# The Essence of Corporate Governance

Over the past 20 years I have been engaged in helping boards, senior executives and shareholder activists worldwide to significantly improve their performance and, therefore, their results. There is so much complexity and confusion around the subject of Corporate Governance that it is a useful exercise to go back to the basics of the meaning of governance and what it is or should really be about in practice.

By Lynn Carneson McGregor

Corporate Governance is fundamentally a human activity related to how important decisions are made concerning the future of corporations and the communities and environments dependent on them. I suggest that although the topics that boards need to address are complex, the actual practice of good corporate governance is simple, even though it is not easy to achieve.

**What Do We Mean By Corporate Governance?**

"Corporate Governance" includes all the activities involved in governing corporations. In my book, *The Human Face of Corporate Governance*, I have suggested that Corporate Governance takes place on four interconnecting levels: Systemic, Intergroup, Interpersonal and Personal governance. Every one of us, regardless of our role and status, is involved in one or more of these levels.

The "systemic level" refers to the

system of governance, both global and local, that sets and controls the rules, laws and regulations relating to the running of businesses and other organisations and carries out penalties for those found breaking the law. This level is run by big global players – governments, the legal system and other large institutions governing financial systems or trade regulations. The King 3 Report and various government Acts and laws, such as the New Companies Act, operate at this level. It is possible to influence or change the system in various ways. If the financial or economic system is in trouble, this will affect the ability of companies to operate.

"Intergroup governance" refers to the governance processes that occur between representative groups, for example, between government and business and between fund managers and corporations, or between boards and executive committees. It also includes environmental and social lobby groups and the media. Processes often include briefing, sharing of information, consultation, negotiation and doing deals, or the opposite.

The level of "interpersonal corporate governance" describes the relationships and dynamics between groups of people involved in corporate governance. These would include the board, its committees, the executive committee, and the group of investors deciding on whether to invest in specific companies. The quality of making decisions and implementing them depends on how people work together and their levels of competency.

"Personal governance" is how each person "governs" their own life and how they fulfil their particular roles. How effective an individual is likely to be will depend on their character, wisdom, integrity, motivation, values and beliefs, as well as their knowledge and expertise to carry out their work. Corporate Governance is a leadership role. The style and behaviour of the chairperson sets the tone, culture and standards of board behaviour.

**Why is Good Corporate Governance So Important?**

If all the government and governance systems and the people in them are working well, in a perfect world, business can be conducted smoothly, fairly, honestly, without hitches for the general good of all. It is a society in which trust is taken for granted. There are many boards, companies and responsible investors that make a positive difference. However, as we all know, the world is far from perfect.

Good governance enables sustainable wealth creation whereas corrupt governance erodes everything that enables decent sustainable living for the common good. Poor corporate governance, usually through a combination of incompetence or criminal or corrupt practices, causes the eventual long-term destruction of whole communities and countries. The reason for this is that greedy people take as much as they can for their own short-term gains rather than re-investing in continued productivity. The industry then lacks the resources to develop and grow. Millions of people eventually lose their jobs and livelihoods while selfish rich people go off to tax havens to play. What is even worse is that corruption breeds a culture of bribery, blackmail, threat, cover up, deceit, favouritism and vicious attempts to destroy any people who manifest integrity. A corrupt culture infects the quality of our lives and our ability to live together in trust and harmony.

Boards of directors are responsible for the corporate governance of companies. The legacies they leave behind will determine whether our children live in a healthy or unhealthy world. The quality of board performance makes a huge difference.

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**How Can Good Corporate Governance at Board Level Be Achieved in Practice?**

The King 3 Report, and indeed various government Acts, provide excellent guidelines for how boards should conduct themselves. The challenge, however, is to fully understand and conform to what is legally required and then to be able to select what is most important for a particular board. What I like both about the South African Companies Act and King 3 is that they encourage the board to behave intelligently. They highlight three main questions:

1. Are boards thinking about what they are doing?
2. Are they able to "apply" the Companies Act principles, or "explain" why not?
3. Does the board have the required level of skill and diligence to make sound business judgements?

Sound business judgement comes from understanding how a business operates in relation to the organisation being governed. It requires knowledge and expertise in a number of areas such as finance, law, marketing, services, production and technology and human resources. The roles of non-executive directors are different from the executive directors they are supposed to govern. Board members need to understand what the issues are rather than the operational details. These issues relate to four main areas that boards should be competent to govern:

1. Conformance to legal and regulatory requirements;
2. Performance (strategic direction, deal making, setting priorities and targets);
3. Monitoring delivery (including financial monitoring and risk assessment); and
4. Selection and or sacking of board members and top executive directors.

The board also has an overall role to provide oversight of the company being governed and the external environment in which it operates – shareholders, government, media, stakeholders etc. This requires the board to have a multi-dimensional perspective. Experienced directors often have an intuitive grasp


of the right questions to ask. For less experienced boards, I often use a quotation by Sun Tsui, a fifth century philosopher to explain the importance of perspective in governance:

> "Above all, know thyself, know thy enemy
> Know the ground. Know the terrain
> And your victory will be assured."
> – Sun Tsui, *The Art of War*

*Know thyself* refers to the quality of individual board directors and the board as a whole. Self awareness of the chairperson is most important because they lead and manage the board. It is their unique style, personality and way of working that sets the tone, culture and expectations for the board. The chairperson's particular strengths as well as weaknesses will influence how the board operates. The more the chairperson also understands the strengths, weaknesses and needs of each director and the board as a whole, the better able they are to draw on strengths and to mitigate any risks due to weaknesses and gaps in the board's decision making.

*Know thy enemy* is an understanding of external enemies such as bids for hostile take-overs, financial and global crises, media exposure that could damage reputation and significant competition. It is also an understanding of risks internal to the board, such as inappropriate appointments, withheld or false information, insider dealing, fraud, personal greed, corruption, destructive power games, interpersonal difficulties and tensions and general incompetence on the board. Any of these could undermine the ability of the board to do its proper job.

*Know the ground* has to do with whether the board has enough information to make informed decisions about its various tasks. Does it know the senior executives well enough to give them appropriate feedback, checks and balances or encouragement? How well do board members know what is going on in the company in terms of its ability or inability to deliver? How well does the board know the market and marketing trends? How competent is the board as a whole at analysing financial results intelligently? Are they able to scan the immediate environment to prevent major risks in time? Do they know enough about opportunities that might be available so they can decide to change strategic direction? Do they know enough about how actual or potential investors view them? How well does the board manage the media?

*Know the terrain* refers to the wider national or global context in which the board and the company operate. Non-executive directors often act as the antennae to the outside world. For example, if they see a financial downturn coming, preparations and contingencies can be made to mitigate potential loss of income. On the other hand, directors might be aware of technological changes or know about companies that are up for sale or potential merger. It is vital to see the company in a wider context to anticipate its future potential.

*And your victory will be ensured* suggests that only if positive relationships are developed and professionalism, quality of discussion and communication are cultivated will ways of working be created that enable the board to operate well. Because of the limited time most directors have to focus on any one particular board at present, time and energy is extremely valuable and needs to be well managed, not only at board meetings but between board meetings.

By now it should be clear that to

govern well is an art and not a tick-box exercise. It is about the ability to make good decisions.

A highly effective board is a board where people go away from a board meeting inspired, feeling that they contributed to lively discussions and that the board as a whole made the right decision about an important issue that was as far as possible in the best interests of the corporation, its shareholders and stakeholders. Directors are not afraid to speak their minds but also know when it is appropriate to listen, give others time and when a collective decision needs to be made.

There are six key ingredients that occur in all good boards:

1. A good chair that sets standards of performance she or he expects from the board.
2. An understanding and commitment by all board members to the same values.
3. A board that understands key corporate governance principles and is able to carry out its tasks.
4. A board composition that reflects appropriate knowledge and expertise.
5. Ways of working together that enable directors to work at their best.
6. Succession planning and implementation that provides sustainability.

Very few boards are perfect in all areas. The difference between a good board and a poor board is that there is willingness for the board to evaluate where it needs to improve.

A poor board lacks all or most of these ingredients. However, there is a difference between an incompetent board and a corrupt board. For those who know that they need to improve their knowledge and expertise, *learning* is the key. For those who carry out corrupt practices, *unlearning* is the key.

## Incompetent or Dysfunctional Boards

South Africa at present lacks large numbers of competent or experienced directors. There is a lack of skilled expertise to fill our boards. This means that directors who do not know what they are doing are being appointed




to boards. Many have the potential to develop. Fortunately if there is a chairperson who understands the minimum competency necessary for the board to do its job, damage limitation can be done. Investment in developing expertise prevents expensive mistakes. There are written guidelines and courses available from the South African Institute of Directors, the Institute of Chartered Secretaries and various consultancy companies.

In the media there is a different scandal every day. Too many directors are found guilty of corruption and practice nepotism at the expense of others. There is a new breed of directors who are more interested in fast cars and expensive suits than responsible governance. It is easy to see how the poverty trap encourages dishonest behaviour and how this becomes deeply embedded and institutionalised in the culture of a country. People need to understand that alternative ways of operating are possible and better. In addition, a zero tolerance of corruption needs to be practiced – by government, business, courts and judges. Setting up effective and efficient systems and processes will make it more difficult for corrupt practices to be carried out. It is the chairperson's job to insist on and maintain a culture of integrity.

## Summary and Conclusions

South Africa is a land of possibilities and opportunities. Its development will be influenced by the quality of Corporate Governance. Corporate Governance at board level is mainly about the art of decision making. Board governance requires oversight and a general understanding of a number of complex subjects. Corporate Governance fails when the board makes the wrong decisions or no decisions at all. Hopefully an increasing number of our boards will act as a check and balance against those corrupt practices that could cripple our country. For many the jury is still out as to how many of our business leaders will betray our people. I believe that for every one corrupt director, there are many more who, through their ability to govern companies well, will enable this country to thrive.

**References**

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