problems (Dibra, 2016:284-285; Cuong, 2011:586-588; Moloi, 2008:35-36). Even the best regulators might err and regulation that is so strong that it stifles innovation and entrepreneurial activity (Dibra, 2016:284-285; Cuong, 2011:586-588; Moloi, 2008:35-36). Once set in motion, regulation is almost impossible to eliminate as evidenced in the first three years of SOX, which was, an overreaction to Enron and related problems and works (Dibra, 2016:284-285; Cuong, 2011:586-588).

The 56 countries in the Commonwealth, including South Africa and the 27 states in the EU including the United Kingdom, have adopted for a code of principles on a comply/explain basis, in addition to certain governance issues that are legislated (ACCG, 2016:70-79; Dibra, 2016:284-285; Cuong, 2011:586-588; Moloi, 2008:31-36). United Nations, the question whether the United Governance Code should comply/explain or comply/else was hotly debated and the representatives of several world bodies were opposed to the word comply, because it connoted that there had to be adherence and there was no room for flexibility (ACCG, 2016:70-79; Dibra, 2016:284-285; Cuong, 2011:586-588; Moloi, 2008:31-36).

Following King II, the Johannesburg Stock Exchange Limited (JSE) required listed companies to include in their annual report a narrative statement as to how they had complied with the principles set out in King II, providing explanations that would enable stakeholders evaluated the extent of the company's compliance and stating whether the reasons for the non-compliance were justified (ACCG, 2016:70-79; Moloi, 2008:31-47). The board of directors must ensure that they act in the best interests of the company as an overriding factor, and they also must deal with the legitimate interest and expectation of all the company's stakeholders (ACCG, 2016:70-79; Buys & Cronje, 2016:120-122; Wilson, 2015:5).

South African listed companies are regarded by foreign institutional investors as being among the best governed in the world's emerging economies.
and we must strive to maintain that high ranking (ACCG, 2016:70-79; Moloi, 2008:31-47). South Africa has benefited enormously from listed companies following good governance principles and practices, as was evidenced by the significant capital inflows into South Africa before the global financial crisis of 2008 (ACCG, 2016:70-79; Moloi, 2008:31-47). It is for this reasons that King Committee believes that there should be a code of principles and practices on a non-legislated basis (Moloi, 2008:41-47).

Approaches to voluntary basis for governance compliance and the International one of comply or explain principle has also evolved into different approaches (ACCG, 2016:70-79; Moloi, 2008:31-47). At the United Nations, for instance, it was ultimately agreed that the UN code should be on an adopt or explain basis (ACCG, 2016:70-79; King III, 2009:5; Moloi, 2008:31-47). In the Netherland Code the apply or explain approach was adopted (ACCG, 2016:70-79; Bekkum, Hijink, Schouten & Winter, 2009:2-4; Moloi, 2008:31-47). The comply and explain approach could denote a mindless response to the King Code and its recommendation whereas the apply or explain regime shows an appreciation for the fact that it is often not a case of whether to comply or not but rather to consider how the principles and recommendations can be applied (McGregor, 2008:6; Bris, 2010:2-7; Moloi, 2008:46-54).

King III therefore is an apply or explain basis and its practical execution is important for the company, and it is the legal duty of directors to act in the best interest of the company (King III, 2009:6-7; McGregor, 2008:6). In following the apply or explain approach, the board of directors in collective decision making, could conclude that to follow a recommendation would not, in the circumstance, be in the best interests of the company (Cuong, 2011:586-588; King III, 2009:6-7). The board could decide to apply the recommendation differently or apply other practice and still achieve the objective of the overarching corporate governance principles of fairness, accountability, responsibility and transparency (Khurama, 2016:3592; Wilson, 2015:5; Cuong, 2011:586-588; King III, 2009:6-7). In explaining how the principles and recommendations were applied or not applied, the reasons for not applying them were required.

There is always a link between good governance and compliance with law therefore good governance is not something that exists separately from the law and it is entirely inappropriate to unhinge governance from the law (Wilson, 2015:5; McGregor, 2008:6; Cuong, 2011:586-588). These duties are grouped into two categories, namely, the duty to care, skill and diligence and the fiduciary duties which is the responsibility of the board ACCG. When it comes to the body of legislation that applies to a company, corporate governance involves the establishment of structure and processes, with an appropriate checks and balances that enable directors to discuss their legal responsibilities and oversee compliance with legislation (McGregor, 2008:6; Bris, 2010:2-7; Moloi, 2008:46-54).

In addition, compliance with legislation, criteria of good governance, governance codes and guidelines will be relevant to determine what is regarded as an appropriate standard of conduct for directors (McGregor, 2008:6; Cuong, 2011:586-588). The more recognized governance principles become, the more possible a court would regard conduct that conforms with these practices as meeting the required standard of care as is expected from the board of directors (Wilson, 2015:5; McGregor, 2008:6). Corporate governance practices, codes and guidelines therefore lift the bar of what are regarded as appropriate standard of conduct (McGregor, 2008:6). It can therefore be argued that the world hybrid systems are developing wherein some of the principles of good governance are being legislated in addition to a voluntary code of good governance practice. In the case of apply or explain approach, the principles override specific recommended practices. However, some principles and recommended practices have been legislated and they therefore require compliance with the letter of the law without having tried different interpretations.

5. The Era of Corporate Failures and Transgressions

Corporate failures were experienced all over the world and included amongst others the following:

Adelphia, in this instance John Rigas was both chairman and Chief Executive Officer of the board and his sons and son in law were all directors and this type of arrangement compromises the board of directors (KPMG, 2016:18; Wilson, 2015:5). In the Sydney based Governance International gave HIH a zero score out of five points when assessing them on their corporate governance and the assessment was a precursor to the collapse that happened four
years later (KPMG, 2016:18). This failure came about despite the participation of former audit partners in the board (KPMG, 2016:18). It can therefore be insinuated that it was expected for the former audit partners to be more conversant with the corporate governance rules, particularly that one of them was the chairman of the board and audit committee, which is also a governance concern to have one person chairing both the board and audit committee (KPMG, 2016:18; Cuong, 2011:586-588). The inclusion of friends and associates in the board of HIH also had an impact on the governance adherence because in such a situation there will be lack of accountability and independence within the board and it will make it impossible to oversee the management reporting process (Khurama, 2016:3592; KPMG, 2016:19; Cuong, 2011:586-588).

In the case of WorldCom, both of the assurance parities were ineffective, that is internal and external audits and these are expected to be areas of corporate governance defence (KPMG, 2016:18). In the case of Satyam, there were numerous non-financial red flags which directed toward the failure of corporate governance, with the main contributory factor being the Chief Executive Officer of the company, who was also the chairman of the board, which is already a sign of conflict of interest in the separation of powers between the board and management which is a sign of lack of independence (KPMG, 2016:4-19). The lack of financial skills by those appointed in the audit committee of Satyam was also a contributory factor.

The lack of independent board, inadequate governance structures which resulted in the absence of board committees oversees the various work streams or in certain instances a single member of the committee being burdened with such a role (KPMG, 2016:18; Kirkpatrick, 2009:2). The other contributory factor is the inclusion of a person who not appropriately qualified and this compromised the work of overseeing the company's operation. In this case family members or people with no financial qualifications being made responsible for roles that required someone who is financially qualified (KPMG, 2016:18; Kirkpatrick, 2009:2; Cuong, 2011:586-588; Mwaura, 2007:40). The other critical contributor to the failures lies squarely at the door of auditors and regulators who have responsibility to detect and ensure compliance with the governance rules and precepts (KPMG, 2016:18; Kirkpatrick, 2009:2).

6. South Africa’s Corporate Governance Frameworks

The establishment of the King Committee coincided with the profound social and political transformation at the time, the drawing of democracy and the re-admission of South Africa into the community of nations and the world economy (ACCG, 2016:70-79; Naidoo, 2002:1). The emergence of corporate governance in South Africa has been both reactive and pro-active (ACCG, 2016:70-79). Internationally, there have been moves over the last few decades aimed at developing universal corporate governance codes that will create uniformity of practices in the world (van Hooij, 2014:12-15). South Africa’s recent past prompted the need for a unique approach to corporate governance (ACCG, 2016:70-79).

While South Africa’s corporate environment was not without its corporate failures, our internationally-recognised trailblazing corporate governance initiatives arose mainly from during and after the country’s unified approach to corporate governance during and after the country’s transition to democracy (ACCG, 2016:70-79). The need for clear guidance for those people who had been previously excluded from holding the reins of political and economic power was identified by, amongst others Nelson Mandela in conversation with Mervyn King as far back as the early 1990’s (ACCG, 2016:70-79). The institute of Directors in South Africa established the King committee on corporate Governance in July 1993, to develop recommendations for a Corporate Governance Framework for South Africa (ACCG, 2016:70-79).

The King Report on corporate governance for South Africa (King 1 Report) was released in November 1994, the King code (King 1) embraces an inclusive approach to Corporate Governance that was wider than that set out in the Cadbury report (ACCG, 2016:70-79). It considered inter alia financial reporting and accountability, responsibilities of directors and auditors and set out standards of governance (ACCG, 2016:70-79; Khurama, 2016:3592; van Hooij, 2014:15-16). Since the drafting of the King 1 Report, significant changes in the theoretical institutional and legal landscape relating to the governance of companies occurred in South Africa and abroad (ACCG, 2016:70-79). The need to recognise and codify these in a new, updated and more inclusive corporate governance framework was recognised (ACCG, 2016:70-79).
The King Committee on Corporate governance released the King Report on Corporate Governance in South Africa in 2002, hereafter referred to as King II in March 2002 (ACCG, 2016:70-79). King II expands on the principles covered in the original report, and taking a wider perspective of corporate governance, there is also an extended applicability to the development (ACCG, 2016:70-79). King II has been acknowledged to its in-depth explanation as a leading contribution to the corporate governance debate internationally (ACCG, 2016:70-79). The key characteristics of good corporate governance as determined for South Africa are set out in the Code of Corporate Practices and Conduct in the King IV report which has made vast improvement from its predecessor, King III.

7. Conclusion

Emanating from the discussion, it can be concluded that corporate governance is a code of ethics, which is supported by a set of regulations by which companies should abide. Given that many of the quantitative or specified requirements related to corporate governance can be ignored and that many of the qualitative principles cannot be policed, corporate governance is an innovation that have the capacity to self-policing. A corporate governance framework is therefore not a formula for business performance, but a starting point for corporate, managerial and stakeholder protection, accountability, responsibility and success which is key fundamental for the success of business (Khurama, 2016:3592; ACCG, 2016:70-79). Corporate governance is not a panacea that will ensure companies on-going success and productivity. The burden of complying with good corporate governance principles should not push a marginal company into liquidation, instead it should steer it towards success. Making alignment with the company’s operations with the prevailing philosophical, socio-political, legal and commercial context within which it operates is critical for the success of business.

Corporate governance, if applied and followed through, has the capacity to develop ethical frameworks that can guide how directors, managers and staff conduct a company’s affairs and that continually build the ethical base of individuals responsible for fulfilling corporate responsibilities. Emanating from the discussion above, it is evident that understanding and meeting or bettering the legal roles, obligations and responsibilities of directors and managers in ensuring well-run companies hinges on the application of corporate governance principles. Ensuring compliance with corporate governance in respect of the letter and spirit of organisational structures, including their composition and functions as required will give companies the best chance of complying with good governance practices. One other key element worth mentioning is the good corporate citizenship which deals with doing business in a responsible and sufficiently open manner that ensures a balance between maximum profits, positive social, economic and environmental benefits and minimised negative impacts for all direct and indirect stakeholders. In pursuing business success, there is a need to report on the 'triple bottom line' which is of environmental, social and economic performance.

To understand corporate governance and its challenges, there is need to understand, the differences between governance and management and the corporate governance systems, as well as understand the context in which companies are governed or the context of how corporate governance is applied. There is plethora of laws that determine, direct and influence corporate governance, and corporate governance structures and systems. These factors determine the context in which companies are managed. It has also become evident from the discussion above that it expected in most jurisdictions for the directors to behave in ways that promote good governance. The company law being promulgated, demands that directors’ act with honesty, integrity and frankness toward their shareholders and they must disclose any actual or potential conflicts of interest to the board and may usually not trade in the company’s shares based on information that is price sensitive and obtained because of privileged position and not generally available to the public, that is insider trading. Directors are also generally bound by legation and they are duty bound exercise reasonable care, diligence and skill in their work as directors.

The regulatory bodies that are set up by government are also there to assist in ensuring compliance with corporate governance. There are regulations that involves the government agencies and regulatory bodies determined by the state for the governance of companies and the protection of investors and this includes bodies such as the Competition Commission, the Financial Services Board, the securities and exchange commission in the US, as well as authorities formed to deal with specific commercial
crimes. These regulatory bodies are set up to ensure compliance with the company laws and regulations. If the application of these regulations is monitored and policed, there is no doubt that corporate governance will improve and become better rather than fail.

References

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