

**THE CRITICAL EVALUATION OF BOARD OF
DIRECTORS COMPOSITION AND THEIR
EFFECTIVENESS**

*Is there a Link between composition and
effectiveness of board of directors?*

(A special case analysis of KwaZulu Natal based companies)

By

DON B. MKHWANAZI

**Graduate School of Business, University of Natal
In partial fulfilment of the requirements for the Degree of Master of
Business Administration**

Supervised by: Professor Elza Thomson

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(i)

DECLARATION

This work has not been previously accepted in substance for any degree and is not being concurrently in candidature for any degree.

D.B. Mkhwanazi

31 July 2002

I declare that this dissertation is my own work. It is being submitted for the degree of Master of Business Administration at the University of Natal, South Africa. It was never submitted for any other degree or examination in any other University. All the references used or quoted have been acknowledged by means of referencing.

D.B. Mkhwanazi

31 July 2002

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DEDICATION

This dissertation is dedicated to my beloved parents (the late Joy and Dan). My family, especially all my children who have earned but not enjoyed the love and the attention that they so much deserve, which they missed so immensely during this assignment.

(iii)

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ABSTRACT

The major aim of the study is to establish whether a relationship exists between the composition and effectiveness of the board of directors. Selection, particularly selection procedures became relevant in the study, whether there were different selection procedures for board of directors in South Africa. Developing common selection guidelines and board composition profile is an important element of this study.

A case study research method was used to collect data. The sample was drawn from KwaZulu Natal based companies including 25 directors of companies not necessarily members of the companies in our sample. The sample parameters included a listed conglomerate, municipal funded, unlisted private, black economic empowerment and parastatal companies.

The conclusion is that, composition does impact on the effectiveness of the board of directors. Secondly, boards of directors have different composition profiles. Furthermore, their selection procedures differ to an extent. These differences are driven by the needs of the organization rather than sectoral location. However, sectoral imperatives do have an influence, which cannot be completely excluded.

Whilst, the study found that there were certain uniform requirements to be met by all companies in terms of corporate governance, there were certain instances where the universality of guidelines and/or models and/or perspectives were suspect due to a number of factors. Accordingly recommendations and/or guidelines are outlined to improve effectiveness of the board of directors. These entail amongst other issues:

- Board Structure and size
- Board Composition
- Board Selection
- Board Induction
- The Chairman's Role
- The Roles of Chief Executive Officers
- The Role of Executive Directors

- The Role of Non-Executive Directors
- The Executive Director
- Board Committees
- Gender Equality and Diversity
- Compensation of the Board
- Board Appraisal / Evaluation
- Shareholder Activism

Enforcement takes precedence over voluntary compliance to corporate governance in the guidelines recommended in this study.

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CHAPTER ONE

1.1 INTRODUCTION

Corporate governance has become a subject of active academic and keen policy debate throughout the world. However, this is not confined to academic institutions nor administrative boundaries. In less than a decade, it has become a major factor in defining the way board of directors operate and the responsibility of directors (Dr Egon Zehnder, Zwich 1997).

Corporate governance is often applied narrowly to questions about the structure and functioning of board of directors or the rights and prerogatives of shareholders in boardroom decision making (but) a broader view of corporate governance is one that refers to the whole set of legal, cultural and institutional arrangements that determine what publicly traded corporations can do, who controls them, how that control is exercised and how the risks and returns from the activities they undertake are allocated (Blair, Ownership and Control 1995). Corporate governance is a system by which companies are directed and controlled.

According to William G Bowen, corporate governance is not only a fascinating subject where everyone is an expert, the bottom line is, that it has to do with power and accountability – who exercises this power, on behalf of whom, and how the exercise of the power is controlled.

No matter how we look at corporate governance, which has gained prominence and currency, the board of directors, is central to it. There are a number of factors, which have contributed to this prominence. Put another way, corporate boards and directors have become primary targets for attention in recent years.

Besides, the fact that boards of directors are accountable to shareholders for overall company performance, other critical factors come into the equation. The underlying reasons for the growing interest in corporate governance are: the wide spread demand for greater degree of accountability from organisations which society sees as exercising power and the emergence of global markets. Secondly, but more importantly companies are seen to be too powerful. Public corporations in particular, have always been powerful institutions, but their influence especially with globalisation, is perceived to have grown dramatically, partly, because that of politicians has declined. *“Corporations determine far more than any other institution – the air we breathe, the quality of water we*

drink, even where we live. Yet, they are not accountable to anyone" (Robert Marks and Neill Minow 1991).

Most decisions taken by boards of directors may have far reaching implications for society. William G Bowen and eminent U.S. authority on boards of directors say, *"When things go wrong at major corporations such as General Motors and IBM, there are serious consequences for society at large as well as workers, investors and communities affected most directly. The directors are accountable; it is up to them to guide a reassessment of strategic directions and if need be to replace the CEO or see that other managerial changes are made."*

The importance and the impact of board of directors on society has resulted, across the world in a number of guidelines and codes being drawn up to set out more clearly the role of the board and so establish the accountability of the board to all the stakeholder groups although initially and/or primarily to shareholders.

1.2 BACKGROUND

Effectiveness and accountability of board of directors are the basic governance issues that some of the corporate governance codes and guidelines deal with. Effectiveness is measured by performance. Ultimately the effectiveness of boards and quality of leadership that they give to their companies is measured by the financial returns, which they achieve for their shareholders (Sir Adrian Cadbury 1996).

Board accountability is the key to the legitimacy of the corporate system. Companies are seen to have power and their use of their power is only legitimised through being exercised within a recognised framework.

Public criticisms of companies, particularly, conglomerates (seen to be having too much power) internationally, have centred on the weak influence of shareholders and the lack of enterprise, leadership and control by boards. The reaction of shareholders (shareholder activism) to these perceived deficiencies has led to today's focus on boards, their accountability and effectiveness.

The recent events in Corporate America, Wall Street, UK, Europe and in South Africa have created a new set of challenges for boards of directors. Directors are expected to do more and to do it well.

A number of critical questions have arisen:

- What role does the board play in strategic planning?
- What role do boards play in top management succession?

- How best can it best be positioned to provide oversight to its company?
- Which types of measurements should a board employ to effectively monitor performance?
- What are the changing legal responsibilities of directors?
- What are the personal liabilities of directors?

These complex issues have been put under microscopic scrutiny by the failure and collapse of major corporations.

Board of directors have figured prominently in many sensational stories over the past few years. Directors are being goaded into action by ever more aggressive institutional shareholders. Shareholder activism is on the ascendancy. Boards are receiving unprecedented attention world over.

South Africa's situation is compounded by a number of unique factors, compared to their first world cousins. The birth of new non-racial democratic society in 1994 did not only bring a new era but a new way of life enshrined in the constitution of South Africa. This new way of life is not confined within the boundaries of the political terrain. The winds of the democratic change go beyond the political system and its institutional framework (Southey, 1999).

The process of total transformation cannot be complete without the democratisation of the South African economy and the workplace (Kunene 1998). Companies occupy the centre stage of the economy. Sir Adrian Cadbury alludes to this when he says, "*The country's economy depends on the drive and efficiency of its companies. Thus the effectiveness with which their boards discharge their responsibilities determines Britain's competitive position*". This applies equally to South Africa.

What compounds and/or complicates the situation in South Africa making it even more urgent, is that, the advent of democracy has brought certain basic fundamentals, which need to be incorporated in the way companies do business (Mokoape 1998). These fundamentals include the following:

- Transparency
- Accountability
- Accessibility
- Tolerance
- Freedom of choice
- Freedom of association
- Freedom of speech

These are bound to impact on business with far reaching implications (Magwaza 1996). Fundamental change that needs to take place in South Africa, given the challenges of the demographic reality, employment equity, black economic empowerment and the deracialisation of the economy makes it an imperative for board of directors. In short they cannot remain as they are.

The board of directors play the most crucial, critical and central role in the strategic direction of the corporation, Gould (1993) argues that South African corporations are at a critical stage as they attempt to respond to the impact of environmental change, technology development, globalisation etc. The increasing complexity of the local business environment coupled with globalisation of markets is placing increasing demands on corporate leadership (board of directors). The volatile transitional environment poses a number of questions:

- Are board of directors as currently constituted effective?
- Are they equipped to steer the corporate organisation into a new era?
- Who should be selected to the board?
- Why should these people be selected?
- What skills do they require to add value?

It is the board of directors that must drive the radical change in response to the fast changing environment.

However, the big question is?

Can the South African board of directors, as they are composed, be equal to the task at hand?

These are some of the complex issues ranging from board composition to director selection, induction, compensation and evaluation that we intend exploring, to unleash the full potential of the South African economy. The boards themselves cannot escape the changes that are necessary if it is to successfully lead the company to sustainable prosperity (Malimela 1996).

1.3 MOTIVATION

The inspiration to conduct this study of establishing a link between the composition of the board of directors and effectiveness is due to the researchers own experiences within the corporate world. The role, composition and effectiveness of Board of Directors in South Africa have become relevant and topical given the unprecedented pressures and complex challenges facing business today. These pressures and challenges have

catapulted Corporate Governance into the forefront. The landmark report by Sir Cadbury in United Kingdom in December 1, 1992 is a clear manifestation of Corporate Governance gaining currency worldwide.

In South Africa, this was captured to an extent by the Kings' Code of Corporate Practices and Conduct, Nov 29, 1994, which was severely criticized for falling short of the landmark United Kingdom Cadbury Report (1992). The recent and second King Corporate Governance Report (2001) is a bold attempt to respond to that criticism. This has put the whole question of Corporate Governance and the role of Boards into perspective. The response of the South African Corporate to the Kings' II Corporate Governance Report poses a critical question on the ability of South African Board of Directors to realize the maximum value for their stakeholder groups.

Secondly, shareholder activism in South Africa is on the ascendancy. For too long, South African Shareholders were very passive. The Chief Executive Officer's (CEO) was law and the Board of Directors decisions were left unchallenged. However, in recent years we have seen shareholders exercising their rights and powers, questioning the decisions of either the CEO's or Directors (Roberts, 1999).

The Nail Option Scheme, which resulted in Chairman, Dr. Motlana and his colleague resigning, is a clear example of shareholders activism in South Africa. The IDC / Anglovaal Mining Alliance against ISCOR's Board decision to unbundle the company into the steel and mining companies is another case. These show that shareholders in South Africa are no longer willing to rubber stamp Board Decisions. The recent DATATEC revolt by shareholders is yet another glaring example of this pro-activism on the part of shareholders. The question that arises, which is directly linked to shareholder activism are:

- What kind of skills and expertise is required for the directors appointed to these boards;
- Are the directors not supposed to present the best interests of shareholders?
- Whose interest do they really represent?
- How is this shareholder activism going to impact on the composition of the boards, the way they function or deliver? (Sunday Times Newspaper, 1999).

Part of the changes or requirements brought by the ushering of the new Democratic order in South Africa is the reflection of the Demographic reality in the corporations from the Board of Directors to the lowest level. There is no question that credible, qualified and previously disadvantaged individuals should be appointed to the Board of Directors.

However, the question that remains is whether the influx of Blacks and women into boards will have a positive or negative impact in terms of effective service delivery to the stakeholder groups and/or enhanced effectiveness of the boards. To complicate matters, how is the preponderance of South African companies to appoint high profile retired Black politicians to their Boards, going to impact on the effectiveness of the board of directors?

The fast changing Global environment, the rise of shareholders' activism coupled with dominance of Institutional Investors, takeovers, mergers and acquisition, demands of the new political order in South Africa and the need for overall Socio-Economic Transformation (Economic Liberation) have placed not only the composition of Boards but duties, responsibilities and role of Board of Directors under microscopic scrutiny (Malimela 1996).

It is against this background that an investigation of the link between the composition of the Board of Directors and their effectiveness becomes more relevant.

Critical issues in making boards more effective range from board composition, director selection, induction, compensation, board evaluation and role of shareholders. These are some of the issues we will be exploring.

1.4 PROBLEM STATEMENT

In South Africa, the main challenge facing the organization is to enhance robust corporate governance and effective service delivery; this was discussed extensively Cadbury Report (1999). This has put the whole question of Corporate Governance and the role of Boards into perspective. For instance, there is still much resistance in South Africa in disclosing fully the remuneration packages of Directors, which in United Kingdom and United State of America is the norm. Separation of chairman and chief executive positions in South Africa is almost nonexistent. South African Board of Directors is still dominated by executive directors of the business rather than non-executive directors who are independents. Independent non-executive directors have no allegiance to any particular group. The resistance to fully embrace not only the change in the composition of the board of directors and transparency poses a critical question mark on the ability of South African Board of Directors to realize the maximum value for their stakeholder groups. This study will therefore look at the link between the composition of the Board of Directors and their effectiveness. (Is there a relationship between the way the boards are composed and their effectiveness?)

Boards as we have indicated elsewhere cannot remain as they are.

Who should be on the board and who should not?

The test is the contribution, which the board as a whole makes to the company. Boards are teams and to be successful they need members with different attributes and skills.

Board effectiveness might be dependent on the selection of the team and on the leadership of the chairman. A number of critical questions come to the fore:

- Are there different selection procedures for Board of Directors in South Africa?
- Do parastatals, private and public sectors have different composition of the Board of Directors?
- Is there a correlation between the composition of the Board of Directors and effectiveness?
- Are there commonalities in selection guidelines as well as composition of the Board of Directors in all sectors?

1.5 OBJECTIVES OF THE PROJECT

- To determine whether there is a relationship between composition and effectiveness of board of directors
- To find out if there are different selection procedures for Board of Directors in South Africa.
- To establish whether parastatals, unlisted private, listed public (conglomerate), municipal funded or black economic empowerment companies have different composition of the Board of Directors.
- To develop common selection guidelines and board composition profile.

1.6 LIMITATIONS OF THE STUDY

This study may be limited by lack of cooperation and support from the Chairpersons of relevant Board of Directors. Since permission from the directors identified in the sample will be obtained they may suspect that this study will publicize its findings and thus harm their companies.

This applies to individual directors who might not be willing to participate and express their views. Availability of accurate statistics in terms of gender and racial profile of boards of directors is a constraint.

This is an introductory chapter that presents the problem to be investigated, the aims of the study and hypotheses that will guide this study.

Chapter Two

This chapter deals with the relevant literature, relevant studies and corporate governance guidelines from studies on the correlation between the composition and effectiveness of boards of directors. Our model is developed pertaining to the complex issues of board structure and size, director selection, distribution of power, induction of directors, compensation of directors, board evaluation, gender equality, diversity and shareholder activism.

Chapter Three

Chapter three deals with research methods used in this case study and the research design, research instruments and their administration are also discussed.

Chapter Four

Chapter four presents the results as well as their analysis. The results are presented in the form of tables and figures. Findings of this study are presented and evaluated

Chapter Five

Chapter five presents the conclusion and recommendations.

1.8 SUMMARY

This chapter has clearly indicated the critical questions to be answered as well as aims and hypotheses of the study including limitations of the study. The critical issue being to establish whether there is a relationship between composition and effectiveness of board of directors. Issues that have become central to corporate governance.

CHAPTER TWO

THEORETICAL PERSPECTIVES ON DEVELOPING A MODEL FOR THE COMPOSITION OF THE BOARD OF DIRECTORS.

2.1 INTRODUCTION

The aims of this study is to find out if there are different selection procedures for Board of Directors in South Africa; establish whether parastatals, private or public sectors have different composition of the Board of Directors; determine whether there is a link between the composition and effectiveness of the board of directors, develop common selection guidelines and board composition profile. These aims are looked at in different sections in this chapter. Through defining, describing and developing a theoretical model, primarily for the composition of the board of directors, the aims of the study will be achieved. It is necessary to review the critical issues that impact and shape the dynamics relevant to the composition of the board. Among such factors, effectiveness of the board of directors is an important factor to consider (King, 2002). The model or framework for the composition of the board of directors that is being developed will form the basis of the guidelines for how the composition of the board of directors should be. Such guidelines will determine the terms on how boards should be composed or constituted. Some of the critical issues that are relevant to board composition are outlined:

- (i) The structure and the size of the board
- (ii) The selection of the board members
- (iii) Induction of directors
- (iv) Distribution of power within the board
 - Chairman
 - Chief executive
 - Executive directors
 - Non-executive directors
 - Non-executive directors with interest
 - Independent non-executive directors (outside directors)
- (v) Compensation of directors
- (vi) Gender equity and diversity
- (vii) Evaluation of directors

(viii) Shareholder activism (Cadbury, 1997).

The composition of the board of directors is a critical element in ensuring the effectiveness of the board. There are a number of questions that need to be answered in this section. They include, inter alia.

- How the board is constituted?
- Who is selected in the board?
- Who serves in the board?
- What are the expertise, knowledge and experience required for members of the board to be effective?
- How does the board apply itself as a collective entity?
- How does the board harness the unique abilities of each board member?

The answers to these questions will unlock the full potential of boards as well as benefit the guidelines on the composition of the board of directors and how this can be made to be more viable (Davies, 1999).

2.2 BACKGROUND INFORMATION ON THE COMPOSITION OF THE BOARD OF DIRECTORS IN SOUTH AFRICA.

In South Africa, companies have directors who are assigned the responsibility to control the company. The shareholders are the owners of a company because they appoint directors who then control the company on their behalf. The powers of the directors are set out in the constitution of the company. The shareholders can alter the powers of directors or sometimes remove the directors when necessary. The latter happens, for instance, when a director receives a lot of criticism, such as mismanaging the company, not fulfilling his/ her duties or even the failure of a company (Gloeck and de Jager, 1995). Since most companies in South Africa have non-executive directors, who are outsiders, usually they are not excluded from any criticism. Even though as outsiders they devote only part of their time to the affairs of the company, and is consequently at a disadvantage to the executive directors, their legal responsibility is no less than that of executive directors (Khoza, 2000).

It has been reported in other studies, (Cohen, 1972), that, in spite, of the increased attention accorded to directors, very few directors seem to know what they are supposed to do and what the company expects from them. There is a need to investigate the practical functioning of boards of directors and the issues, which lead to effective boards. One crucial issue about this is that boards do not make decisions, and that the key

function of the board is the selection of management. Therefore the key factor in an effective board is dependent on the relationship between the chairman and the chief executive (Wessels, 1988).

Corporate governance in South Africa was institutionalised after the Publication of the King Report on Corporate Governance in November 1994 (King Report, 1994). The King Committee on Corporate Governance formed in 1992, under the auspices of the Institution of Directors, considered corporate governance an area of increasing interest around the world and in South Africa. The purpose of the King Report of 1994 was, and remains, to promote the highest standards of corporate governance in South Africa. This means in governance terms that one is accountable in common law and by statute to the company, for instance, a director is responsible to the stakeholders (Mbabane, 2000).

The 1994 King Report is now commonly known as King I Report. These recommendations are superseded by legislation in the social and political transformation that coincided with its release. Some of the more significant legislations that superseded the King's Report recommendations are the Labour Relations Act (No. 66 of 1995), the Basic Conditions of Employment Act (1998) and Environmental Management Act (No. 107 of 1998). During this time some of the recommendations for statutory amendments to the Companies Act (No. 61 of 1973) (Companies Act) contained in the King Report 1994 were promulgated, thereby permitting companies to obtain liability insurance cover, indemnifying their directors and officers, compelling disclosure of the identity of beneficial owners of shares held by nominees, and making it mandatory to appoint the secretary, for public companies with a share capital. Other legislative developments since the publication of the King Report 1994 include the introduction of the Insider Trading Act (No. 135 of 1988) providing for more rigorous supervision and monitoring of insider trading, the Public Finance Management Act (No. 1 of 1999) bringing into force more stringent provisions for reporting and accountability by adopting an approach to financial management in government, that focuses on outputs and responsibilities rather than the driven approach under previous legislation, and a comprehensive update of the provisions and regulations governing the Banks Act (No. 94 of 1990) enforcing substantially higher levels of corporate governance compliance and risk reporting in banking institutions. Also, notable in this period has been the priority accorded to corporate governance practices in state enterprises culminating in the releases of the Policy Framework for State Owned enterprises by the Department of Public enterprises in August 2000, which is in the process of being comprehensively updated (Malherbe

and Segal, 2000). The most challenging question in South Africa today is the relationship between corporate governance and performance. It is now that research in this area is conducted. Previously, it was considered that it's a difficult area of research, because of the complexity of the relationship as well as the measurable aspects of governance such as the proportion of outside directors or the extent to which directors are shareholders, are of limited relevance (King, 2002).

It seems that institutional shareholders in South Africa are now ready to bring pressure on the boards of companies whose results are failing to meet their expectations. In South Africa Boards, and particularly their outside directors, are responding to these pressures and are monitoring the executive management of their enterprises more closely than they did in the past. In most instances, the directors are no longer considered to be agents of the company. The board is recognised as a primary organ of the company, as well as its controlling mind (Clutterbuck and Waine, 1994).

2.3 THEORETICAL FOUNDATION FOR THE COMPOSITION OF BOARD OF DIRECTORS IN SOUTH AFRICA.

Whilst this study does not purport to confine itself only to the examination of the composition of the board of directors, it will determine any direct scientific proven correlation between the board composition and board effectiveness. Moreover, it would be amiss not to test this if the opportunity presents itself (Botha and Jooste, 1997). The examination of such a relationship should be carried out in a perceptual meaningful manner, using a case study. The case study forms our research approach. It would also be important that the development of the model in this study be informed by the King II Report on Corporate Governance (King, 2002). By compiling relevant and sufficient progress in the implementation of this important tool, this is, King Report of 2002; coupled with King's report issued in November 1994; a clear analysis of the composition of the board and its effectiveness will be compiled through case analysis. The development of the proposed model can only gain in value by adding to current trends based on recommendation list.

King II report on corporate governance since its release in January 2002, has gained a broad consensus amongst the South African Corporate Community.

The detailed presentation on the recommendations of the King report on corporate governance, particularly those regarding the critical issues around board composition will be highlighted elsewhere in this chapter.

It would be important to observe that whilst Kings' Reports have occupied the center-stage on Corporate Governance Debate, the input of other key stakeholder groups can only be ignored at our own peril, in developing a model that can be guide over time. Although it is an accepted fact that the input of these critical players do not deal with all the issues of corporate governance per se, in their focus, but promote equity within the South African economy, it would be appropriate to utilize their contributions especially in regard to the composition of Board of Directors (Roussouw, 2002). These key players include:

- Black Management Forum. (BMF)
- National Federated Chamber Of Commerce. (NAFCOC)
- Durban Growth Coalition (DGC)
- National Government (Through the employment equity Act)

It is of utmost importance that this model is developed to measure and be equal to *International Bench Marks*. These measures include; Sir Adrians ground breaking report on *financial aspects of Corporate Governance UK*. Many international commentators and experts in the field of corporate governance have pronounced that King II Report is broader in scope and more balanced than other works on the same subject from first world countries; such as Britain, Canada, United States of America, etc. It is also important to incorporate recent concepts such as the stakeholders. This concept widens the responsibility of directors to include employees and their trade unions, clients, suppliers and anyone else affected by the business (Cadbury, 1997).

The Institute of Directors magazine in its special publication of January and February 2002 titled ***Enterprise with Integrity*** says, " *When Sir Adrians Cadbury author of the groundbreaking Cadbury Report on Corporate Governance read the draft for public comment on the King II Report on Corporate Governance declared that nothing more comprehensive on the subject had ever been published*". However, for our purposes, it is not the comparativeness of Cadbury and Kings Reports that is of significance, but what board composition can harness from these reports.

It is important and appropriate that a brief exploration of each element that is associated with board composition and related issues as identified previously is covered in this section:

(i) The structure and the size of the board

It is true that the most important question about any Board of Directors is the **character and the ability** of men and women who are on it. The structure and the size of the board can hinder, impede or facilitate the effectiveness. The effectiveness of the board is buttressed by its **structure and procedures**. One aspect of the structure is the appointment of committees of the board, such as the audit, remuneration and nomination committees (Coulson-Thomas, 1993).

The need for Board Committees is no longer a legal entity, as they become power centres in their own right. As the board faces unprecedented demands the committee system is proving versatile and facilitates effectiveness. It allows for detailed attention to specific areas of directors' duties and responsibilities and a more comprehensive evaluation of specified issues such as audit, internal control, risk management, remuneration etc. Committees can help share the board's workload. Being smaller, directors serving the committee can go into greater details and deal with complex issues where the full board might not have had enough time. This also begs the questions of:

- How big should boards be?
- Are the boards having too many directors or not?
- What is the appropriate size for the boards to be effective?
- Does the Board Committee structure suggest that there is an inherent problem within size of the boards today?
- Are they too cumbersome?
- Has size anything to do with cohesiveness?

One of the rationales behind the board committee structure is to prevent a governance task from becoming "every ones' responsibility but "no-ones jobs". It seems apparent that a duty that remains diffused throughout the board as a whole, too often becomes fast in a shuffle. Thus he argues for committees, as they are smaller than the board as a whole. Obviously, there must be some concern about the appropriateness of the board size (Coulson-Thomas, 1993).

(ii) Selection of board members

It has already been indicated that the character and the ability of directors are crucial and critical elements, not only in the composition of boards, but also in its effectiveness. Some observers have actually argued that the character and the ability of men and

women who occupy seats in corridors of corporate power make the difference in the overall performance of the companies. Whilst this debate can be a subject of a separate and focused study – the selection and appointment of directors in the boards cannot be ignored (Carver, 1990).

“Numbers in the boardroom may be statistics, but who goes into those numbers and how and why are they recruited continues to change” (the Corporate Director. J.M. Juran and J. Keith Jouden, American Management Association) **Selection and Appointment of Directors** has not inspired confidence nor shows any streak of objectivity.

Traditional people were nominated to the board through the suggestion and support of the CEO or Managing Director. This was the beginning and the end of the matter, with the endorsement by the nomination committee (if one existed), then by the whole board and approval by shareholders serving only as legal punctuation of the process. In a company the shareholders are the owners because they appoint Directors who then control their company on their behalf. Shareholders are responsible ultimately for electing or removing board members. It is in their interests that the board is properly constituted. The shareholders can alter the powers of Directors or sometimes remove the Directors when necessary. However, it is doubtful that in practice, shareholders have been proactive in the selection of Directors. Chief Executives or / and powerful board members individually and/or collectively tended to hold a sway in the selection and appointment of Directors. As long as the CEO and/or any other powerful force on the board selected directors on the strength of their connections, nepotism, cronyism and malleability, it was indeed an adequate process. However, today's demands coupled with high rate of corporate failure, personal legal liabilities, rise of shareholder activism, the country club approach or legal liabilities, school network became less than practical (Coulson-Thomas, 1993).

In South Africa we have seen a trend of selection of high-ranking politicians into boards, From Cabinet Ministers, etc. for instance, Ramaphosas, Sexwales, Mac Maharaj and Jay Naidoo former Minister of Transport and Minister of Telecommunication, respectively. Today's boards places high premium on expertise and skill. Whilst standing and reputation in the community is important, experience and knowledge, expertise and professional skills should take precedence. What the director knows has become vital among South African boards. Expertise world-wide is being sought on the following;

- Entrepreneurial skills

- Top-level Finance
- International markets
- Marketing
- Restructuring
- Telecommunications and Technology
- Service industries (Zimmerli, 2000).

The selection and appointment of board members has become one of the most important issues in effective Corporate Governance because of the need to balance the mix of skills and experience and other critical qualities required on the board and in overseeing a process for assessing the effectiveness of the board as a whole (Coulson-Thomas, 1993).

(iii) Induction of directors

Directors should know exactly the expectations of their stakeholders. Some studies have indicated that many directors are not familiar with neither shareholder expectation nor their duties and responsibilities. It has been reported in other studies (Cohen 1972) that in spite of increased attempts accorded to directors very few directors know what they are supposed to do and what the company expects of them. The advent of personal liabilities, the complexity of the business environment, and heightened stakeholder expectations places huge and severe duties and responsibilities on directors. New directors appointed to the board should be made familiar with the companies' operations, Top and Executive Management and its business environment.

New directors should be familiar amongst a number of issues with:

- The marketplace, including competitors market development.
- Processes of the business including underlying technology and developments.
- The financial position
- The employees and labour relations
- Social and community relations
- The General Economic, Social, Political situation internationally

New directors should be made aware of their fiduciary duties, responsibilities and obligations. The induction programme should meet the specific needs of both the company and the individual to maximize Directors contribution as quickly as possible. Whilst the induction programme is critical – as it orientates the new Director, joining a board, an ongoing learning about the corporation and its industry is equally important

coupled with governance basics (van Wyk and Hofmeyer, 1997). The governance basics include:

- The function and organization of board committee
- Board responsibilities and legal liabilities
- Compensation design, Investor relations, Financial and operating relations
- Boardroom Rules and procedure (Carver, 1990)

(iv) Distribution of power

Where does the power in boards lie?

Maybe it would be more appropriate and relevant if the following questions were posed to ensure board effectiveness. Does the power consonant with the legal responsibilities of directors and/or conventional rules. Every public company in particular should be headed by an effective board, which can both lead and control the business. Within the context of the UK, US and South Africa, Unitary Board system prevails, unlike the German/Japanese model. This means, a single board made-up of a combination of Executive Directors and non-Executive Directors. Shareholders are responsible for electing board members and it is in their interest to see that the boards of these companies are properly constituted and not dominated by one individual (Cadbury, 1997).

Directors it has been argued, especially in the Cadbury Report that they are equally responsible in law in boards' actions and decisions. Certain Directors may have particular responsibilities as executive or non-executive Directors, for which they are accountable to the board. Sir Cadbury says, "*Regardless of specific duties undertaken by individual directors, however, it is for the board collectively to ensure that it is meeting its obligations*". Against this background we have to determine the optimal location of power in the board of directors:

- Who is the boss?
- Who should be the boss?
- How independent are directors?

Let us now deal with each significant component in the location of power and attendant dynamics.

(v) Chairman of the board

Tests of board effectiveness in the way in which members of the board as a whole are together under the chairman, whose role in cooperate governance is fundamental and their collective ability to provide both the leadership and checks and balances which effective governance demands (van Dorsten, 1992).

The chairman's role in reviewing good cooperate governance is crucial. The chairman is the captain of the ship who should be able to stand sufficiently back from the day to day running of the business to ensure that the board of directors is in full control of the companies' affairs and alert not only to its obligations to shareholders but all critical stakeholders groups. The distinct roles of Chief Executive Officer and board chair are less distinct in most US boardrooms. However, in South Africa despite Kings recommendations, the situation is not dissimilar with the US. Cadbury recommendations in UK have been taken seriously where the separation of chairman and CEO is most prevalent, South African companies such as SAB, Old Mutual and Dimension Data, have had to conform to these stringest, but novel requirements. Dr Meyer Kahn was relieved of his CEO role in S.A.B.; this applies to Mike Levett who also relinquished his CEO position. In the case of Jeremy Ord of Dimension Data he stood down as chairman when it listed in UK but remains CEO. Separation of the two posts is a testing requirement in United Kingdom (van Dorsten, 1992).

Because of the importance of the chairman's role, it should be separated from that of the chief executive. If the two roles are concentrated in one person, it represents a considerable concentration of power. No wonder most reports on corporate governance including King I and King II reports have recommended the separation of role.

(vi) Chief executive

The King II Reports on the role and function of CEO departs by saying "The CEO has a critical and strategic role to play in the operational success of a company business. For this reason, as already indicated, the role of the chief executive should be separate from that of the chairperson".

Traditionally, CEO's, however, have been the most powerful sources within Corridors of Corporate Power. The CEO once ruled without question or challenge. The CEO's word was final but not any more. Today the board asks more questions to evaluate the CEO's performance, and digs at all the levels of the company. For the CEO attending to board

members and being nice to them is not enough, suddenly, the CEO's "Directors" want and have the power to demand results (Clutterbuck and Waine, 1994).

The arguments against combining the position of the CHAIR and CEO in one-person do not only seem irresistible but most compelling. However, the question that we won't answer now is simply -*"So why does it continue unabated in South Africa and US where it is common practise to have one person as CHAIR and CEO?"* (Malimela 1994).

(vii) Executive Directors

Directors who are employed by the company are referred to as executive directors. In addition to their board duties, executive directors carry out executive functions for which they are remunerated separately. The board delegate the day- to-day management of the company to the executive directors. The extent of the duty of care and skill of executive directors depends to a considerable degree on the nature of the company's core business and on any particular obligation assumed by or assigned to him. The executive directors must therefore exercise more care in executing such tasks. In that regard there is a difference between the so-called full-time executive director and part-time non-executive director. The full-time executive director participates in the day-to-day management of the company's affairs. The degree of care expected in an executive director differ from that expected in a non-executive director.

Since the executive director participates in the day-to-day management of the company, he/she is therefore bound to give continuous attention to the company's daily affairs (Clutterbuck and Waine, 1994).

(viii) Non- Executive Directors

Directors, who are not employed by the company full-time, are referred to as non-executive directors or sometimes called unaffiliated directors. They do not take part in the day-to-day management of the company and rely on the management for the report, which appear before them. The report is usually tabled at board meetings. Non-executive director are appointed to boards because they can provide a wider perspective, fresh stimuli, wider strategic horizons and an enhanced sense of general responsibility. He/ she acts in a dual capacity. In respect of each capacity he/ she has a different set of rights, powers and duties to those that may be assigned to the full-time executive director. For instance, when an executive director is removed from office it does not necessarily follow that he/ she will be dismissed as an employee. As an

employee, he/ she will be entitled to the protection provided for in labour laws of the country (Lorsch, 1989).

The duties of non-executive directors are as general rules have been, less time-consuming than those of executive directors in the past. The legal rules are the same for all directors. In application of these rules each case determine how they are applied. In countries such as the United Kingdom, the overwhelming majority of listed companies appear to have established an "audit committee", and a "remuneration committee" with a preponderance of non-executive director. A committee of non-executive directors could be established to review the performance of executive directors and the effectiveness of the board. This strategy works well so far, among these companies.

(ix) Independent Non-Executive Directors (Outside Directors)

The outside directors or independent non-executive directors of the Board should at least meet in Executive Session three times each year. The format of these meetings includes a discussion with the Chief Executive Officer on each occasion. The Board believes that there should be no current relationship between an outside director and general manager that would be construed in any way to compromise any board, as long as the member is designated independent.

The approach to be used in describing the non-executive directors and their roles will be presented step-by-step in the following outline.

First step involves explaining the reality of cooperative governance, this will include:

- Examining who serves on boards
- How they are selected
- What motivates them to take board seats

Such an analysis will help to evaluate the perceptions that are usually expressed by Chief Executive Officers who also serve as a director of other companies. The perception that there has been a growing predominance of outside directors who are there not only to provide a new perspective to top management's thinking, but, also to provide necessary oversight only possible from an outsider.

This perception reflects a general consensus that an increasing proportion of outside directors is a positive step. While not disputing the trend, recent findings reveal that despite serious motives for joining boards, many directors still feel they are serving at the pleasure of the Chief Executive Officers or Chairman. This is true even though 74% of directors are now outsiders, of whom 69% are non-management personnel with no

other contact with the company. The remaining 5% are indirectly affiliated with the company as bankers, lawyers, or retired executives. Exact comparative data is scarce, but considering that in 1938 only 58% of United States companies had a majority of outside directors, and by 1979 that proportion had grown to 83%, one can thus assume a sharp increase in the number of outside directors per individual company. As the percentage of outside directors has increased, the challenge of locating qualified candidates has grown (Carver, 1990).

(x) Compensation of Directors

A Managing Director is entitled to remuneration only if the articles provide for remuneration and the Board exercises its power to award him.

Lorsch and MacIver (1989) argue that linking some of the managing directors compensation directly into the company's long-term financial performance, might encourage directors to focus on their broader responsibilities. Such compensation might be in stock options tied to company performance, which would vest, for instance, the fifth to ninth year out. Another possibility is an annual grant of a fixed number of shares to directors. These proposals are believed to have merit for motivational or psychological reasons. These options give directors a sense of identification with the company and a feeling of success (Cadbury, 1997).

(xi) Evaluation Of Directors

Most companies frequently measure the output of managers, however, companies find it hard to measure performance of directors. This is due to uncertainty as to what should be measured. Nash (1991) pointed out that, it is important to have a precise idea of what is expected of directors. Given the broad range of involvement, a director may have with a company, it is not easy to define a generic set of measurements, which enable shareholders and executives to judge their worth. However, it should be a standard part of the appointment process to devise with a newly appointed independent director just how his or her performance will be evaluated. Measurements that can be applied include the following:

- Contribution to establishing a strategic direction
- Type and extent of alternative experience he or she is able to bring to bear on discussions.
- Influence on key decisions

It is suggested that non-executive directors should be appraised using a matrix that shows the effectiveness in each expected role against the importance of the role within a particular Board. The directors themselves can conduct this appraisal process. The same kind of matrix can be used to assess each of the skills or competencies in terms of importance and effectiveness. The most difficult issue is who should appraise the independent director? Theoretically, at least it should be the chairman, but practically this may pose a problem in a company where independent directors do not fully support the chairman. A strategy for doing this appraisal system needs to be developed in line with expected outcomes (Nkuhlu, 2000).

(ix) Shareholder Activism

Shareholder activism is an important component in effective governance, but it is not visible in most South African Companies. The need to have shareholders support is a crucial governance issue due to the growing influence of investors. The fundamental reasons behind this, is an increasing proportion of shares owned by the investing institutions. For instance, the pension funds alone now own about one-third of the shares of British companies and institutions in total (Cadbury, 1997). The rapid growth world wide of investment is being driven by institutions, which now hold a high proportion of the equity in shares and can no longer easily sell their shares, if they lose confidence in the way a company is being run. This means that they have a collective interest in using their influence as shareholders to improve corporate performance. It is vital that strategies for enhancing shareholder activism in South African are needed in order to ensure the effectiveness of the board (Khoza, 2000).

(x) Gender equity and diversity

Shareholders should continue to focus on boardroom governance, but this focus must include the broader debate towards the investing issues of gender equity and diversity within their institutions. The issues of power and accountability are important because they spill over to corporate boards and board governance. These should be raised in the context of the growing power debates and relative lack of practical steps in implementation of gender equity strategies in many boards.

2.4 CONTEXTUAL ANALYSIS OF THE KING'S REPORT

The Kings report points out that the most difficult of all tasks of the board is the relationship between corporate governance and performance. It is not readily

susceptible to research, because of the complexity of the relationship and because measurable aspects of governance, such as the proportion of outside directors or the extent to which directors are shareholders are of limited relevance. In most instances what matters is the calibre of the directors concerned. This is an important reason for preferring market regulation, where possible over statutory legislation. The law has to deal with form, but what counts is substance, on which investors are in a position to make a judgement. This can thus be translated into improved performance. The recommendations that were drawn point to the broad principles that must address the various organisations around the world. These include:

➤ **Clear board responsibility**

This indicates the need for absolute clarity about the powers and duties of a board, addressing the key question, 'what is the board therefore and what are the responsibilities?' (King, 2002).

➤ **Board Composition**

The major issue to be dealt with is board composition. This includes, who should be on the board and who should not? There is a general agreement that board should include members who are 'independent'. This is to help resolve conflicts of interest and to ensure objectivity in board decision making processes. This also gives breadth to the debates on such matters as strategy and the wider external question with which boards deal (Cadbury, 1991).

➤ **Board Selection**

Board structures aim to combine the detailed knowledge of executive directors with the wider experience of outside directors, either separately through a two-tier board or together on a unitary board.

➤ **Director supply and demand**

This is mostly an issue that do not receive much attention, but has relevance on particular issues where directors have traditionally been drawn from a small or largely self-selected pool (Southey, 1999).

➤ **Board size**

The most specific advice on board size is Lorsch and Liptons (1989) statement: "*The size of a board should be limited to a maximum of ten directors, indeed boards of eight or nine are favored.*" the argument here, is that boards of this size allow the directors to get to know each other, to participate fully in discussions and to reach a true consensus. This approach to building an

effective board team is surely right, although international companies are increasingly looking at strengthening their boards with directors from other countries.

➤ **Independence**

Boards should develop their own criteria for selecting board members with the over-riding requirement that there should be a majority of 'unrelated' directors. Boards should favour outside directors more (Roberts, 1999).

➤ **The chairman's role**

The importance of the chairman's role in transforming the board of directors into an effective board is vital. The recommendations on board selection and on balancing executive knowledge with outside experience are designed to ensure that the membership of boards is appropriate to the challenges facing their companies. Equally, proposals that directors should be appointed for fixed terms, with re-appointment possible but not automatic, enable chairman to renew their boards as circumstances, or the contribution of individuals (King, 1999).

➤ **Board leadership and control**

Most reports on board failures pay particular attention to the control and supervisory aspects of a board's tasks. They are basically written for unitary boards, made up of executive and outside directors in varying proportions. *Boards must be free to drive their companies forward, but exercise that freedom within a framework of effective accountability. This is the essence of any system of good corporate governance* (Sir Cadbury).

➤ **Board committees**

Committees of the board are important since they carry out the board work and the way, in which they strengthen the position of the outside directors, of whom they are largely composed (Gould, 1993).

➤ **Financial controls**

A particular duty of boards is to establish an effective system of internal financial control. This helps to prevent frauds and failures, which often lead to the creation and the need to resolve a degree of confusion about the precise responsibilities of directors and auditors in the matter (Ward, 1997).

➤ **Board appraisal**

The key objectives of corporate governance are to promote board effectiveness and to help boards give companies the leadership to which they are entitled. It is thus imperative to develop board appraisal systems.

These should be in line with the board charter that set out its responsibilities, and they should be disclosed in its annual report. At a minimum the charter should:

- Confirm the boards' responsibility for the adoption of strategic plans
- Monitoring of operational performance and management
- Determination of policy and processes to ensure the integrity of the company's risk management and internal controls
- Communications policy
- Director selection, orientation and evaluation.

This will allow the board to determine the company's purpose, values and stakeholders relevant to the business of the company and develop strategies combining all three elements. The board will thus ensure that procedures are in place to monitor and evaluate the implementation of its strategies, policies, senior management performance criteria and business plans. Ultimately the board will be able to direct the company, exercise the leadership, enterprise, integrity and judgement based on fairness, accountability, responsibility and transparency. Given the positive interaction and diversity of views that take place between individuals of different skills, experience and background, the unitary board structure with executive and non-executive directors remains appropriate for South African companies. It will be an important step if the board give strategic direction to the company, appoint the chief executive officer and ensure that succession is planned. This will enable the board to retain full and effective control over the company, and monitor the management in carrying out board plans and strategies (King, 2000).

➤ **Effective Board**

In order for companies to achieve expected effectiveness, an effective board that can both lead and control the company should head the company. The board should comprise a balance of executive and non-executive directors preferably with a majority of non-executive directors of whom sufficient should be independent of management for shareowner interest (including minority interests) to be protected. An obvious consideration for South African companies would be

to consider the demographics in relation to the composition of the board. An effective board will ensure that the company complies with all relevant laws, regulations and codes of best business practice, and that it communicates with its share owners and relevant stakeholders (internal and external) openly and promptly and with substance prevailing over form. This coupled with board's regular review of processes and procedures to ensure the effectiveness of the company's internal system of control, so that its decision-making and the accuracy of its reporting are maintained at a higher level at all times. The board should meet regularly, at least once a quarter if not more frequently as circumstances require, and should disclose in the annual report the number of board and committee meetings held in the year and the details of attendance of each director (as applicable). Also important is the board definition of the levels of materiality, reserving specific powers to its and delegating other matters with the necessary written authority to management. These matters should be monitored and evaluated on a regular basis (Creamer, 2000).

➤ **The Power of the Board**

The board should have unrestricted access to all company information, records, documents and property. The information needs of the board should have well defined and regularly monitored. The board should consider developing corporate code of conduct that addresses the conflicts of interests, particularly relating to director and management, which should be regularly reviewed and updated as necessary. The board should have an agreed procedure whereby directors may, if necessary, take independent professional advice at the company's expense.

Efficient and timely methods should be determined for informing and briefing the members prior to meetings while each board member is responsible for being satisfied that, objectively, they have been furnished with all the relevant information and facts before making a decision. Every board should consider whether or not its size, diversity and demography make it effective. Non-executive directors should have access to management and may even meet separately with management, without the attendance of executive directors. This should, however, be agreed collectively by the board usually facilitated by the non- executive chairperson or lead independent non-executive directors. The board should ensure that each item of special business included in the notice of

annual general meeting, or any other shareowners' meeting, is accompanied by a full explanation of the effects of any proposed resolutions (Ward, 1997).

➤ **Transparency Issues**

The board should encourage shareowners to attend annual general meetings, which will enhance transparency. At this meeting the directors should present, and more particularly the chairpersons of each of the board's committees—especially the audit and remuneration committees. Also a brief Curriculum Vitae of each director standing for election or re-election at the annual general meeting should accompany the notice contained in the annual report. The board must identify key risk areas and key performance indicators of the business enterprise. These should be regularly monitored, with particular attention given to technology and systems. The board should identify and monitor the non-financial aspects relevant to the business of the company. The board should record the facts and assumptions on which it relies to conclude that the business will continue as a going concern in the financial year ahead or why it will not, and in that case, the steps the board is taking. The board must find the correct balance between conforming to governance constraints and performing in an entrepreneurial way. There should be a clearly accepted division of responsibilities at the head of the company to ensure a balance of power and authority, so that no one individual has unfettered powers of decision-making (Spangeberg, Schroder and Duvenage, 1999).

➤ **The Chairperson**

The chairperson should preferably be an independent non-executive director. Where the roles of the chairperson and chief executive officer are combined, there should be either an independent non-executive director serving as deputy chairperson or a strong independent non-executive director element on the board, and any such decision to combine should be justified each year in the company's annual report. The board should appraise the performance of the chairperson on annual or such other basis as the board may determine (Wessels, 1988).

➤ **The Roles of Chief Executive Officer/ Chairperson**

If the roles of chairperson and chief executive officer are combined, then the independent deputy chairperson and maybe, two or more members drawn from shareholder grouping or an independent person for transparency and

accountability must play a leading part in the evaluation. Given the strategic operational role of the chief executive officer, these functions should be separate from that of the chairperson. The chairperson, or a sub-committee appointed by the board, should appraise the performance of the chief executive officer. The board should satisfy itself that an appraisal of the chief executive is performed at least annually. The result of such appraisal should also be considered by the Remuneration Committee to guide it in its evaluation of the performance and the remuneration of the chief executive officer. The board should ensure that there is an appropriate balance of power and authority on the board, such that no one individual or block of individual can dominate the board's decision taking (Mbabane, 2000).

➤ **The Non-executive directors**

The Non-executive directors should be individuals of calibre and credibility, and have the necessary skills and experience to bring judgement to bear independent of management, on issues of strategy, performance, resources, transformation, diversity and employment equity, standard of conduct, and evaluation of performance (Mbabane, 2000).

➤ **The annual reporting**

In the annual report the capacity of the director should be categorized as follows:
Executive director- should be an individual that is involved in the day-to-day management and/or is in full time salaried employment of the company and/or any of its subsidiaries.

Non-executive director – should be an individual not involved in the day-to-day management and not a full-time salaried employee of the company and its subsidiaries. An individual in the full-time employment of the holding company or of its subsidiaries, other than the company concerned, would also be considered to be a non-executive director unless such individual by his/her conduct or executive authority could be construed to be direct in the day-to-day management of the company and its subsidiaries (Creamer, 2000).

Independent director – is a non-executive director who:

- (i) Is not a representative of a shareowner who has the ability to control or significantly influence management.
- (ii) Has not been employed by the company or the group of which it currently forms part, in any executive capacity for the preceding three financial years.

- (iii) Is not a member of the immediate family of an individual who is, or has been in any of the past three financial years, employed by the company or the group in an executive capacity.
- (vi) Is not a professional advisor to the company or the group, other than in a director capacity.
- (v) Is not a significant supplier, or customer of the company or group,
- (vi) Has no significant contractual relationship with the company or group; and
- (vii) Is free from any business or other relationship which could be seen to materially interfere with the individual's capacity to act in an independent manner (Roberts, 1999).

A "shadow director" - should be considered to be a person in accordance with whose directions or instructions (whether they extend over the whole or part of the activities of the company), the directors of the company are accustomed to act. Shadow directors should be encouraged.

Executive director - should be encouraged to hold other non-executive directorships, only if they do not interfere with their immediate management responsibilities.

Non-executive directors - should carefully consider limiting the number of appointments they take in that capacity in order to ensure that the companies on which they serve enjoy the full benefit of their expertise, experience and knowledge.

Level of remuneration - should be sufficient to attract, retain and motivate executive of the quality required by the board. The company - should appoint a remuneration committee or such other appropriate board committee, consisting entirely or mainly of independent non-executive directors, to make recommendations to the board within agreed terms of reference on the company's framework of executive remuneration and to determine specific remuneration packages for each of the executive directors. This is ultimately, the responsibility of the board. An independent non-executive director must chair this committee. In order to obtain input on the remuneration of the other executives the committee should consult the chief executive officer, who may attend the meetings by invitation. However, a chief executive should play no part in decisions regarding his/her own remuneration. Membership of the remuneration committee or board committee that considers executive remuneration must be

disclosed in the annual report and the chairperson of such committee should attend annual general meetings to answer any questions from shareowners (King, 2002).

Companies - should provide full disclosure of directors remuneration on an individual basis giving details of earning, share options, restraint payments and all other benefits.

Performance related elements of remuneration - should constitute a substantial portion of the total remuneration package of executives in order to align their interests with shareowners, and should be designed to provide incentives to perform at the highest operational standards.

Share options may be granted to non –executive directors but must be the subject of prior approval of shareowners (usually at the annual general meeting) having regard also to the specific requirements of the Companies Act. Because of the apparent dilution of “independence”, in some international markets the view is that non-executive directors should preferably receive shares rather than share options (Southey, 1999).

Allocation of share options

In regard to the allocation of share options, Boards should be mindful of the following:

- A vesting period in relation to the allocation of share options to non-executive directors should be applied to dissuade short-term decision taking, but also have regard to possibility or consequences of the removal or resignation of such directors prior to the vesting period maturing and any perceived impact on their independence
- Where it is proposed to re-price share options, this should be the subject of prior shareowners approval. Details of the share options of each executive and non-executive who stands to benefit from any such proposal should be provided and should be subject to shareowner approval individual in respect of each director.
- If share options are to be issued, at a discounted ruling price, shareowners should vote separately on this clause in the trust deed at the inception. Any subsequent amendment's proposed to an existing trust deed, that would permit allocation of these options at a discount, must be subject to the specific approval of shareowners (Roberts, 1999).

Disclosure

The overriding principle of full disclosure by directors, on an individual basis, should apply to all share schemes and any other incentives schemes proposed by

management. It is not considered appropriate that an executive director's fixed-term service contract, if any, should exist for three years. If so, full disclosure of this fact with reasons should be given, and the consent of shareowners should be sought. Companies should establish a formal and transparent procedure for developing in succession learning, particularly in respect of the chief executive officer and executive management. Every listed company should have a practice prohibiting dealing in its security by directors, officers and other selected employees for a designated period preceding the announcement of its financial results or in any other period considered sensitive, have regard to the listings requirements of the JSE in respect of dealings of directors. This should be determined by way of a formal policy established by the board and implemented by the company secretary.

Director Selection

Procedures for appointment to the board should be formal and transparent, and a matter for the board as a whole, assisted where appropriate by a nomination committee. This committee should constitute only non-executive director, of whom the majority should be independent and be chaired by board chairperson. Board continuity, subject to the performance and eligibility for re-election is imperative, programme ensuring a staggered rotation of directors should be put in place by the board to the extent that this is not already regulated (King 2002).

Induction and Orientation Programmes

The board should establish a formal orientation programme to familiarize incoming directors with the company's operations, senior management and its business environment, and to induct them in their fiduciary duties and responsibilities. Directors should receive further briefings from time to time on relevant new laws and regulations as well as on changing commercial risk. New directors with no or limited board experience should receive development and education to inform them of their duties, responsibilities, powers and potential liabilities. The company secretary, in consultation with the chairperson should play a substantial role in the orientation process for directors, and in attending to any educational or development requirements. The board, through the nomination committee or similar board committee, should regularly review its required needs of skills and experience and other qualities such as its demographics and diversity in order to assess the effectiveness of the board. This should be by means of a self-evaluation of the board as well as whole, its committees and the contribution of the each individual director King, 2002).

Evaluations

The evaluations should be conducted at least annually. Legislative changes are recommended to buttress the existing provisions of the Companies Act regarding directors' disqualification. Boards should ascertain whether potential new directors are fit and proper and are not disqualified from being directors. Prior to their appointment, these should be investigated along the lines of the approach required for listed companies by the JSE or under the Banks Act, as appropriate. The nomination committee will prove useful for this purpose. There should be a formal procedure for certain functions of the board to be delegated, describing the extent of such delegation to enable the board to properly discharge its duties and responsibilities and to effectively fulfil its decision taking process. Board committees with formally determined terms of reference, life span, role and function constitute an important element of this process and should be established with clearly agreed upon reporting procedures and scope of authority. As a general principle, there should be a transparency and full disclosure from the board committee to the board, except where the board has mandated the committee otherwise. At a minimum each board should have an audit and a remuneration committee. Industry and company specific issues will dictate the requirements for other committees ((Spangeberg, Schroder and Duvenage, 1999).

Board Committees.

Non-executive directors must play an important role in board committees. An independent non-executive director should preferably chair all board committees, whether this is the board chairperson or some other appropriate individual. The exception should be a board committee fulfilling an executive function. Board committees should be free to take independent outside professional advice as when necessary. Committee composition, a brief description of its remit, the number of meetings held and other relevant information should be disclosed in the annual report. The chairpersons of the board committees, particularly those in respect of audit, remuneration, should attend the company's annual general meeting. Board committees should be subject to regular evaluation by the board to ascertain their performance and effectiveness. The Standing Advisory on Company Law should investigate whether there is a need for the rule "business judgment rule "in South Africa.

Company Secretary

The board should be cognizant of the duties imposed upon the company secretary and should empower the company secretary accordingly to enable him or her to properly fulfil those duties. In addition to extensive statutory duties, the company secretary must

provide the board as a whole and directors individually with details and guidance as to how their responsibilities should be properly discharged in the best interest of the company. The company secretary has an important role in the induction of new or inexperienced directors, and in assisting the chairperson and chief executive officer in determining the annual board plan and the administration of other issues of a strategy nature at the board level. The company secretary should provide a central source of guidance and advice to the board, and within the company, on matters of ethics and good governance. The company secretary should be subjected to a fit and proper test in the same manner as is recommended for new director appointments.

Management of Risk

The board has the responsibility to ensure that the company has implemented an effective ongoing process to identify risk, to measure its potential impact against board set of assumptions, and then to activate what is necessary to proactively manage those risks. Risk management and internal control should be practiced throughout the company by all staff, and should be embedded in day-to-day activities. The board should make use of generally recognized risk management and internal control models and frameworks in order to maintain a sound system of risk management and internal control to provide reasonable assurance regarding the achievement of organizational objectives with respect to:

- The effectiveness and efficiency of operation,
- The safeguarding of the company 's assets (including information);
- Compliance with applicable laws; regulation and supervisor requirements;
- Supporting business sustainability under normal as well as adverse operating conditions;
- The reliability of reporting; and
- Behaving responsibility towards all stakeholders (Roberts, 1999).

Risk should not only be viewed from a negative perspective. The review process identifies areas of opportunity, such as where effective risk management can be turned to competitive advantage. The board is responsible for the total process of risk management, as well as for forming its own opinion on the effectiveness of the process. Management is accountable to the board for designing, implementing and monitoring the process of risk management, and integrating it into the day-to-day activities of the company. The board should set the risk strategy policies with the executive directors and senior management. These policies should be clearly communicated to all employees to ensure that the risk strategy is incorporated into the language and culture of the

company. The board is responsible for ensuring that a systematic, documented assessment of the processes outcomes surrounding of key risk is undertaken at least annually for the purposes of making its public statement on risk management. It should, at appropriately considered intervals, receive the review reports on the risk management process in the company. This risk assessment should address the company's exposure to at least the following:

- Physical and operational risk
- Human resource risk
- Technology risk
- Business continuity and disaster recovery
- Credit and market risk
- Compliance risks (Southey, 1990)

A board committee, either a dedicated committee or one with other responsibilities, should be appointed to assist the board in reviewing the risk management process and the significant risk facing the company. The board is responsible for disclosure in relation to risk in the annual report and should acknowledge that it is accountable for the risk management procedures. The internal audit function should not assume the function, systems and processes of risk management, but should be used to provide independent assurance in relation to management's assertions surrounding the effectiveness of risk management and internal control. If a compliance function exists it will provide assurance in relation to compliance with applicable laws, regulations and supervisor requirement. The board to ensure that risks are mitigated and that the company's objectives are attained should establish a comprehensive system of control. The control environment should also set the tone of the company and cover ethical values, management's philosophy and the competence of employees. Risks should be assessed on an on-going basis, and control activities should be designed to respond to risks throughout the company. Pertinent information arising from the risk assessment, and relating to control activities, and should be identified, captured and communicated in a form and timeframe that enables employees to carry out their responsibilities properly. Both line management and assurance providers should monitor these controls. Companies should develop a system of risk management and internal control that builds more robust business operations (King, 2002).

2.5 CONCLUSION

This chapter focuses on the King's report recommendations as well as the functions of the board of directors, the roles of different components within the board, such as chief executive, the non-executive director, etc. The recommendations of the Kings report on the composition and functions of the board of directors are presented and discussed within the context of the composition and effectiveness of the board of directors in South Africa. This contextual presentation lead to the following method of collecting data and the actual case history used in this research project.

CHAPTER THREE

RESEARCH METHOD

3.1 INTRODUCTION

The King's report recommendation on board of directors gives guidelines not only to private organizations' board of directors but also to parastatals and public organizations. Literature reviewed showed that there are a number of issues around the functions of the board of directors and its units, which need to be looked at especially within board of directors in South Africa. It is, therefore, important that a survey that analyses selected cases of the board of directors are selected in order to gather data for this study on the effectiveness of the board of directors. The King's Report recommendations serve as a guide in the data collection and in the data analysis. The method of data collection, sampling and data analysis is further discussed in the following sections.

3.2 CASE STUDY RESEARCH METHOD

This research used a case study approach to collect data that answer the critical questions of this research. This research approach is relevant because the aims of this research focuses on an in-depth analysis of the board of directors be it in a parastatal, public organization and/ or private organization. The method of data collection and analysis conducted involves three cases analysis:

- Collecting data on specific cases
- Conducting data analysis
- Concluding and making recommendations

The advantage of this method, particularly in this study, is that:

- The King's report recommendations will be looked at by directors serving in different boards and thus the findings will be relevant and applicable to different board of directors.
- The other advantage is that the five selected companies are different and therefore, their responses can enable them to reorganise their boards and implement some of King's report recommendations.
- The researcher in this study has the been serving in different boards and thus formulating a case study was due to this knowledge about different boards in South Africa.

The researcher should know and understand well the research parameters, research units and area of research, especially when a case study method is used (Kumar, 2000). This allows the researcher to get a better idea about the relevant sources of information. The researcher's involvement in different board of directors ensures maximum support by all respondents who were included in data gathering. The next section covers ethical guidelines, sampling procedures, research instruments, data collection and the data analysis method.

3.2.1 ETHICAL GUIDELINES

Ethical standards were maintained through out this study. The following ethical guidelines will be adhered to:

- The researcher ensured that members of the board of directors who were part of the study were protected from any harm.
- The board of directors taking part in the study were informed about all the aspects of this study that might influence their willingness to take part.
- The researcher ensured that the study of the link between the composition of the board of directors and effectiveness does not take advantage of the participants.
- All the members of the board of directors who were participating in this study were treated with respect and concern for their well-being.
- Information gathered on this study was treated confidentially and used for research purposes only.

3.2.2 SAMPLING PROCEDURE

The sample was drawn from the KwaZulu-Natal Headquarter Companies. The sample parameters included two of the following;

- Municipal funded entity
- Parastatal
- Listed conglomerate
- Unlisted private company
- Black economic empowerment company

The sample units include a minimum of two directors and maximum of 5 from each sample parameter.i.e. from each selected category. The characteristics for selecting respondents included racial and gender. Over and above the respondents selected from each selected category of companies a sample of 12 respondents (minimum) was selected randomly from a pool of leading directors in South Africa based in KZN Province. These are as follows:

- 2 Black Female Directors
- 2 White Female Directors
- 2 Black Male Directors
- 2 Coloured Male Directors
- 2 Indian Male Directors
- 2 White Male Directors

These directors have already been identified. The sample is such that in our analysis we would be able to detect any variations and differences between the four major categories. Each grouping (between parastatals, unlisted, listed, municipal entity and black economic entity and/or within each one of them). Due to time constraints one company was chosen from each sector and/or segment.

3.2.3 RESEARCH INSTRUMENTS

The research instruments used in this study include:

3.2.4 QUESTIONNAIRES

The questionnaires in this study reliably and validly discriminate between the composition of the board of directors and their effectiveness. The closed-ended questions provided alternatives that the respondent could select from, when responding. This allowed speedy responses. The open-ended questions provided the respondent with an opportunity to clarify his / her choices. The advantage of open-end questions in this study is that they allow participants to provide a wide range of detailed responses and also permit a researcher to potentially discover many relevant attitudes, and experiences that may confound the results. The advantage of using a questionnaire in this study is that it reduces reactivity and social desirability. This is due to the fact that completing a questionnaire anonymously is less threatening than talking to another person. Questionnaires in this study provide more efficient data collection, because most respondents can complete at one time. Questionnaires are also used in this study because they are less expensive and have an added advantage of taking less time to collect.

3.2.5 INTERVIEWS

A follow up interviews were used in this study to ensure that the respondents get a chance to express their thoughts openly with justifications where necessary. This allowed the interviewer to react to the information provided by a respondent, by either requesting clarity or exploring additional, unanticipated topics brought up by the respondent.

3.2.6 DATA COLLECTION PLAN

Cooperation and support of the Chairpersons of relevant of Board of Directors was sought. The permission of the directors identified in the sample was obtained. They were briefed about the study. Their informed consent was obtained in written form. The study took five months to complete. The follow up interviews were conducted with a group of selected members of the board of directors. Questionnaires were distributed to members of the board of directors.

3.2.7 DATA ANALYSIS METHOD

Data on questionnaires were analysed using a statistical techniques. Data from focus interviews was analysed using content analysis method. Data from focus interviews were further analysed using theme analysis.

3.3 THE CASE - DOCUMENT ANALYSIS

The document analysis conducted in this section included the data from parastatals, listed conglomerate, private, unlisted, black economic empowerment companies and municipal entities.

(i) PARASTATAL

The structure of the board in the parastatal has 16 members who serve as the Accounting Authority. The exco has 5 members including the chairperson. In the parastatal the government appoints the board members to represent the interest of the customers and stakeholders. The board members meet monthly. The position of a chairperson of the board and that of the chief executive officer are separate. The board structure reflects 25% women representatives and 75% men representatives. The exco members are 100% men. The racial representation reflects the demographics of South Africa. The period of term for board members is 5 years. The comparative analysis of the board in a 5 year period before the current board's 5 year term, show that there was an increase of essential services whereas in the last 5 year period indicates a decline in service provision. The sub-committees of the board include the following: -

- Finance Committee
- Audit Committee
- Remuneration Committee
- Transformation Committee

(ii) PRIVATE LISTED (Conglomerate)

The structure of the board in private listed companies has 19 members. The exco has 10 members. Out of the 21 board members, there are 10 non-executive board members. The position of a chairman is alternated between two persons. In private companies the directors are appointed by the shareholders to represent the interest of the shareholders. The board members meet five times a year. The board members are provided outside professional advice whenever they need it. The position of a chairperson of the board and that of the chief executive officer used to be one, until very recently. The exco members are 100% men and these are managing directors of subsidiaries and executive directors representing support services such as human resources corporate affairs etc. the sub-committees of the board include the following: -

- Executive Committee
- Audit and Compliance Committee
- Remuneration Committee
- Employment Equity Committee

(iii) MUNICIPAL ENTITY

The structure of the board in the municipal entity has 13 members. There is an executive committee. Out of the 13 board members, the position of a chairperson and that of the chief executive officer are separate. The board members meet quarterly. The sub-committees meet monthly. The racial representation reflects the demographics of South Africa. The period of term for board members is 1 year; they have the following board committees:

- Executive Committee
- Finance Committee
- Marketing Committee
- Human Resources Committee

(iv) PRIVATE UNLISTED

The board consists of 9 members. This company has more sub-committees than any other company in our sample. It goes beyond the requirements of the King II Report. Some of these innovative and uncommon sub-committees include procurement, corporate governance, government affairs and foreign opportunities committees. The position of chief executive and chair combined into one person who happens to be the major shareholder. The board meets

quarterly. The demographic reality is not reflected in the board as Indians represent the dominant component.

(v) BLACK ECONOMIC EMPOWERMENT COMPANIES

The structure of the board in black empowerment companies has 7 members. There is no executive committee. Out of the 7 board members, the position of the chairperson, managing director and company secretary are separated. In black empowerment companies the directors are appointed by the shareholders to represent the interest of the shareholders. The board members meet regularly, once a month. The position of a chairperson of the board and that of the managing director are not the same. The racial representation do not reflects the demographics of South Africa. The period of term for board members is 1 year. The board is limited to 7 members and the board assumes all responsibilities of the relevant sub-committees.

3.3.1 The identification of the Companies in the Sample;

Company A – National Parastatal

Company B – Black Economic Empowerment Company

Company C – Unlisted Private Company

Company D – Municipal Entity

Company E – Listed Private Corporation (Conglomerate)

3.3.2 Structure of the Board

Company	A	B	C *	D	E
Subcommittees					
Executive	X	√	X	√	√
Audit	√	X	√	X	√
Finance	√	X	√	√	√
Remuneration	√	X	√	X	
Human Resources	X	X	X	√	
Employment Equity	X	X	√	X	√
Nomination	X	X	X	X	X
Investment	X	X	√	X	X
Public Affairs	X	X	√	X	X
Transformation	√	X		X	X
Marketing	X	X	√	√	X

3.3.3 Size of the Board

Size	Companies				
Number of members	A	B	C	D	E
1 to 5					
5 to 10		√	√		
10 to 15				√	
15 to 20	√				√
20 plus					

3.3.4 – Directors

(i) Executive versus Non-Executive Directors

Type	Companies				
Number of members	A	B	C	D	E
Executive	1	1	4	1	9
Non-Executive	15	6	5	12	10
Total	16	7	9	13	19

(ii) Split between inside and totally independent non-executive (outside director)

Type	Companies				
Non-executive directors	A	B	C	D	E
Inside	-	4	-	4	7
Outside	15	2	5	8	3
Total	15	6	5	12	10

3.3.5 (i) Chairperson and Chief Executive positions

Nature	Companies				
	A	B	C	D	E
Combined			√		
Separate	√	√		√	√

3.3.6 (ii) Tenure of Office of Chair / CEO

The term of office of both chairperson and CEO in all companies in the sample is not limited except company A (the parastatal) and Company D (Unicity entity) where the two positions of CEO are contractual but renewable based on performance. Whilst the position of Chairs in these two latter companies is based on statutory limitations at the

end of the term of office the responsible ministry in the case of the parastatal and by cabinet sanction – the incumbent may be reappointed. With regards to the municipality entity the chair is appointed by the board, which is strongly influenced by board members representing the municipality executive committee (the shareholder in this instance).

3.3.7 Selection of Directors

Selection Guidelines	Companies				
	A	B	C	D	E
Exist (formalised)	√				
Non-existent		√	√	√	√

No formal selection guidelines and/or procedures exist but normally when a vacancy occurs any director may nominate and/or suggest, notably chairs play a prominent part including non-executive directors representing shareholders.

3.3.8 Formal Induction of Directors

Induction Programming	Companies				
	A	B	C	D	E
Exist (formalised)					
Non-existent	√	√	√	√	√

3.3.9 Composition by Gender

Company	Companies				
	A	B	C	D	E
Female	5	2	1	3	2
Male	11	5	8	10	17
Total	16	7	9	13	19

- In Company A, all women are Black and 1 out of the total of five is not African but Indian.
- In Company B all women are African.
- In Company E the split is 50% African and 50% White.
- In Company C the female is African.

3.3.10 Composition by Race

Company	Companies				
Racial Group	A	B	C	D	E
African	9	7	3	6	2
Indian	3	-	5	1	1
Coloured	-	-	-	-	-
White	4	-	1	6	16
Total	16	7	9	13	19

3.3.11 Evaluation of Board Members

In all the 5 companies there was no formal evaluation or/and performance appraisal of the individual board members or the board as a collective.

3.4 Conclusion:

The quantitative and qualitative approach used in this study gives an advantage because it is a small sample that needs thorough data analysis. Data collection method shows that the respondents were given questionnaires, then follow-up interviews were also conducted, this allowed the researcher to gather as much as possible. Document analysis provided information on unlisted, listed, parastatal, black economic empowerment company and municipal entity. The analysis of data yielded valuable information that is interrogated and presented in the next chapter. Issues revolving around the skills profile, expertise, experience, selection of directors, number of boards in which they serve, their compensation and remuneration, perceptions and views on Corporate Governance Reports such as King II Report and functioning of board sub-committees will be dealt with in the next chapter. The next chapter 4 will focus on the findings of the survey, including the critical evaluation of these findings against our Model in Chapter 2

CHAPTER FOUR

DISCUSSION OF RESULTS

4.1 INTRODUCTION

The results of this research are presented according to the data collected through the investigation conducted as indicated in the previous chapter. The results were carefully and systematically executed, according to the plan of data collection and analysis, in order to derive valid conclusions about the findings. The results, in this study are consistently presented in the following format: The characteristics of the sample units are presented first, then the aims of the study which are presented, followed by a table and / or figure and the description of the table/ figure. The data sources were archives primary data sources. The latter, consisted of all directors of the boards.

4.2 CHARACTERISTICS OF DATA SOURCES

The data sources consisted of the archives and primary data sources. The characteristics are as follows:

Table 4.1: Characteristics of the archives.

NATURE OF ARCHIVE	CONTENT	SPECIFICATIONS
Parastatals	Board structure and composition	Board sub-committees
Private listed company	Board structure and composition	Board sub-committees
Unicity Entity	Board structure and composition	Board sub-committees
Black economic empowerment company	Board structure and composition	Board sub-committees
Private unlisted company	Board structure and composition	Board sub-committees

Table 4.1 shows that document reviewed were those from parastatals, private listed company, unicity entity, private unlisted and black economic empowerment company. The focus was on board structure and composition as well as board sub-committees.

Table 4.4 shows that, 12% of respondents were between the ages 16-25 years, 8% were between the ages of 26-35 years, 24% were between the ages of 36-45 years, 44% were between the ages of 46-55 years and 12% were 56 years and above.

Table 4.5: Characteristics of primary respondents according to experience as a director.

Experience in years	Frequencies	Percentage
1-5 years	7	28%
6-10 years	8	32%
11 years and above	10	40%

Table 4.5 shows that, most (40%) respondents had an experience as board directors for 11 years and above, other 28% had 1-5 years and 32% 6-10 years experience.

Table 4.6: Characteristics of primary respondents according to marital status

Marital status	Frequency	Percentages
Never married	1	4%
Married	22	88%
Divorced	2	8%
Widowed	0	0%

Table 4.6 shows that, most (88%) respondents were married, 8% were divorced and the other 4% never married.

Table 4.7: Characteristics of primary respondents according to types of sector they serve as directors

Type of sector	Frequency	Percentage
Private	16	64%
Public	4	16%
Parastatals	5	20%

Table 4.7 shows that, most (64%) respondents serve in a private sector, 16% served in public sector and 20% serve in parastatals.

Table 4.8: Characteristics of primary respondents according to the number of board of directors they serve

Number of Boards	Frequency	Percentages
1-2 Boards	4	16%
3-5 Boards	9	36%
6-10 Boards	10	40%
11 Boards and above	2	8%

Table 4.8 shows that, 16% of respondents serve in 1-2 boards, 36% serve in 3-5 boards, 40% serve in 6-10 boards and 8% serve in 11 or more boards.

Table 4.9: Characteristics of primary respondents according to the size of the Board they serve in.

Size of the Board	Frequency	Percentages
1-5 Members	2	8%
5-10 Members	7	28%
10-15 Members	11	44%
15-20 Members	5	20%
20 Members & Above	0	0%

Table 4.9 shows that, 8% of respondents serve in boards a with 1-5 members, 28% serve in boards with 5-10 members, 44% serve in boards with 10-15 members and 20% serve in boards with 15-20 members.

4.3 KING II REPORT ON CORPORATE GOVERNANCE

THEME A: AWARENESS OF THE KING II REPORT.

All respondents, (100%) were aware of the King II Report, without exception.

THEME B: IMPRESSIONS OR/AND VIEWS ON THE REPORT

Whilst, all respondents regarded the Kings II Report as a positive development, 2% had some reservations about it. (This will be alluded to, elsewhere in our report). However, the positive aspects revolve around the following;

- Directors accountability has been given new meaning
- Transparency and disclosure

- Good corporate governance guidelines and sound principles in the role, responsibilities and expectations of directors.
- Importance of the triple bottom-line concept, which in the long run, it is believed, **will** ensure sustainability of the business.
- Establishes sound foundation upon which individual companies can build
- Provides sound objective framework within which to build.

In summary: -

70% of the respondents felt that the report enhances the understanding of the directors' role and responsibilities.

70% believed that it gives real meaning to directors' accountability to shareholders.

90% thought it laid firm foundation for good corporate guidelines and 25% said it made good business sense.

50% of respondents (all of them, from the previously disadvantaged group) thought that the triple bottom-line concept advocated in the report encourages responsibility to the environment, social and well-being of overall society.

60% of the respondents said it gives credence to the need for effective boards through the establishment and utilisation of the board committee system.

THEME C: CRITICAL FEATURES

The respondents identified the following as the critical elements of the King II Report:

- Transparency and accountability
- Directors remuneration
- Risk management and internal control
- Role of non-executive and executive directors
- In line with international benchmarks – critical for investor confidence
- Business ethics and organisational integrity

THEME D: - ACCEPTANCE

All respondents accepted the King II Report and would recommend it to their boards to embrace and implement it.

5% of the respondent's boards had already accepted and implemented the King II Report.

THEME E: - CRITICISM OF THE REPORT

14% of the respondents felt that the report was too onerous placing much demand on non-executive directors who were not involved in day-to-day operations. Related to this, is that non-executive directors are given too much accountability and exertive liabilities.

71% of those who felt that the report was onerous, thought that levels of responsibility should be guided by the size of the company, either measured in terms of assets, turnover or/and profit. Blanket approach would negatively impact on small medium sized enterprises. 10% of the respondents felt that it might be easier for larger companies to implement, than small to medium sized companies. These might find it expensive to implement.

15% of the respondents – (entirely previously disadvantaged individuals) felt that it was rather radical and may not exactly be suitable for a developing country especially on the part of non –executive directors.

THEME F: KINGS REPORT ON SELECTION OF DIRECTORS

All respondents were in agreement with Kings II Report recommendations on the selection guidelines for directors.

- Procedures for appointments to the board should be formal and transparent, and a matter for the board as a whole, assisted where appropriate by a nomination committee. This committee should constitute only non-executive directors of whom the majority should be independent, and chaired by the board chairperson.
- Board continuity, subject to performance and eligibility for re-election, is imperative and a programme ensuring a staggered rotation of directors should be put in place by the board to the extent where affected companies incorporated under the Companies Act do not already regulate this.
- The board to familiarise incoming directors with the company's operations, senior management and its business environment and to induct them in their fiduciary duties and responsibilities should establish a formal orientation programme.
- Directors should receive further briefings from time to time, on relevant new laws and regulations and changing commercial risks.
- New directors with no or limited board experience, should receive training in their unaccustomed responsibility, which carries with it potential personal liability.
- The company secretary, in consultation with the chairperson, should play a substantial role in the orientation process for directors and in attending to any training or development requirements.

THEME G: - THE STATUS OF THE COMPANIES IN OUR SAMPLE IN RELATION TO KINGS II REPORT

Parastatal – Company A

Corporate governance is not only embraced but, being fully implemented. The King II Report is currently being implemented in all respects. However, in the 2000 – 2001 Financial Year, the company covers all aspects of the organisation and including the key tenets of the latest in corporate governance. These include:

- Code of ethics
- Going concern
- Internal control
- Policies, objectives and performance measurement
- Strategic planning
- Risk management
- Public finance management act (PFMA)
- Employment equity
- Governance structures
- Sub-committees of the board which is in line with King II Report

Ongoing assessment in line with the requirements of a highly dynamic environment is in vogue, i.e. continuous review of the structures.

Black Economic Empowerment Company – Company B

Clearly, from the Annual Report of Company B – Kings I Report has been embraced, in all respects, except the board sub-committee structure. As indicated in Chapter 3, they only have an executive committee, which deals with all the functions of the audit, and remuneration committees. Their argument is that their board, which consists of 7 members, acts as an executive committee and meets once a month in that capacity. Its size gives it an added advantage and dimension, as it involves all board members in detailed discussions pertaining to issues of audit and remuneration or any other important aspect of board business, which, is normally deferred to various board sub-committees in large sized boards.

The position of chairman and CEO are separate. It is however, significant to note that, the CEO is the founder and the major shareholder in the group. The chairman is also a shareholder in the company, to a far lesser degree than the founder. 71% of the directors are shareholders in the company. The question that arises is, whether this company is geared to deal with all the implications of King II Report:

- Is the non-executive chairman really independent?
- Can he succumb or withstand any pressure or undue demands from the founder and CEO?
- King II report insists on audit and remuneration board committees. Is this a luxury they can do without?
- Would non-compliance with the King II Report structures prejudice the company in its drive to attract more private black shareholders?

The founder and CEO views on King II Report are very succinct *"It is a step in the right direction. If all recommendations were implemented great progress, stability and confidence would be achieved."*

PRIVATELY OWNED – UNLISTED – COMPANY C

In the words of the founder, chairman and CEO of the company – who owns more than 60% of the holding company – expressing his sentiments on King II Report says: *"In view of events of corporate non-compliance worldwide the King II Report on corporate governance recommendations will help build confidence in the South African Corporate."* Whilst this company is the only one in our sample that has a combined chairman/CEO position – it has more board sub-committees than any of the companies in our sample, beyond the requirements of any corporate governance report or/and dictum, as indicated in Chapter 3.

Some of the questions that arose for Company B are as relevant as ever in the case of this privately owned but, unlisted company.

It is interesting to note that both Company B (Black Empowerment) and Company C (Private unlisted) are not listed. Clearly, if and when they list, it would be in their interest to conform to the requirements of the King II Report. We need to point out however, that to-date, they have complied with all material aspects of the King II Report, although some of the requirements are not listing prerequisites or/and find expression in law. For them, they seem to be even ahead, not only of their peers, but some big tested "brothers" or "sisters" who are listed.

CITY ENTITY – COMPANY D

Company D, whilst alluding and expressing positive sentiments about the need for good corporate governance, indications are that in terms of board committees it is lacking. Whilst, the human resources committee deals with all issues pertaining to remuneration, there is no audit committee. However, it has been said that the finance committee deals with all the issues of audit. In recommending the establishment of the audit committee

even in its first report – Kings Committee advanced sound arguments for such committee as a separate entity, from finance or investment committees, if the audit committee is not separate from the finance committee. Matters and issues seem to get clouded and confused resulting in audit issues remaining in the periphery, if not compromised.

The audit committee is responsible mainly for oversight of the corporations or company's financial reporting process. The primary functions of the audit committee in summary are:

- Risk profile
- Outside auditor
- Auditor independence
- Critical accounting, policies, judgements and estimates
- Internal controls
- Compliance
- Financial statements
- Internal audit function
- Communication

These are very specific duties, which should not be confused with other financial and/or investment issues.

It is however, noteworthy that Company D as a public corporation, whose sole and main shareholder is government at local level – has to meet and satisfy other charters and/or Acts of Parliament, rules and regulations which are more demanding which govern these entities. These include for example, Public Finance Management Act, the Municipal Finance Management Bill that is under discussion in parliament currently.

It's also noteworthy that, the position of chairman and CEO are separate in this company. As indicated in Chapter 3, non-executive directors are in the majority, a manifestation of Kings II Report recommendations.

LISTED PRIVATE CORPORATION – COMPANY E

A leading company in the sphere of its operations, which has complied with the code of corporate practises and conduct (King I Report on Corporate Governance). The company goes further in its Annual Report 2001 published early this year confirms that, independent auditors have verified compliance with King I Report.

This compliance finds expression in that the CEO and chairman positions have been separated. Further manifestation of this compliance and endorsement of effective corporate governance, as advocated in Kings Report, are found in the board and

committee structures, audit and compliance committee, which consist of all independent non-executive directors.

The remuneration committee consists of 40% of executive directors and 60% of non-executive directors. What is significant with the membership of both the audit and remuneration committees is that, whilst non-executive directors comprises the majority of these two committees, inside non-executive directors seem to dominate. In the instance of the remuneration committee, the ratio is 2:1 in favour of inside non-executives. Although, in the audit and compliance committee the ratio is 2:2. Two of the non-executive directors in this board are executive directors of the holding company, which owns more than 50% of Company E. The questions that arise are;

- o Firstly, how independent are they?
- o Secondly, the non-executive chairman is the immediate past CEO of the company. Is it desirable or not to have the immediate past CEO remaining as a non-executive director, after his retirement as CEO, let alone, becoming the next non-executive chairman?

Whilst, both King I and II Report do not address themselves to these questions, these are issues that can no longer be ignored in the critical evaluation of board composition and effectiveness.

The company has committed itself to considering the recommendations of the second King Report with the intention of taking appropriate compliance action.

4.4 COMPOSITION OF BOARD OF DIRECTORS

THEME A – STRUCTURE OF THE BOARD OF DIRECTORS

It is true that it cannot be gainsaid, that companies in general particularly publicly owned corporations (listed companies) employ diverse approaches to board structure and operations and no one structure is right for every company and/or corporation?

SUB THEME (I) SIZE OF THE BOARD OF DIRECTORS

Board of directors vary in size from industry to industry, and company to company. In determining the board size, directors should consider the nature, size and complexity of the business, as well as, the stage of its development. Scholars and experts in corporate governance, tend to agree that smaller boards are often more cohesive and work more effectively than larger boards.

Our research suggests, that the board size should be dependent on the needs and nature of the business in which the company operates. 80% of the respondents agreed with this view. In terms of actual numbers in the board of directors;

- 8 – 10 member boards were preferred by 65% of the respondents
- 7 – 10 member boards were preferred by 45% of the respondents
- 25% of the respondents preferred boards with 10 –12 members
- 8% of the respondents thought 15 member boards should be the norm allowing for balance of skills, racial demographic reflection and gender equity ratio.

What was very striking is that without exception, smaller boards are seen to be ideal because they provide;

- Robust discussion and debate
- Effective decision making
- Lean and mean boards – meaning speed of decision-making.

Furthermore, directors who served in private unlisted companies favoured smaller and leaner boards whereas those in publicly owned listed companies tended to aggravate to 12 – 15 member boards. Whether there is a correlation between the size of board and it's listing or unlisted status, is a question that needs further examination. One leading director who serves in a number of publicly owned corporations and on multi-national said, *"For large national or international businesses, and for the balance of skills, and allowing for variety, breadth and depth of views and experience, it is unlikely or doubtful, that the board can be less than 15 members"*.

The question of uneven and even numbers was raised by 8% of the directors – irrespective of the total number of members in the board. 4% of the respondents thought uneven numbers lent themselves to effectiveness as they prevented deadlocks. The balance of 4% thought even numbers encouraged consensus. A cursory look on the companies in our sample indicates that all boards except, company A had uneven numbers.

Company A – 16

Company B –7

Company C - 9

Company D – 13

Company E – 19

Is this a coincidence or deliberate. We are unable to answer, but it may be in line with the position taken by the 4% of the sample that favours uneven numbers.

It is also interesting to note that privately owned – unlisted companies in our sample had less than 10 members. This seems to be in line with the theory of the evolution of the board and stage of development. Whereas, the publicly owned (listed Company E) and parastatal (Company A) had more than 15 members. The city entity has 13 – more than 10, but less than 15. Is there any visible and/or credible rationale to this state of affairs? The further question that arises is – Is the nature of ownership related to the size of the board? Research done in UK and USA seem to confirm this, that, boards start small and the business grows, becoming complex and board numbers expand too. Furthermore, what are the implications of the need and Kings requirement to have more non-executive directors than executive directors? In short, what impact does/might or could, non-executive directors have upon the size of the board, and what would be the advantages and disadvantages of smaller or larger number of directors?

The optimum size of the board depends upon the circumstances of the company, the qualities of directors and how the business of the board is conducted (Coulson Thomas 1993). In concurring, one of the leading authorities in board size and effectiveness – Alan Wakelan in his paper 1991 titled "The Effective Board: Current Practises, Myths, and realities for the UK Institute of Directors" says, *"Whether or not a board of a certain size is effective will depend upon a number of factors such as, composition and dynamics, the personalities of its members, its priorities, qualities of the chairmanship and how the business of the board is managed. When assessing the impact of board size upon its effectiveness, these other influences and considerations will need to be taken into account."*

SUB-THEME (ii) CHAIRMAN / CEO

There has been a great deal of debate about the desirability of separating the roles of CEO and chairman. Our research indicated that, in most respondent boards (88%), the position of the chairman was separate from that of the chief executive i.e. individual directors in our sample (not necessarily those representing the companies in our sample). However, even those representing the companies in the sample, concur with this view. Some of the rationale advanced for the separation, is in line with Kings II Report motivation in this respect. Most respondents echoed the words of John Whitehead a leading director in US who said, *"One man rule is a bad idea. A single CEO-Chairman can do great damage before being reigned in – often when it is too late or almost too late"* when they said *"It is not healthy to give too much power to one*

individual. The question of accountability becomes an issue and before you know you have a disastrous dictator in your midst"

It is striking that in the instance of these positions being combined – historical reasons were highlighted and this tended to be located in the privately owned unlisted companies. (Company C) In the instance of Company E, the position had just been split to accommodate King II report although a further question arises.

Is it healthy for an immediate past CEO, who has just retired, to become the chairman? Is it in fact, desirable that, he or she even remains in the board as a non-executive director? Does this not stifle and hinder the new CEO, who might have to look over his shoulder, especially, if the new chairman is overbearing and still unconsciously believes that he is still in charge, as a CEO? This area needs further research.

All the companies in our sample as already indicated in Chapter 3 – the position of chairman and CEO were separate and held by two different individuals, except in Company C – the privately owned – unlisted company.

SUB-THEME (iii) – CHIEF EXECUTIVE TENURE OF OFFICE

Should the term of office of the chief executive be limited to a fixed period or not?

Our research findings show a clear divide between non-executive and executive directors on this question. Executive directors were unanimous in their view that the term of office should be unlimited. Their assertion was based on the fact that the board has the power to fire the CEO at anytime if the circumstances demanded. They also felt that, if the CEO is constantly delivering and adding value to shareholders, there was no need to limit the term of office depriving the company and the board immense value. The term of office should depend entirely on performance and track record. Continuity was also strongly highlighted. However, non-executive directors were of different view, advocating for a fixed term of office, although non-executive directors who previously served as CEO's tended to be sympathetic with the views of executive directors on this issue. These sympathetic non-executive directors thought that CEO's term of office should be guided by proper performance evaluation and reward as part of their review. Tenure being determined by this review rather than a fixed contract. Parastatals and municipal entities CEO's terms of office seem to be determined by fixed term contract renewable on the basis of performance. This was the case with Company A and D in our sample. In Company B, C and E the CEO's did not have any fixed term of office, but were subject to board evaluation and review.

The question that arises is whether performance evaluation of a CEO, who is a major shareholder, can really result in him or her being fired by the board if he/she is not performing. Is this really possible in Company B and C, where the CEO holds more than 50% of equity? It was very interesting to note that non-executive directors appointed by the state or municipality, opted very strongly for fixed term contract that was renewable for the CEO. Other non-executive directors felt that the term should be fixed. 60% of these respondents felt that 4 – 6 years was an appropriate term of office for the CEO. 30% of these thought 7 – 10 years were most relevant. 10% believing that 3 years was enough.

A whole range of reasons were advanced such as:

- To encourage healthy and constructive competitive spirit amongst top management, which would be compromised if CEO's term was unlimited
- It encourages effective succession planning which is a great morale booster to those below CEO level.
- To allow for good planning and continuity – a sound corporate governance principles to prevent abuse of power as well as to allow for a fresh perspective
- The company needs change of leadership, injection of new blood, experience and growth
- If the term is not limited it is complacency that sets in, but also stale thinking, same approach, too much confidence and one individual can become too powerful.

It is believed that the issue should not be confined to CEO's term of office being fixed or not. We believe it should go beyond that, if it is related to the effectiveness of the boards. The question that becomes relevant is – should the retiring CEO remain in the board as a non-executive director after relinquishing the position of the CEO?

There seems to be clear advantages and disadvantages on the issue of the presence of former CEO's on boards of companies in which they served as CEO's.

Key relationships, deep insight into the markets and operations of the company, understanding of customers, suppliers investors are some of the advantages highlighted. Historical knowledge – *“Institutional memory is available to the board and benefits of continuity maximised”* (Bowden 1994).

However, scholars and practitioners in this field feel that there are more compelling factors for the exclusion of retired CEO's in the boards they have been serving.

Arguments advanced against continuing service include:

- It makes it clear to everyone that the new CEO is in fact now in charge and fully accountable
- With the best intention in the world it is very difficult for many former CEO's to be entirely objective about decisions made on their watch.
- Emotional issues – personal loyalty to the former CEO will inevitably make it difficult for board members to reverse some of the former CEO decisions in their presence, especially if they remain friends.
- The new CEO might be intimidated in the presence of the former CEO (if he was highly regarded) and was previously the new CEO's boss. The new CEO might have great affection and respect for her/his former boss. This might be intimidation to frank and open discussion.

Two U.S. leading former CEO's, Michael Blumenthal and another former CEO said respectively, *"I absolutely agree that a former CEO should not be in the board, such a person, even a very good one, can be in an impossible bind. If he criticizes the new incumbent, he is suspect if he has real reservations and does not speak out he is not doing his job. Save him the dilemma"* (Coulson-Thomas 1993). The other former CEO said *"I made a mistake in staying in the board after stepping down as CEO. The discussions were painful, I never knew when I should comment or when I should keep quiet and it was just not a good idea to stay there. If people wanted my views they could obtain them in other ways"* (Ralph 1996).

Our experience and observations are that retiring CEO's are not only encouraged to stay on the boards as non-executive directors, but assume the non-executive chairmanship of the company. There are a number of living examples in South Africa, starting with Anglo American Group. The Standard Bank Group for example, Dr Conrad Strauss when he retired as CEO he became chairman until two years ago when he was replaced by Derek Cooper – who doubles up as chairman of Liberty Life – a major shareholder in the Standard Bank Group. Chris Liebenberg was the CEO of the Nedcor Group and assumed the chairmanship after retiring as CEO (although he had a two year stint as Minister of Finance in the Mandela Government). The frequency with which former CEO's have continued to serve as directors and/or as chairman in the boards in which they were CEO's and the impact of this on the effectiveness of the board is an area that needs further scientific investigation.

SUB-THEME IV – EXECUTIVE AND NON-EXECUTIVE DIRECTORS

There is a general view, that non-executive directors because of their “independence” should be in the majority of boards, especially those of publicly owned companies (listed).

All non-executive respondents felt that non-executive directors should be in the majority. Whilst 80% of the executive director respondents felt very strongly that there should be a balance between executive and non-executive directors i.e. 50:50 basis. 10% of these respondents (executive directors) said in fact executive directors should be in the majority, because they are closer to the pulse of the business.

Another 10% of the executive directors agreed with non-executive directors notion that, non-executive directors should be in the majority.

The extent of this bias towards non-executive directors varied from the following ratios:

90% to 10% - 10% in favour

80% to 20% - 15% in favour

75% to 25% - 40% in favour

70% to 30% - 20% in favour

60% to 40% - 15% in favour

Those who were predisposed towards the non-executive majority advanced a number of factors to support such a position:

- Independent thinking that is required. Executive directors are too close to the business and have inherent potential for conflict of interest.
- There is normally collusion between executive directors
- In order that executives do not get carried away with their own directions as opposed to boards strategy and control.

On the other hand, executive directors countered this view by saying:

- You need a strong executive base to guide non-executive base
- More executive directors to ensure that the business is run efficiently.
- You need strong substance and balance
- Companies need more dedication and commitment from directors than that given by non-executive directors.

The companies in our sample, as recorded in Chapter 3 – have more non-executive directors than executive directors.

However, our research and observations indicate that the majority of the non-executive directors in South Africa tend to be “inside directors” – they are not independent

directors as defined and outlined in the King II Report. The majority of these non-executive directors tend to be representatives of shareowners, who have the ability to control and/or significantly influence management. This is applicable to company E, D, C and B in our sample.

The question that arises is; How does this impact on the effectiveness of such boards? Further research is required in this area.

SUB-THEME V – BOARD COMMITTEES

Virtually all boards of directors of large, privately particularly publicly owned corporations operate using committees to assist them. A committee structure permits the board to address key areas in more depth than may be possible in a full board meeting.

As observed in Chapter 3 the 5, companies in our primary sample i.e. Company A, B, C, D and E i.e. parastatal, black economic empowerment unlisted, municipal entity and the publicly owned (listed) companies did have board sub-committees.

Company B and Company D did not have neither the audit nor the remuneration subcommittees. In the case of Company B, the executive committee undertakes the duties and functions of the audit and remuneration committees, which, is very powerful in this company and meets once a month. In the case of the municipal entity, the audit functions are located in the finance committee, whereas, the remuneration aspects are dealt with under the human resources subcommittee. Companies A, C and E complied with the requirements of the King II Report as they have in place the audit and remuneration subcommittees.

All companies in our sample did not have nomination committees, which have recently found favour with King II Report. King II Report is very cautious. However, actually accentuating the fact that nominating committees might be inappropriate in certain circumstances. The King II Report says *"While the committee was previously not disposed towards nomination committees, there is evidence to suggest that, in appropriate circumstances such a body can provide a useful forum in which to assist the board to identify suitable candidates for consideration."* The King II Report does not elaborate on the appropriate circumstances, but our own view is that nominating committees could play a crucial, central and critical role not only in assisting the whole board in a formal and transparent procedure in the appointment of directors, but effective evaluation of the board individually and as a collective. Of the major committees, nominating committee is one of the newest and least defined but has gained major ground in the U.S.

Ralph D. Ward says on nominating committees – editor of the popular U.S. magazine called “The Corporate Board” – a nationally recognised writer and commentator on the role of corporate boards of directors and their future in American Corporate Governance says *“The nominating committees are gaining rapidly in corporate popularity. The 1995 Korn / Ferry survey found 71% of major companies have on (though the prevalence declines amongst smaller corporation) In 1973 the same survey found them at a negligible 2.4% of corporations. In 1994 Ted Jadick of Heidrich & Struggles called nominating committees “the most striking example of board committee coming of age”.*

In our secondary sample of individual directors (25) – 8% of those respondents said their companies had a nominating committee that were assigned for searching for new directors on whose recommendation the board based its appointments.

Many boards have been accused of “inbred sameness”. Directors in most U.S. and U.K. corporations were wealthy, middle-aged white guys who too often both looked and thought alike. Such concerns fit in well with South African boards, which are dominated by the same old guys. The need to reflect the demographic reality in all spheres of the South African corporate life is encouraging the appointment of women and blacks in corporate boards. Since the South African boards have been accused of being too insular and self-generating the need for an objective, outward looking transparent process in the form of a nominating committee becomes even more desirable. The tendency of the CEO or chairman or CEO/chairman (combined in one person) suggesting another CEO of his acquaintance, as an impressive addition to the board and the board members already constituting the board duly agreeing would be avoided.

The nominating committee has added a patina of professionalism and objectivity to the process of deciding board membership needs. Although right up to the present day, suggestions for new directors still typically come from the CEO, the nominating committee has both supported and compiled a better strategic consideration of the boards' roster (Brancato Carolyn 1996).

100% of the respondents had executive committees of their boards. 16% did not audit committees. 28% did not have remuneration committees.

The functions of the remuneration committee were located in the human resources committee of the board.

Smaller boards tended to centralise these functions, either in the board or finance or human resources committee. All respondents who did not have some of these committees (audit and remuneration) as advocated by King II Report confirmed that

these issues were not totally ignored as they were handled at another level within the board.

Matter or/and issues dealt within the various board committees were never left without discussion at board level. Minutes of the board committees were circulated with the main board papers for information and perusal by all board members including those who were not members of the respective board committee.

A standing agenda item on each board committee was the general practice. The chairperson of each committee made a short presentation highlighting the significant aspects in the deliberations of his/her board committee.

Each board member is always at liberty to raise questions or issues with any matter captured in the minutes or the subcommittee chair input.

Committees appraise the full board of their activities on a regular basis. The bottom-line is that in most boards drawn in our sample processes are there and monitored to keep the boards informed through oral and/or written reports.

In conclusion, it is important to say that a particular committee structure is not essential for all companies. What is important is that the independent members of the board address key issues effectively. Other committees such as executive or finance marketing etc. committees other than the audit, remuneration committees may also be used, Company C is a typical example (it had more committees than any other company in our sample) it finds it useful to establish additional committees to examine special problems or opportunities in greater depth than would otherwise be feasible.

Most importantly and crucial to avoid any overlap and grey areas, each committee should be clearly defined and understood. A written charter approved by the board or/and board resolution establishing the committee is appropriate.

The final approval rests with the whole board. Committees should not make major policy decisions for the board as a whole. The board ratifies and/or endorses the recommendations of each board subcommittee.

4.4 DIFFERENT SELECTION PROCEDURES FOR BOARD OF DIRECTORS' IN SOUTH AFRICA.

THEME A: THE RATIONALE FOR SELECTION TO THE BOARD/S

Shareholders have the ultimate responsibility for selecting board members to ensure a mixed balance of skills and in the long-term interest of the company. Academic background, business skills and experience of members tend to play an important role in their selection.

Diversity in U.S. and U.K. boards has become an issue for some time. However, in South Africa black empowerment and employment equity, which is going to change the face of boards. Furthermore, diversity of both backgrounds and perspectives beyond gender and racial profile is important in composing a board but it needs to be achieved without sacrificing agreement on common set of assumptions about the institution and its mission. Having an effective board involves not only recruiting exceptional individuals who are well suited to the requirements of a particular organisation but also assembling a group of people who compliment one another by contributing a variety of background experiences and perspectives (Bowen William 1994).

All respondents in our sample agreed that there should be selection guidelines to assist their boards in the recruitment, appointment and removal of directors. We have already indicated that they also endorsed King II report recommendations on the selection of directors. However, only 60% of the respondents companies had selection guidelines. The balance of 40% did not have such. In most of these companies, traditionally, prospective directors were nominated to the board through the suggestion and support of directors but predominately by the CEO and/or chairman. This has been the process, the beginning and the end of the matter with the endorsement by the whole board and approval of shareholders serving only as the legal punctuation for the process. This is applicable to the 3 companies in the sample with the exception of Company A and D. In the case of Company A, nominations are sought from the public by the responsible ministry. The ministries' recommendation is then tabled to the cabinet for approval. In the case of the municipal entity – the executive committee of municipality must first approve nominations, which are drawn not only from the board recommendations but also from other stakeholders. However, there is no clear and transparent process that is written or laid down and followed except for the fact that the executive committee must approve nominations.

Further probing of the respondents in terms of the desirability of selection guidelines resulted in some confusion. They tended to interchange (confuse) guidelines and the actual criteria that should be utilised in selecting directors.

Some of these are captured below:

- Leadership qualities
- Ability to think strategically
- Expertise, experience, continuity
- Experience in business management

- Compatibility with King II Report
- Quality of networks
- Demonstrated and relevant experience
- Availability, commitment and passion
- Understanding of the industry
- Integrity, competence, independence
- Influence, insight, dedication
- Ability to work with others
- Political clout and influence – (it must be said that one respondent was totally against this when she said *“It is a joke in most cases, these boards have a tendency now of looking for political clout and of famous people even if they do not add value commercially, as long as their names are there”*)

Clearly what is outlined above are not the reasons why boards should have selection guidelines but the qualities that those selected should have.

However, there were few relevant comments relating to what selection guidelines would bring about including the following:

- Balance of skills
- To avoid “broerkap” and jobs for pals
- To demystify and expose weakness of collegiality
- To bring in new perspectives and approaches
- Breaking down the “old boys school club network” which has put most boards in a mess
- To encourage robust and courageous debate
- Specialist skills, which can compliment other skills in the board.

Whilst all respondents confirmed the presence of women and blacks in their board of directors – they are still in the minority and not in line with the demographic reality of South Africa. A disturbing trend that is developing is that few faces particularly those who are politically connected seem to be dominating the South African corporate boards. They are overburdened with directorships. Some of them have more than 10 directorships. The question that arises – can they really be effective board members? Or are they just spectators? This raises a further question – Should there be a limit to the directorships that one individual can hold at a point in time?

A closer look at the companies in our sample indicates that most women and black directors are there for their skills, background, experience, demonstrated leadership and track record, not political clout.

The issue of board diversity in South Africa is going to be one of the most powerful trends in board make-up given the seriousness with which the government is taking the Black Economic Empowerment Commission's Report initiated by the Black Business Council.

This report makes specific recommendations on the composition of boards in the terms of gender and racial profile.

It is our belief that those companies that ignore such do so at their own disadvantage. We sincerely hope that the quotation from Ralph D Ward on the issue won't hold true in South Africa, he said in 1996 *"Despite 20 years of effort to add women and minorities to corporate boards, most still look like the cynical tag applied to Richard Nixons' first cabinet – "Twelve grey haired white guys named George"*.

THEME B: THE MINIMUM REQUIREMENTS FOR BECOMING A DIRECTOR

The knowledge of business, achievement in a chosen field and track record coupled with a person having a reasonable qualification, understanding and interpretation of financial statements were seen by most respondents as the minimum requirement to qualify as a director.

What was interesting is that almost 70% of the respondents felt that the minimum requirements were dependent on the size, turnover and complexity of the industry. Some respondents - 48% saw matric and years of experience as a prerequisite for non-executive director appointments. A post matric qualification for executive directors coupled with coalface experience was touted by 90% of the executive directors in our sample.

Good communication skills were seen as important. 40% of the respondents felt that academic qualifications were irrelevant – what was important was financial understanding, some measure of business achievement and more importantly good knowledge and understanding of the industry.

THEME C: WHY THEY WERE SELECTED AS DIRECTORS.

70% of the respondents were selected because of their business experience. 60% of the respondents thought they were selected because of their competence and understanding of the industry in which they were serving.

Another 60% believed that they were appointed because of their community involvement, the quality and spread of their network, 60% of these respondents were black, 40% of the respondents were appointed because of their speciality skills. 60% thought that their independent thinking got them the nod. All women in the sample thought their independent streak won them the day.

30% thought that they were appointed because they were shareholders or/and represented shareholders.

30% sighted demonstrated leadership as the reason.

A number of other reasons were advanced including:

- Being a woman
- Being black
- Being KZN based
- Commitment to the organisation
- Contribution to corporate strategy
- Academic and business background
- Contact base
- Person of colour (Indian)
- Integrity
- Performance and credibility as an executive.

The most striking observation is that there is a direct correlation between these responses and the qualities highlighted in Theme A (The rationale for selection to boards) under the selection procedures for board of directors in South Africa.

THEME D: INDUCTION PROGRAMME FOR DIRECTORS.

Table 4.10: Induction programmes in board of directors

RESPONSES	FREQUENCIES	PERCENTAGE
Yes, there is an induction	10	40%
No, there is no induction	15	60%

Table 4.10 shows that 40% of respondents agree that there was induction and another 60% said there was no induction programme conducted in boards in which they are involved.

All respondents felt that induction of new directors was absolutely critical. Proper induction is seen as key to effective and cohesive board, enabling new incumbents to gain deeper understanding of the company's business operations and environment. It provides new directors with a base not only to familiarise themselves but also, gain deeper insight into the company's vision, strategy, aims and objectives. In short in order to be effective board members all new directors need to know about all aspects of the company's business through an induction programme.

THEME E: AWARENESS OF EDUCATIONAL, TRAINING AND DEVELOPMENT PROGRAMMES AIMED AT EMPOWERING ASPIRANT, POTENTIAL AND CURRENT DIRECTORS TO BE EFFECTIVE IN THEIR ROLES AND DUTIES.

Table 4.11: Need and awareness of empowerment programmes for aspiring and current directors

RESPONSES	FREQUENCIES	PERCENTAGE
Need	25	100%
No need	0	0%
Aware	16	64%
Not aware	9	36%

Table 4.11 shows all respondents felt there was a need for educational training and development programmes aimed at empowering aspirant potential and current directors. This is in line with their response to the induction of new directors. It also shows that 64% of respondents are aware about the programmes for empowering aspiring and current directors to be effective in their roles and duties. The programmes mentioned above include the directors' course at the University of Western Cape, the Cape Town Business Schools' programmes including the Executive development programme, 60% of respondents rated this programme very good. 30% thought it was good. The institute of directors' programme was mentioned by 40% of the respondents. 35% of the respondents alluded to the Graduate Institute of Management and Technologies" (GMIT) postgraduate diploma in company direction as the best and most relevant programme. This programme is done in collaboration with Henley University in the UK. The Black Management Forums' Director Development Programme was mentioned by 40% of the

respondents. Kagiso Leadership School programme was mentioned by 10% of the respondents.

16% of the respondents said that International Auditing firms in South Africa offered some courses and programmes aimed at aspirant, political and current directors. These programmes and courses were a critical ingredient for board effectiveness. They were seen to be enabling directors to understand and execute their roles effectively. Furthermore the relevance of such training and development was seen in terms of South Africa's peculiar history and policies of exclusion and the fact that director's responsibilities were different to those of management. Directors are accountable to all stakeholders.

THEME F: DIRECTORS AWARENESS OF THEIR DUTIES AND OBLIGATIONS.

Table 4.12: Directors awareness of their duties

RESPONSES	FREQUENCIES	PERCENTAGE
Aware	13	52%
Not aware	12	48%

Table 4.12 shows that 48% of respondents, feel that directors are not aware of their duties and obligations. The argument here is that most companies do not put an emphasis on educating their boards on these obligations and duties. They take it for granted, that, when people accept appointments as directors, they know exactly what is expected of them. 100% of African respondents felt that at times, it was a deliberate attempt, by established partners of empowerment companies, to thrive on the ignorance of the other black directors, who are not aware of their duties and obligations. They are new entrants in this game. Other directors, 40%, felt it was the duty of any aspirant director, to make sure that they understood and appreciated their duties and obligations. 30%, of the respondents felt that most directors have been around far too long and have not made it their effort to become current with their duties and obligations, as enshrined in King II Report (For example).

THEME G: APPROPRIATE STEPS FOR ENSURING THAT EACH AND EVERY DIRECTOR IS AWARE OF HIS/HER DUTIES AND OBLIGATIONS IN TERMS OF CORPORATE GOVERNANCE AND EXPECTATIONS OF STAKEHOLDERS.

All respondents think that the directors must undergo extensive training, on their duties and responsibilities. The King 2 Report, on corporate governance, should be by law, a compulsory training module during induction of directors. Furthermore, refresher courses were appropriate and would be a welcome development. Duties, obligations

and responsibility of directors should be part of an ongoing discussion and an issue at board meetings.

THEME H: PERCEIVED STRENGTHS AND WEAKNESSES OF THE PRESENT BOARD/S IN TERMS OF STRUCTURE, SIZE AND MEMBERSHIP.

Most respondents think that most boards are too big and consist of many directors who are not committed. Moreover, the nature of the structure is biased towards white males. Most Executive directors are White males. In fact, this is also applicable to non-executive directors. This also, negates the size and membership of the board. Furthermore, this encouraged "passengerism" if the board was too big. The tendency is to flood boards with black non-executive directors, who don't wield much influence, nor have insight into operations, which, is normally found in executive directors. Black executive directors are in the minority, in comparison to non-executive directors. Real power lies in executive directors, who are in day-to-day control of companies. The need for demographic diversification in board membership at both executive and non-executive director level, can no longer be overemphasised, more black executive directors are needed.

THEME I: BLACK DIRECTORS IN BOARD/S

Table 4.13: presence of black directors in boards

RESPONSES	FREQUENCIES	PERCENTAGE
YES	25	100%
NO	0	0%

Table 4.13 shows that 100% of the respondents agree that there are black directors in their boards. The main motivation for having black directors is to undo the imbalances of the past, since it is perceived that Blacks are the future in the economic strength of this country. It is not only based on the levelling of the playing fields, but unleashing the full economic potential of the country by harnessing all available talent and resources.

THEME J: EQUITY IN BOARD/S OF DIRECTORS

Table 4.14: Gender equity in board of directors

RESPONSES	FREQUENCIES	PERCENTAGE
Yes, there are women	25	100%
No, there are not	0	0%

Table 4.14 shows that 100% of respondents agree that there are women in their boards of directors. The unfortunate part is two fold – there are too few women who are directors. Most companies have only a lone female on their boards. In the U.S. of the Top Fortune 50 in the early 90's, 54% of companies had only one woman on their board and 30% of the companies had no woman on their board. Mind you, this is happening against the activist campaign to increase the representation of women in boards having started in 1970 (Feminist Majority Foundation – 2001). This is found in most boards in South Africa; particularly the Business Times Top 100 companies. It is doubtful, whether women represent more than 10% (we are being generous – Institute of Directors refuse to give this information). Although women have made inroads into U.S. middle management, the senior levels of corporations remain exclusively male domains. In the early 90's only 5.6% of Fortune Service 500 directorships were held by women and 4.5% of Fortune 500 (Feminist Research Centre 2002). Furthermore, what is disturbing is that some women dominated the South African boards (same faces). This was equally true even in our sample. Women directors in some instances are busier than their male counterparts. (One lady in our sample is holding 9 directorships): Borrowing from 1995 (catalyst census on female board of directors study "Certain Estimable Women" take up an unusually high number of the seats held by females. This is a trend very much in evidence in South Africa; we believe there are many good women out there who need to be roped in to these boards.

To date, we have a limited pool of outstanding women, who are unfortunately monopolising boards of directors. What happened with the male domination of boards by few individuals should be nipped at the bud. There must be more women out there who are savvy, competent, and strong and could be an invaluable asset to any board. White, Indian and Coloured female directors seem to be out numbered by their African counterparts. Whilst black female directors are still very small, they far exceed the other racial groups. Minority representatively, which took U.S. Corporate boards by storm in the 70's – (though proving to be a damp squibb in the long run) seem to be now obtaining in South Africa. Off course, in South Africa it is the other way around, not minorities but the majority that has been excluded.

4.6: COMPENSATION OF DIRECTORS IN BOARDS. THEME A – HOW DIRECTORS ARE COMPENSATED

The compensation of directors is different and varies from board to board. All boards across sectors tend to compensate directors in terms of size, number of meetings and length of meetings in which a member participated. The other boards compensate

directors on a monthly or quarterly basis, irrespective of the number or length of board meetings. The rationale being that directors remain directors who must still carry their fiduciary duties and discharge their obligations at meetings and outside meetings. They remain directors at all times during their term of office. "*Exercising their duties and obligations does not end with board meetings*" (Reddy Vivian 2002) 30% of all respondents were paid per meetings in our sample.

An equal proportion of respondents 30% were compensated in the form of board fees per month or quarterly.

20% of the respondents indicated that the number and the length of meetings attended determine their compensation.

10% of the respondents were compensated only for subsistence and travel costs. This was relevant to non-profit organisations and municipal entities.

It might just be opportune to briefly look at alternative bases of remuneration, which has wide spread options and may have relevance to non-profit bodies.

These are:

- No Remuneration
The option is based on the premise that participation in the board is voluntary. The following risks however are pretty obvious:
 - The board may not attract non-executive directors of the calibre and credibility it requires.
 - The level of commitment offered by individuals may not be satisfactory.
- Symbolic fees
 - The payment of a symbolic fee recognises that individuals offering their skills and experience be remunerated at a nominal amount.
- Compensation for loss of income
This recognises that individuals offer their skills and experience at an opportunity cost and on this basis aims to compensate them for income they would have lost in return for their services.
- A combination of symbolic fees and compensation for loss of income.
This is a middle ground between nominal fee and partial compensation of loss of earnings.

(Reproduced from Manase Associates Document – titled “First Draft Report on the preparation of shareholders policy with respect to remuneration of board members of municipality funded entities”)

The following is a summary of the relevant principles extracted from the King II Report:

- Non-executive directors should be individuals of calibre and credibility, and have the necessary skill and experience to bring judgement to bear independent of management, on issues of strategy, performance, resources, transformation, diversity and employment equity, standards of conduct and evaluation performance.
- Levels of remuneration should be sufficient to attract, retain and motivate executives of the quality required by the board.
- The practice of paying non-uniform fees to non-executive directors should also be carefully considered. The level of fees should preferably be determined according to the relative contributions of each non-executive director and their participation in the activities of the board and its committees.

The question we should be asking:

- Would the companies paying only for subsistence and travel costs attract the right calibre?
- Would they attract retired White executives who were rich?
- How does this impact on maximising and harmonising all stakeholders' interests?
- Can we afford to exclude people who are poor from these boards?
- Who has what it takes?

The remaining 10% of the respondents is divided equally among those who claim that they are compensated relative to size of company, poorly compensated, compensation dependent on attendance of meetings and only after director's reports have been read; and no compensation for non-executive directors.

THEME B – WHERE DOES THE COMPENSATION DECISION FOR DIRECTORS LIE?

Every publicly owned corporation should have a committee comprised solely of independent directors that addresses compensation issues. This compensation committee is at times called remuneration committee whereas in some companies it is called compensation committee. Three of the companies in our sample Company A, C and E had remuneration committees, whilst Company B and D did not have these committees. In company B, the executive committee dealt with the matter. In company D, the municipal entity, the HR committee dealt with the issue of compensation. Compensation or remuneration committees have two interrelated responsibilities: overseeing the corporations overall remuneration regime and setting CEO and Senior Management packages.

40% of our respondents said remuneration committees decided on the compensation of directors in their boards.

30% said the full board decided.

10% said the Minister responsible or, MEC or executive committee of the municipality decided.

10% said management of the parent/holding company (who are directors of the subsidiary) normally takes the decision.

The remaining 10% are divided equally among those who responded: Human resource committee and shareholders decide on this and those who had no idea whatsoever.

The critical importance of director compensation cannot be overlooked or deferred to the sidelines if boards are to be effective and deliver to stakeholder groups.

4.7 EFFECTIVENESS OF THE BOARD OF DIRECTORS

THEME A: CRITICAL FACTORS IN BOARD EFFECTIVENESS

In summary, this question generated wide-ranging responses.

Overall, the most frequent factors mentioned were those, which emphasized the responsibilities of the board as far as their leadership roles, is concerned. It was strongly suggested that they are expected to be the leaders of the company's strategy and provide clear strategic direction.

Second to that, was the need to possess business acumen, especially financial (e.g. be conversant with financial statement, which are the main indicators of the business performance). This should be underlined by a full understanding of the business in which the company was operating, their markets and products. Monitoring performance

and achievement of strategic objectives and providing necessary support for the realisation of stated strategic objectives. Further thereto were various positive traits or characteristics expected from board members. These ranged from integrity; honesty and transparency, objectivity, decisiveness, accountability, credibility and diligence. Commitment and protecting the best interest of the company and improving the triple bottom-line, which includes economic social and environmental performance.

THEME B: FACTORS THAT MAKE OTHER BOARDS MORE EFFECTIVE THAN OTHERS

Table 4.15 Factors contributing to effectiveness

ACTIVITIES	RANK
Accountability	1
Strategic Direction / Independence	2
Transparency, Stipulate objectives/understanding	3
Social responsibility, Monitor activities and objectives	4

Table 4.15 shows that respondents think that accountability is the most important factor that makes a board more effective than others. The next most important factors were giving a clear strategic direction and independence followed by stipulating objectives. The last in ranking order is social responsibility and monitoring activities of strategic objectives. The measurement of effectiveness of the board is determined by the quality of questions they asked in the meetings; their attendance of meetings; continuous interaction with the chair and with each other's; through accountability and transparency. Understanding the business, the sector, the product and the market also featured prominently. Although the above methods are used to measure the effectiveness of the board, it should be measured through the following methods:

- Company should achieve revenue targets as set out by the board.
- Accountability to shareholders.

THEME C: HOW SHOULD BOARD EFFECTIVENESS BE MEASURED?

While there was a number of respondents who did not respond to this question, most of those that did respond, pointed to measuring effectiveness by gauging the performance of the company. Was it reaching its revenue targets? Were its strategic goals being met?

THEME D; SIR CADBURY STATEMENT ON CORPORATE GOVERNANCE

The basic Governance issues concern the effectiveness and accountability of the Board of Directors. How well do boards run their companies and how they can be encouraged to run them better.

Table 4.16: Participants opinion on the statement by Sir Cadbury.

RESPONSES	FREQUENCIES	PERCENTAGE
Agreement	20	80
Do not agree	5	20

Table 4.16 shows that 80% of respondents agree with Sir Cadbury statement on corporate governance, whereas 20% did not agree. There are reasons for this agreement. They include that; there is a lot at stake for the shareholders who can only be protected by the boards. It is basically the main aim of all boards. Accountability, effectiveness and efficiency are key to success. For far too long directors have not been held accountable for the performance of the company or companies. They have been totally insulated and protected; they have been Lords and Gods unto themselves. However, today aggressive institutional shareholders have put the whole question of accountability and effectiveness in the forefront (Bowen, 1994). Board members now can be held liable for poor corporate governance. Board provides leadership and experience. The effectiveness and accountability of boards should be improved. Boards need to understand their accountability and their fiduciary duties in order to do an effective job of leading the organization. The importance of corporate governance lies in its contribution both to business, accountability, credibility, and transparency associated with the organization.

THEME E: BOARD EFFECTIVENESS AND OVERALL PERFORMANCE

(i) Does Board Composition impact on Board Effectiveness?

All respondents that responded to this question did so with a unanimous "yes". Their comments varied, but were by and large clearly suggesting that it will take the right people to produce the right results. The main response suggests that directors with the right skills, expertise, business acumen and commitment will bring positive impact on the boards effectiveness. It emerged by way of suggestion that non-alignment of certain members of the board can have a detrimental effect on the reaching of decisions. A further suggestion was that issues of race, gender and religion are addressed if the board is properly composed. Another response

cautioned against boards composed of too many people possessing same skills, e.g. accountants, as this provides a particular slant on the business

(ii) Relationship between Board Composition and Overall Performance.

The overriding factor in board effectiveness according to all respondents without exception must be reflected in the overall performance of the company as measured in the shareholders wealth created.

In short the quality of the board makes the difference.

84% of the respondents were very positive that there was a direct relationship between the composition of the board and overall performance. Whilst 16% thought there was no positive or direct correlation between composition and overall performance of the company.

It is very significant that the 16% that didn't see any relationship between the two were executive directors in their companies. There is an indication that whenever the executive directors felt their power or/and position threatened tended to adopt a defensive stance.

Their argument is supported by notions that management at the end of the day has a sway and more impact than non-executive directors. Depth of skills and day-to-day operations are located in executive directors (management), which enhances the overall performance of the company. However, there was a strong case for a relationship between composition and overall performance, despite executive directors assertions.

Well-governed boards, which comprises of competent people and individuals whether non-executive and/or executive directors always show consistent results. A board composed of individuals with necessary but varied and critical skills and disciplines can enhance the overall performance of the company. The board furthermore plays an important role in the determination, implementation and monitoring of the strategic direction of the company. A proactive and effective board reviews results and demands performance from the CEO/managing director and members of top and senior management. Most respondents agreed that a weak board would be unable to provide strategic direction, which would impact negatively on the performance of the company. It was the board's prerogative to approve the organisations strategy and ensure control over its implementation. In a nutshell and the majority of respondents (84%) agree effective boards create highly successful companies. It is also true that boards cannot substitute for the required quality and motivation of the fulltime management but cannot

abdicate their responsibility and role in the strategic direction, approval of strategy, monitoring the performance of the CEO's and speed of implementation.

There can be no de-linking the composition of the board and overall performance of the company. However, with the triple bottom-line concept performance measurement cannot be limited to financial measures like return on equity and earnings per share. The balanced scorecard – measures that drive performance as expounded by Robert S Kaplan and David P Norton (Marvin Bower Professor of Leadership Development at the Harvard Business School and founder and President of the Renaissance Worldwide Strategy Group – Boston USA – respectively).

This leading edge performance measurement gives directors and top management a fast but comprehensive view of the business. The balanced scorecard includes financial measures that tell results of actions already taken. These are complimented with three sets of operational measures having to do with customer satisfaction, internal processes and the company's ability to learn and improve – the activities that drive future financial performance (Harvard Business review on measuring corporate performance – Harvard Business School Press 1998).

4.8 EVALUATION OF BOARD OF DIRECTORS

THEME A: EVALUATION OF DIRECTORS ON THEIR PERFORMANCE

Table 4.17: Evaluation of directors' performance

RESPONSES	FREQUENCIES	PERCENTAGE
Yes, there is performance evaluation	0	0%
No, there is no performance evaluation	25	100%

Table 4.17 shows that 100% respondents reported that there is no performance evaluation of directors across all sectors. There are a number of factors, which cause lack of performance evaluation among directors. These are; directors within boards that are too scared to be evaluated. There is no incentive towards the evaluation of directors. Whilst the question on how directors should be evaluated is an important element, there seems to be some reluctance to do so. A number of issues arise: should performance appraisals be formalised and become part of this effective management style? Should the senior employees participate in the evaluation of the Chief Executive Officers or not? The non-executive directors, should they be evaluated by their active presence,

participation at meetings, or/and contribution to the bottom-line? How should these be measured? Who should evaluate them?

Whilst there was no performance evaluation of directors our respondents felt that with such negative developments in the corporate world particularly the demise of Enron, World Com and others in South Africa such as Leisure Net, Regal Bank to mention a few, the need for the evaluation of directors performance should be central to effective corporate governance. A number of other reasons are advanced such as:

- This is a new development but necessary as passenger directors are of no value
- Old outdated systems, which put the onus on the performance of executive management, should be done away with.
- Non-executive directors had it easy in the past
- Evaluation of directors would ensure superior performance

4.8 SHAREHOLDER ACTIVISM

THEME A –VIEWS OF THE RESPONDENTS

28% of the respondents responded to this aspect whilst the balance was non-committal and made no comment whatsoever.

Whether this has to do with headlines in the Business Media in South Africa such as:

- "Shareholder Activism is still limited in South Africa"
- "Activist asset managers may shoot themselves in the foot"
- "Investors declare war on directors"
- "Shareholders have had enough of sitting back and waiting for results"
- "Shareholder activism issues come thick and fast these days"
- "Activism bug could bite" etc.

The subject of shareholder activism seems to be taboo and controversial.

However, all the respondents that expressed their views, were very positive believing that it was a healthy development as long as it remained rationale and constructive and not interfering with executive responsibilities. They felt that for too long South African institutional investors had been passive preventing minorities from being proactive in the midst of inactive and/or reactive institutional investors who were all powerful and very influential.

The dramatic events such as Enron abroad and closer home, Profurn, Comparex, Primedia, Kersaf, Durban Roodepoort Deep, Regal Private Treasury Bank, Unifer,

Macmed etc. have activated shareholders from their passive yolks. Respondents actually said *“Given what we see in the world today, shareholders must become activists”*. Shareholders must demand to be fully informed, briefed continuously by the chair and the CEO of the company.

THEME B: WHY SHOULD IT BE ENCOURAGED?

Respondent's comments revolved around:

- to keep the boards on their toes, not in their laurels
- shareholder activism brings in new perspectives direct from shareholders with vested interest
- to ensure accountability of management
- leaving absolute trust to management has proven extremely dangerous
- to reduce and minimise risk to shareholders, depending on what is at stake.

THEME C: OUR OBSERVATIONS

Clearly shareholder activism is on the ascendancy. The underlying factors for such activism seem to lie when things go wrong or perceived to be moving in the wrong direction. Piet Viljoen, the Chief Investment strategist at Investec Asset Managers seems to underpin this observation when he says *“The changes have less to do with renewed shareholder activism than with shareholders taking action in a bear market, where shares are under performing. In some cases companies are sitting on piles of cash”*. Empirical evidence conducted in USA indicates that shareholders are most vocal when the market is bearish – this has however not stopped even during times of economic boom. The pressure on boards to truly hold management accountable, to exercise strong oversight and to increase shareholder value has been quietly building during a time of economic growth. What will it be like when the next recession actually hits us? The next recession in US is certain to come sooner or later – economics assures us of that (Ward Ralph D 21st Century Corporate Board – 1996).

It is also clear that this activism is led mainly by institutional investors, Adele Shevel and Gaenor Lipson writing in Business Times June 23, 2002 had this to say *“Shareholders in South African companies are finally digging in their heels and calling for action to get value out of their investment. Long lambasted for being passive participants in companies, more inclined to walk away from a dud investment than do anything to*

change the status quo – institutional investors called for and in one case achieved change this week”.

Allan Gray Asset Management, Active Value (UK based investor) Investec Asset Management, are few examples of institutional investors who have been leading this activism in South Africa in recent times. 15 years ago, the shareholders upheavals would have been unheard of, particularly from private pension funds and mutual funds, but, with the rude awakening of shareholders value destruction –institutional investors world over seem to be everywhere at once, going public, compiling figures, granting interviews, lambasting directors and in fact asking for a shake-up in boards – replacing incumbent directors with their own representatives. *“Board performance today is now being handicapped as closely as CEO’s quarterly results. The boards pay perks, size and structure are being studied carefully as share price for indicators of the company’s prospects”* (Ward 1996).

This interesting development of shareholder activism raises a number of pertinent questions:

- Should board representation be in line with shareholding structure (shareholder activists are demanding board seats)?
- Whose interests are these activist representatives representing in the board? Are they representing the best interest of the company and all shareholders? Is this possible?
- What about the possible conflict of interest that may arise? Is this in conflict with the groundbreaking judgement by Justice Boschof in Cohen versus Segal? *“They (directors) occupy a fiduciary position towards the company and must exercise their powers bona fide solely for the benefit of the company as a whole and not for ulterior motive”* Max Gebhardt of the Business Report arguing on this point say and we agree that what the learned Judge was saying was that directors were appointed not to be servants of shareholders but servants of the company. This fiduciary role is given credence in the King II Report on corporate governance, which says directors must act in the best interest of the company and never for any sectoral interest.
- How will this concerted effort to have major shareholder representatives as directors impinge on the desirability and/or requirement for the demographic reality of South Africa to be reflected in boards and top management (Employment Equity Act)?

Whilst shareholders activism is most welcome it raises a number of fundamental questions in the corporate governance web.

4.9 CONCLUSION

The results and findings were presented and evaluated. The presentation of the characteristics of respondents comes first followed by the presentation of results according to the aims of the study. The results are presented in tables and graphs as well as in the form of theme analysis. The findings of this research are presented according to the results of the study in this chapter and literature search and review of the model in Chapter 2. The latter, was carefully and systematically executed according to a plan that involved document analysis. This was conducted in order to derive valid conclusions about the findings. The findings in this study are discussed according to the aims of the study. The respondents are all directors in different sectors mainly domiciled in KwaZulu Natal (KZN), some of the directors serve in boards outside KZN.

The findings of the study show that all sectors need to develop guidelines that will help in developing and maintaining effective boards of directors. The guidelines and recommendations to be developed are based on the findings of this study.

CHAPTER 5

CONCLUSION AND RECOMMENDATIONS

5.1 INTRODUCTION

The study has clearly indicated the critical questions to be answered, as well as, aims and hypotheses of the study. It also indicated the enhancing of the correlation between the composition of the board of directors and board effectiveness. The qualitative and quantitative approach used in this study gives an advantage, because, it is a small sample that needs thorough data analysis. Data collection method shows that the document analysis provided information on private, public, parastatal, municipal entity and black economic empowerment companies; as well as responses from questionnaires and follow-up interviews conducted. This allowed the researcher to gather as much data as possible. The analysis of data yielded valuable information that was analysed and presented elsewhere in the write-up. We, focused on the Kings Report recommendations, as well as, the major elements of the composition of boards particularly the distribution of power within the boards, the roles of different components in the distribution, such as chief executive, the non-executive director etc.

5.2 COMMON OBSERVATIONS

The findings of the study show that all sectors of employment, be it in a publicly owned, privately owned, government owned, at national provincial or local level and/or black owned need to develop guidelines that will help in developing and maintaining effective boards of directors. There is no question that there is a link between the composition of boards of directors and board effectiveness. In short, how boards are composed, who serves in the board will one way or the other impact on the effectiveness of the board of directors.

Whilst our case study analysis adopted a comparative approach amongst the five entities i.e. Publicly owned (listed), privately owned (unlisted), municipal entity, black empowerment and parastatal (government owned) companies, there are and will be guidelines that are equally relevant and applicable to all sectors without question.

It is also equally true that certain models/guidelines would predominate in one sector or find more relevance than in other sectors. We have found that there may be compelling reasons for a different approach/model or guidelines for a particular sector. William G Bowen in his book "Inside the Boardroom" his words are instructive, "*A recurring question is which principles and propositions have some claim on universality and which*

are lightly specific to particular sectors or even to particular organisation in a given sector at a point in time”

Our view and conclusion is that trying to impose a uniform model and guidelines such as predetermined size of the board can seriously impact negatively on the effectiveness of the board. This finds resonant from the words of a leading Canadian board consultant – Michael Burns, when he says, *“There is no simple “right-way” to structure your board right. The design must reflect the maturity of the organisation and its future needs. The assumption that all boards are alike, that all organisations have the same needs and that they all just have to practice good governance is problematic because this is not always the case.”*

However, we need to reiterate that there are certain minimum requirements and/or guidelines that each corporate, be it listed or unlisted, privately or publicly owned, individually owned or government owned that must be met irrespective of the sector.

It is important to say that whilst the King II Report was acceptable to all our respondents the major problem is that it is voluntary and not enforceable by law. Ours is thus not to rehash its recommendations but to add value to them and give some teeth in a meaningful way based on the findings of the case analysis. Whilst acknowledging that ours has neither been final nor exhaustive, requiring further research in many areas the following recommendations are formulated.

5.3 STRUCTURES AND SIZE OF THE BOARD

The board design or structure should reflect the boards' stage of development. Many organisations have been caught up in the traditional/versus the Carver Model. What is crucial and important are the needs of the organisation as pointed out by Michael Burns elsewhere in this write-up. The needs of a small privately owned company may be different from a publicly listed conglomerate. No imposed uniform structure can work for all companies. The structure that best delivers your corporate strategy is the route to take.

This applies to size. However, we believe that board of directors should not be church choirs, even with publicly owned conglomerates where +15 board members tend to be the order of the day. An analysis of these boards show that managing directors or/and chief executives of the subsidiaries are also directors of the main board e.g. Company E in our sample. We find that only the CEO, finance director; human resource director should be a member of the main board with the rest being in attendance. They should

not be members of the board. They should remain members of the boards of their divisions and/or subsidiaries. Given this approach we believe that a maximum number (size) of the board of directors should not exceed 15 directors especially in publicly listed and parastatal companies, (with varied expertise, perspectives, skill, experiences, demography required). In unlisted – privately owned the size requirement might be less and different e.g. private unlisted companies should not exceed 8 directors. Michel Blumenthal quoted elsewhere – says *“Twelve to fifteen is best for most corporate boards – certainly at 18 – 24, real group cohesion, interaction, debate and collegiality became impossible – in my experience at least as a rule if there are more than 24 members the sheer size of the board erodes its effectiveness”* Board structures should combine the detailed knowledge of executive directors with under exposure of independent director (outside directors) either separately through a two tier board or together in on a unitary board. Unitary boards predominate in S.A., UK and US. An area for further research might be which model is appropriate? Is our unitary model more effective than the other? (Two tier board system found in Germany for example) Why is that the case if its so?

5.4 SELECTION PROCEDURES FOR BOARD OF DIRECTORS

In line with the King II Report recommendations, procedures for appointments to the board should be formal and transparent and a matter of the board as a whole. A nomination committee must assist the board. A new committee of the board that must be mandatory for all companies without exception. The nomination committee, a new concept in South Africa, must be part and parcel of the boards' committee system. Non-executive directors only should constitute the nomination committee. The independent directors should be in the majority of the non-executive directors. The chairperson of the main board must chair this committee.

People selected to serve on boards of directors should have relevant business and/or industry experience that is beneficial to the board as a whole. Directors with such varied backgrounds can provide a useful perspective on significant risks and competitive advantages and an understanding of the challenges facing the business. The companys' need for particular backgrounds and experiences may change over time. The board should continually monitor mix of skills and experience of its directors in order to assess at each stage in the lifecycle of the company whether the board has the necessary tools to perform its oversight function effectively.

The oversight function of the board of directors depends on its independence from management. Board independence depends not only on directors individual relationships – personal, employment of business but also on boards overall attitude toward management. The independence of directors must be in both fact and appearance. Director or/and board independence has an advantage of helping resolve conflict of interest and ensure objectivity in the board decision-making, this also gives breadth and depth in the scope of debates on such matters as strategic vision and the under external question with which the board deal. In selecting board members care should be taken to avoid “incestuous” relationships and to preserve a certain amount of distance between board members and chief executive officer (Allen William 1992)

Whilst we have attempted to provide a guideline on who should serve on the board, it is important to overemphasise not only the general agreement that boards should have a majority of independent non-executive directors but it is advisable to note that there are few if any formulaic solutions to selection guidelines, nor issues of governance. We should be ready to hear the case for an exception of anything purporting to be an overriding principle (Bowden 1994). However, experience has shown and taught us that it is possible even necessary to have in mind what we call presumptive norms – propositions that should govern the size, composition and functioning of the boards unless there is a convincing case for consciously setting aside in a particular context (Kurtz Daniel L 1988).

Furthermore, the question of gender equity, diversity and/or racial balance is critical in the selection and composition of boards. The recommendations on these issues will be dealt with later in the chapter.

Finally how many directorships should one individual hold? We believe there should be a limit on the number of directorships that an individual can hold, especially in listed and parastatal companies. A number of studies have indicated that having more than 5 directorships (listed companies) is asking for too much. Accountability is compromised. The National Association of Pension Funds in the UK and The Association of British Assurers have recently recommended that the executive directors be allowed to hold only one (non-executive) directorship and that non-executive directors be limited to a maximum of such 5 positions.

5.5 INDUCTION OF NEW DIRECTORS

The board should have an induction programme to familiarise all incoming directors with all aspects of the company including their fiduciary duties and responsibilities. There must be some form of examination or individual assessment to determine directors' knowledge of the company, its strategy and objectives, all issues pertaining to corporate governance, including King II Report and other relevant international developments. New directors with no or limited board experience should receive development and education to inform them of their duties, responsibilities, powers, obligations and potential personal liabilities in the conduct of the board or company. Courses such as The Graduate Diploma in Company Direction offered by The Graduate Institute of Management and Technology in conjunction with The Institute of Directors is very relevant. It covers the following:

- Corporate governance, duties, responsibilities and liabilities of directors
- Strategic planning for the board –corporate reputation and branding. Ethics and leadership.
- Finance for the board – director development
- Strategic risk and policy issues

The programme is aimed at director development and designed to be a leadership planning and board succession tool essential to every corporation.

We believe that such courses should be recommended for new directors and those who are out of date. The Black Management forums director development course is highly recommended.

Furthermore, due to the dynamic nature of the corporate environment in which companies operate it is important to have annual updates on the developments in the area of corporate governance and legislative changes impinging on board's for all directors. Corporate governance issues including duties, responsibilities and obligations should be part of an ongoing and structured discussion for the whole board not an after thought and/or fashion fad that is taking board of directors by storm, King II Report says *"Directors have awesome responsibilities and they must be properly prepared to carry out their duties"* These words are most relevant, instructive and should be taken seriously by all directors, new and old.

5.6 DISTRIBUTION OF POWER IN BOARDS

Where should the power in boards lie?

5.6.1 Chairman's' Role:

Chairman and chief executive position should be separated and not be held by one person; unfortunately this requirement is not enforceable by law in South Africa as we indicated in Chapter 2. Our recommendation is that in South Africa this should be a listing requirement. We are conscious that this might not be suitable for owner/managed private and unlisted companies. However, when the company lists it must be forced to have the two positions separated:

- The chairman of the company must be an independent non-executive director with no direct or/and indirect relationship with the company.
- An independent, outside unrelated non-executive director should only be considered for the chairmanship of any publicly listed company.
- Secondly, the chairman of the company should not be drawn or selected from immediate past chief executive of the company.
- Former chief executives may be eligible for chairmanship after at least a minimum of 5 years complete break with the company after their retirement as chief executive. All these guidelines are put in place to enshrine the critical importance of the independence of the board, thus its effectiveness.

5.6.2 The Chief Executive

The split between chairperson and CEO roles is now well understood, accepted and documented. However, no formal research seems to have been done on the optimal tenure of the CEO or the chairperson for that matter making it an excellent topic for further research.

However, our view is that:

- The term of office for the chief executive should be limited to 7 years. King II Report is silent on this issue.
- Secondly, a retiring chief executive should not be appointed as a non-executive director or chairman of the company for reasons also stated in Chapter 4.
- The new CEO should feel free to use his/her predecessor as a consultant, drawing from the experience, wisdom and wealth of knowledge.

It is important to emphasise that the most important task of the board is the choice of the chief executive and the establishment of an effective relationship is even more important (Carver 1990).

We cannot underestimate; the critical, central and crucial role played by the chief executive and as such King II Report recommendations on the chief executive should be endorsed. *"The appraisal and remuneration committee to guide it in its evaluation of the performance and remuneration of the chief executive officer."*

A powerfully designed CEO position is a key to board excellence. It enables the board to focus and avoid the intricacies and short-term focus of staff management and to work exclusively on a holistic long-term focus of governance (Deakin and Hughes 1997). Given the board's oversight role, shareholders should not expect the board to micromanage the company's business by performing or duplicating the tasks of the CEO and senior executive management. Chief executives in South Africa are predominantly white males and neither King II Report, NAFCO's, BMF and Black Economic Empowerment Commission Report, pronounce on this particular aspect. They say nothing on targets for blacks to be chief executives. They only pronounce on targets for executive and non-executive directors. We believe that black and female CEO's are too thin on the ground. A concerted effort through targets should be developed including the credible sources from which these can be drawn. A few black chief executives including white and black females have done very well right across the sectorial divide. Maybe they are there because they are exceptional and have broken fundamental barriers preventing their influx. Without much attention to this aspect – the drive to have the demographic reality of South Africa reflected from the top, to the lowest level, would be an elusive dream. Critical mass at the top is critical for an effective cascading effect down the line.

5.6.3 Executive Directors

There is a general agreement that there should be a balance in the boardroom and not an imbalance by the domination for example of one executive director or domination by non-executive directors. This is the cautious approach adopted even by King II Report. In South Africa, boards tend to be dominated by executive directors or/and inside non-executive directors.

If it is true that independence is a cornerstone of effective boards, we feel that independent non-executive directors (outside unrelated non-executive directors) should be in the majority. The majority of our sample concurred with this position although this view did not find favour with the majority of executive directors. A ratio of 4:1 in favour of non-executive directors is highly recommended. Executive chairman who are also

majority shareholders further complicates the equation in South Africa. E.g. Vivian Reddy of Edison Corporation, Raymond Ackerman of Pick 'n Pay, Don Ncube of Real Africa, Bill Venter of Altron to mention a few. For private unlisted companies it does not matter much e.g. Edison Corporation, but when the company goes public independent non-executive directors should dominate. This must be applicable to parastatals, provincial and local government funded companies. Whilst the selection, compensation and evaluation of chief executive is the single most important function of the board, the appointment and approval of other members of top management remain also the prerogative of the board of directors acting in concert with the CEO.

5.6.4 Non-executive Directors

Throughout our analysis we have attempted to show the important oversight role of the board, the relevance and sacrocanancy of independence for effective boards. It is agreed that directors should not represent the interests of any particular stakeholder except the best interest of the company. It is said and we concur that directors should;

- Maintain an attitude of constructive scepticism.
- Ask incisive probing questions and require accurate, honest answers
- Act with integrity
- Demonstrate a commitment to the corporation, its business plans and long-term stakeholder value (Deakin and Slinger 1997).

The boards' oversight function carries with it a number of specific duties, responsibilities, obligations and personal liabilities. The question is no longer whether they should be independent or not, because independence should be a given. The real question is how independent are non-executive directors in corporate South Africa. How long should they serve? South African boards are not only dominated by executive directors, but inside non-executive directors.

In South Africa we should be striving to increase the number of independent non-executive directors. Given that executive directors are a dominant factor in South African boards, we recommend that the proportion between independent non-executive directors and inside non-executive directors be 3:1, this would ensure the 4:1 ratio between non-executive directors as a group as against executive directors who should be in a minority.

Non-executive directors have two important functions. The first as indicated already reviewing the performance of the board and management. The second resolution of

conflicts when they arise in the company e.g. when a takeover is imminent there might be a conflict. Non-executive directors play a vital role in such situations there are many instances of such conflict such as company and/or management might over-inflate share value to encourage investment in the company. It might understate (or overstate costs) for tax savings for instance, it can amortise short-term operational costs/debts to improve balance sheets (Enron, WorldCom). Shareholders on the other hand might ignore environmental / social costs (Petro Chemicals, Cape Asbestos Mining, Union Carbide Chemical disaster in Bhopal India, Chernobyl Russian Nuclear Disaster etc.). engage in socially responsible but poor performing activities. Given all these possibilities, the independence of non-executive directors should not be undermined or the need thereof be under estimated.

All directors whether non-executive or/and executive are the same in the eyes of the law, despite the fact that non-executive directors are not in the day to day running of the company. What does this mean? To keep independence and/or capacity to ensure this independence.

One of the interesting aspects to examine in the future is whether non-executive directors can on the one hand join with management as part of a unitary board deciding on important matters of strategy and direction while on the other hand act as monitors of executive directors in the best interest of the company.

5.6.5 GENDER EQUITY AND DIVERSITY

Whilst, we share the sentiments expressed by King II Report on gender equity and diversity we are disappointed that there are no specific recommendations on targets. Statements such as companies should strive for adequate representation of women in top management and board levels have been said for so many years but nothing to show for it on the ground. The need for women and black participation in the economy can no longer be emphasised. It is a:

- Political imperative

- Social imperative

- Moral imperative

- Economic imperative

- Strategic imperative

This has long been paraded and understood; particularly that it makes business sense (Magwaza)

Our firm view is that this needs to be translated to mandatory plans and actionable targets over a defined period, with stiff penalties for non-compliance.

The National African Federated Chamber of Commerce and industry (NAFCOC) was the first black organisation more than 20 years ago to come up with targets based on a programme aimed at empowering and developing blacks in business. It further identified the role that the government should play in facilitating the implementation of the programme.

The salient features of the NAFCOC's programme for black economic empowerment relevant to our subject matter and popularly know as 3, 4, 5, 6 Programme are as follows:

The programme sets the Year 2000 as a target by such time:

- (i) 30% of seats of boards on companies quoted on the Johannesburg Stock Exchange (JSE) should be occupied by blacks
- (ii) 40% of equity should be held by blacks
- (iii) 50% of inputs sourced should be from black enterprises
- (iv) 60% of managerial posts should be held by blacks

No one needs to be reminded that these targets are not close to being achieved even in 2002.

This was followed by the black management forum (BMF) the Basotho Hat Formula in 1993.



The BMF resolved that within 7 years (by Year 2000) organisations in South Africa should have reached these desirable targets:

- 30% of non-executive directors should be black
- 20% of executive directors should be black
- 30% of senior managers should be black
- 40% of middle managers should be black
- 50% of junior managers should be black
- 70% of all supervisors should be black

80% of all trainees in any training and development programme should be black. None of these targets have however been achieved. All sectors of the economy remain dominated by white companies and white skilled people. Black penetration in sectors (in terms of ownership) of the economy is still mini scale. (Black Economic Empowerment Commission, 2001).

It should be clear that unless some form of punitive measures are introduced and linked to these targets no one would take them seriously.

The findings of BEEC allude to these BEE targets and confirm that the country is still far away from the goals that were set.

The BEEC recommendations will suffer the same fate as those of their older counterparts. I.e. NAFCOG and BMF targets. The difference between BEEC and the latter is that it is taken very seriously by the government of the day. Secondly whilst the BEEC was initiated by the BMF in the late 1990's it enjoys the recognition of the Black Business Council (BBC – an umbrella body of all black business and professional organisations) and most importantly the confidence of the President himself. Members nominated by the BBC serve in the Presidents Black Business Working Group. Finally, the overall recommendations of the BEEC are now subject to an intense discussion by the Cabinet Task team of the economic cluster ministries (finance, trade and industry, minerals and energy, public enterprise, telecommunications and technology) together with the Black Business Working Group.

Our stance is clear the BEEC recommendations on board composition should be made mandatory and statutory. However, companies would be given a grace to achieve these targets over a period of time, which would be discussed with all concerned.

The struggle for gender equality is a complex and protracted process. Whilst, statistics could indicate that much progress has been made in SA showing a number of black women being chairperson and/or chief executives and directors of leading institutions – the task of integrating women remains elusive, as indicated, few women have made significant impact. E.g:

- Wendy Luhabe – chairperson of Industrial Development Corporation (IDC), Vodacom and director of many companies
- Mrs Nomazizi Mtshotshisa – chairperson of Telkom and director of IDC and many others
- Gloria Serobe – chairperson of African Capital – formerly Metropolitan Life
- Dr Renosi Mokate – chief executive Central Energy Fund. (CEF)

- Mrs Zodwa Manase – chairperson of State Information Technology Company. Director of CEF and many other companies.
- Mrs Manana Nhlanhla – chairperson of Trade and Investment KZN (TIK) and Women Group in Energy and Director of many other companies
- Ms Monhla Hlahla – chief executive of the Airports Company.
- Ms Gugu Molo – chief executive – Umgeni Water Board -

These women are a class of their own, exceptional and talented. They have made marked strides in the corridors of corporate power. However, as the Hon. Minister Jeff Radebe (Public Enterprises) rightly pointed out in his speech – titled - “The leadership role of women in Public Enterprises” delivered on 16 August 2001 at the celebration of Women’s Day – *“But too often there is a tendency to seek comfort in statistics rather than interpret them merely as indicator of an unfinished task. The statistics show for example that number of women in top positions in management and the boardrooms of industry have improved from a pitiful situation “*. The dramatic percentage improvements are a far cry given the dismal base from which they spring. Even the rate of progress does not inspire confidence that the demographic reality would be reached in the foreseeable future.

There is a further complication, as there is a tendency to appoint the same black women in boards. (Even for that matter – white women directors such as Mrs E Le Bradley who is one of the most sought after directors who serves in a number of boards including blue chip companies such as Sasol, Tongaat-Hulett, Toyota etc.) These ladies are overburdened with responsibilities. Restriction on the number of directorships one individual can hold becomes relevant as alluded to elsewhere above. It is important to say that this restriction has nothing to do with the ability or capacity or willingness of the individual to carry out the duties, obligations and responsibilities. As Terence Craig (Chief Investment Officer – Frater Asset Management) says - *“The Rationale is obvious – no matter how competent, an Executives’ Effort (Directors or individuals effort) becomes diluted by representation on too many boards.”*

This malaise has afflicted former black politicians too. Drawing directors predominantly from a singular base (e.g. early retired politicians or non profit and academic background or community involvement) raises eyebrows. One of the criticisms of such appointments is that most or some of these new incumbents are without a comprehensive business background, resulting in their marginalisation.

The tendency of appointing lone black voices in some leading SA companies should be avoided too. Some board of directors have one black male or one black female or one white female as a director. If this is not dangerous it is tokenism at its height. In isolation, one or even two such board members often are not in a position to exercise great influence. A group of three or four likeminded board members however can more easily make their views known. They can make a difference and that counts.

Ensuring that board members are both diverse, in a broader sense of the word and effective is a worthy goal but difficult to assess. Board of directors as the representatives of shareholders with responsibility for oversight of top corporate management have a special obligation to ensure that the board is adequately diversified. Board diversity helps assure that the voice of all the companies' stakeholders are adequately heard and that no one segment of the population disproportionately dominates the thinking in the corridors of corporate power and that fresh insights from varied viewpoints can be placed on the table at the highest level.

Union representation, directly in companies not through trade union investment companies that are mushrooming is an issue we have not explored. However, prominent former trade unionists are making inroads into boardrooms, (e.g. immediate past president of National Union of Mineworkers (NUM) Mr J Matlatse serves in many boards including Anglo Gold). There are many others like Marcel Golding who has exchanged their union battle garb for twin striped business tuxedos. Can workers afford to have some of their incumbent officials as board members in companies in which they are employees? What if pension and provident funds appoint workers and/or their officials to the board as their representatives? Undoubtedly this is another area for further investigation.

The limited pool of directors in SA cannot be countenance if we are serious about unleashing the full potential of our country. Companies serious about their survival, success and long-term sustainability will take bold steps without any mandatory and/or legislative prodding to implement gender equity and racial balance on one hand and diversity on the other.

5.6.6 BOARD COMMITTEES

Committees of the board or board subcommittees are a must to facilitate effective decisions making. Their importance can no longer be over emphasised to ensure board effectiveness.

The King II Report has recommended the establishment of audit and remuneration committees. King II Report when appropriate sights nomination committees without defining what is appropriate. We believe this is a glaring shortcoming, which cannot be overlooked.

We, therefore recommend that a nomination committee be a legal requirement for any company that intends listing, or that is a listed, parastatals, provincial and local government funded entities.

Furthermore, we believe that a corporate governance compliance committee is central to effective corporate governance.

In some organisations, such as, Durban Investment Promotion Agency and other conglomerates the functions of the corporate governance compliance committee is part of the audit committee and referred to as audit and corporate compliance committee. Whilst, this is a welcome development, which suggests that at least corporate governance compliance is receiving attention, we believe that the importance of corporate governance compliance and its impact on board effectiveness requires serious and separate attention. It must be treated and dealt with in its own right and not drowned in equally important audit issues. Ralph D Ward in his article – “New committees for a New Century” puts it so well when he says - *“Corporations may find that the increasingly strict demands of governance reform are too serious to be imposed on the traditional committee structure. Such tasks as shareholder liaison, succession planning and board CEO evaluation are delicate, prone to management influence and have serious long-term consequences for the company. Adding them to the roles of audit, nominating and compensation committees may be more efficient but will the ultimate result be as good? Also dividing governance matters among several committees, even with tight chartering process will increase overlap and turf disputes, more companies are discovering the value of distinct corporate governance committees”* We concur and support unequivocally. Corporate governance compliance committee would ensure that strong corporate governance structures and mechanisms are in place and that they are constantly reviewed to reflect internal corporate changes, legislative changes and national and international developments in relation to corporate governance.

One other issue that is relevant is the use of non-directors as members of the board committees. We are warming up to this idea, despite King II Report’s cautious approach on it. King II Report says – *“Board committees should as far as possible only comprise*

members of the board. It may be necessary where certain board committees fulfil specialised role, to co-opt specialists as permanent members of such committees but this should be the exception rather than the rule and they should comprise a minority within the committee.” Our attraction to the utilisation of outsiders in board committees is not limited to the specialised perspective that they might bring. The committees could be used as a training ground and a pool for new directors, especially for females and blacks. They would get exposure to the workings of these board committees and gain the necessary experience to qualify for full board membership. They should be used as a breeding ground for new fully-fledged board members.

In conclusion we tend to agree with William G Bowen in his book “Inside the Boardroom – Governance by Directors and Trustees” when he says *“Whatever the size and the structure, a cardinal principle is that committees should report to the board as a whole and should not abrogate to themselves decision-making power. Committee structures should reflect the needs of each organisation and should facilitate the exercise of independent judgement by outside directors, including the nomination of new directors”*

5.7 COMPENSATION OF BOARD OF DIRECTORS

King II Report recommendations are very clear and concise in relation to the compensation of directors.

Directors' emoluments have always revolved around five contentious issues:

- Level of pay
- Full disclosure
- Form of payment
- Link between level of pay and performance
- Should non-executive directors be paid in the same way as executive directors?

Whilst King II addresses some of these issues the problems of compliance and enforcement are glaringly evident. The recommendations still do not enjoy the sanctity of law. Compliance and enforcement of most recommendations relies heavily on peer pressure and so called global market forces to ensure good corporate governance, adoption and implementation of the recommendations.

Off-course the JSE securities exchange does now require that all listed companies comply but with only certain aspects of King II Report as laid out in Schedule 22 of the JSE's listing requirements. Recently we have seen full disclosure of total

remuneration packages of the CEO's by some listed companies. Something unheard of 5 years ago. In-fact full disclosure of director's emoluments particularly executive directors was vigorously resisted in South Africa when the first King Report was in the making in 1994. The King I Report was even too soft compared to the UK where the Companies Act demands far more explicit disclosure of the remuneration of directors. The Cadbury report in UK says *"The overriding principle in respect to board remuneration is that of openness. Shareholders are entitled to a full and clear statement of directors present and future benefits and how they have been determined"*

However, despite JSE requirements, companies not complying with these requirements are not subject to any enforcement or/and sanction. What comes close to sanction may be an "embarrassment". The JSE securities require companies to spell out clearly in a statement the extent of its non-compliance with any principle in the code and the period during which this occurred. Companies are not required to state the reason for failure to comply nor the remedial action to be taken in future. It is gratifying to note that JSE has now made it a requirement for all listed companies to make full disclosure of directors total remuneration.

Performance linked compensation has gained currency. Such pay, it is argued align and reduces the direct need for monitoring. Whether shareholders are involved with the design of the reward system or not, which is a major assumption in this thinking is another matter because the evidence is contrary to this. It is, however, interesting that the majority of share options in existence reward outcomes, but absolve executives from poor performance. Evidence elsewhere in the world is abundant showing huge increases in executive pay but not matching corporate performance. Generally, the steady rise in director compensation that is becoming evident, at least in the last decade, is a good sign. It is indeed certainly an indicator of how boards have begun to matter.

We should regard this development as a sign of finally willing to pay for good governance. The fact that time demands on the boards are growing. The workloads and the dangers associated with being a director of a board, as a legal unit, have also risen. Corporate governance has brought on added responsibilities on the directors, and for their expected equal circumspection, they should be adequately rewarded.

The best corporate boards today just want to have it all, the very best executives and leaders, available for their boards, when they want them. Of course, technology is making this possible. The opportunity costs of these achievers being lost to the company are high and, therefore, adequate compensation should be in place.

The rewards received by directors should reflect the extent to which individually and collectively they are effective. Without clear objectives and agreed measure of the extent to which they have been achieved, it is not easy to determine the basis for remunerating directors.

Of late, it is becoming evident that a greater number of companies are becoming more open and are prepared to disclose in annual accounts more than the legal minimum concerning the compensation of directors.

Those boards that have non-executive directors should involve them in the review of the remuneration of executive directors. Non-executive directors should not be paid so little that they are not encouraged not to take their appointments seriously, nor so much that they become over dependent on them and hence less inclined to be independent and critical.

Stronger pressure must be applied to directors' particularly executive directors to be accountable for their pay.

5.8 BOARD APPRAISAL/EVALUTION

There is no question that the board of directors should develop performance appraisal systems that are easy to implement and cost effective. This will help in maintaining and improving productivity of the members of the board of directors.

An effective board should be self-critical. Whilst, the chairman should continuously monitor the effectiveness of the board, the board itself should be periodically involved in a review of its own activities, priorities and effectiveness. As the board is the "fount of leadership", it should have its functions clearly categorized, mainly with its priority function concerning itself with setting of the policy, objectives, strategy or vision of the company. (Coulson 1993).

Secondary function should then be more of a proactive nature, that of controlling or reviewing strategy, objectives, shareholder requirements or staff.

Critical periodic review of these functions is absolutely essential. Further, there are other general principles that should be applied as critical factors in board effectiveness and which actually make other boards more effective than others. As it

was evident in our research the attitudes and the approach of our board is critical. The board needs to exercise a strategic overview. Its priorities need to be appropriate to the situation and circumstances of the company. Is its strategy realistic? Does the board confront or avoid reality?

The conduct of business is also a critical factor in board effectiveness. For instance does the board meet regularly and conduct formal business? The presentation of information in board papers should be conducive to understanding; the process of the board should allow for the efficient conduct of business and should focus upon those things that are really important for customers and stakeholders.

The directorial qualities came out clearly in our research; the need for directors to be competent and to understand the particular leadership requirements for successful corporate transformation. Also, board effectiveness requires directors that are perceptive, open and frank in raising issues, being rigorous and persistent in seeking to reach "root" causes. Directors should be able to work as a harmonious team. However, harmony should not be achieved at the cost of rigour, diversity and challenge.

In terms of measurement of board effectiveness, it is agreed that the board is entrusted with the responsibility of leading the company. The company today is not only established primarily to achieve the various objectives of its owners or shareholders but also to maximise and harmonise all stakeholder interest for the long-term sustainability of the company and how well it does this will be determined by its performance. Therefore it seems reasonable that by and large the board effectiveness should be measured by the company performance.

It is vital that each board agrees to a means of monitoring and evaluating its own contribution. Boards to measure their effectiveness can use standard models or approaches but again it is important that their applicability is thought through.

Certain ground rules are necessary, like the main functions of the board for the purposes of assessment need to be agreed. How these are defined and the relevance of vision and values to the corporate context could itself be an indicator of board effectiveness.

In respect of each agreed function, clear objectives should be set and these could be accepted as a basis for performance measurement.

Actual performance need next to be assessed against those criteria's agreed upon.

Of course, quantitative performance targets are often easier to measure than

qualitative ones. Measures of performance could be internal and/or external. Internal measures would include e.g. return on capital or net assets, liquidity and other ratios and net income or profit growth.

External measures include credit ratings, brand and corporate image, market share data and other indices of satisfaction and loyalty.

Of course another useful measure of effectiveness is through assessment of effectiveness of individual members of a board. How they conduct themselves in meetings; how much value they bring to the company – in terms of questions, contributions, ideas, leads and others.

Measurement and/or evaluation of individual members of the board and the board as a whole are indeed a critical element in board effectiveness. Directors who are not accountable, who know that their performance is not subject to any formal scrutiny won't take their jobs as seriously as they should. Evaluation of directors would ensure that we do away with the days when people were just appointed to numerous boards and collect their pay cheque without recourse. In the words of Maletsatsi Mosala in The Business Section of the City Press in her article "Talking Tax" – "Simply put the days of champagne directors are gone – they have to take their duties, responsibilities and obligations seriously – they are under spotlight"

We agree with King II Report that the nomination committee should take a leading role in board appraisal and evaluation of individual board members. Ralph Ward also agrees - *"While the entire board shares the responsibility for its evaluation process, nominating committee is an excellent organiser and a go between, the committee also makes a good recruiter and liaison if an outside consultant is sought to assist with the evaluation (an outsider is valuable for bringing third party objectivity to the process). Board evaluation examines such topics as chairs influence and effectiveness, the boards input, structure and contribution, and the value of the present meeting, committee and communications systems."*

We, firmly believe in third party – outside involvement in board evaluation beyond the self – critical evaluation expounded by King II Report.

We also further believe that structured evaluation of board members and the board as a whole should be mandatory finding legal expression in the Companies Act. Board appraisal deals with crucial issues of shareholder accountability, serving the best interest of the company, productivity, maximising shareholders wealth and

harmonising stakeholder interests, pay for performance, board effectiveness and overall performance of the company.

5.9 SHAREHOLDER ACTIVISM

Shareholder activism should be a welcome development as long as it encourages constructive shareholder engagement. However it should not impinge on the rights of other critical stakeholder groups for the company. Thirdly, it should be in line with the requirements and recommendations of the King II Report and consistent with international best practice.

Shareholder activism should not be the monopoly of powerful and influential institutional investors. A mechanism should be found for minority and single individual shareholders feelings to be harnessed and mobilised to prevent "Institutional dictatorships" that we can see emerging in the horizon. We are however not saying that institutional investors should not take a lead by using their muscle (substantive shareholdings) for the benefit of all.

Institutional investors who are in the forefront of shareholder activism include pension and provident funds. These funds in actual fact are not owned by the asset managers (who are very vocal) but, by ordinary workers. When are these asset managers and/or pension and provident funds going to allow the voice and the ordinary workers the real owners of these funds to be heard? What the asset managers are agitating for is equally applicable to the workers in so far as the pension and provident funds are concerned. The words of Dr Blade Nzimande – Secretary General of the South African Communists Party are an ominous warning to asset managers / pension and provident fund managers – *"What role are these funds playing in job creation and confronting the legacy of apartheid. The fund managers tended to invest money offshore and not contribute to job creation and infrastructure development in South Africa. We cannot leave these matters to asset managers. The owners of these funds, the workers, should guide these managers"*.

Asset managers cannot expect board of directors to warm up to their ideas of placing their own representative directors in boards in which they are shareholders whilst shutting the door to workers sentiments (particularly deciding where, how and when their hard earned funds should be invested.

It is encouraging to note that some asset managers have taken the cudgel on behalf of minority shareholders such as Investec Asset Management in the Mettle de-listing

debacle. Investec insisted that the offer to the minorities was too low. If this is a new trend, not just a drop in an ocean it should be welcome with open arms.

Shareholder activism should go beyond maximisation of shareholders wealth but maximisation of all stakeholders' loyalty and harnessing of all stakeholder interests. David Wheeler and Maria Sillanpaa in their book – "The Stakeholder Corporation – A Blue Print for Maximising Stakeholder Value" – say – *"We have no doubt that stakeholder – inclusive companies will outperform stakeholder – exclusive companies with increasing ease in the 21st Century. In future development of loyal relationships with customers, employees, shareholders and other stakeholders will become one, the most important determinants of commercial viability and business success. Increasing shareholder value will be best served if the company cultivates the support of all those who may influence its performance."*

No doubt, shareholder activism rightly channelled and structured should impact not only on the behaviour of companies including composition of boards but on their effectiveness and overall performance. Finally we share the sentiments of King II Report on shareholder activism as outlined in Chapter 6 of King Report.

5.10 CONCLUSION

Whilst our conclusions were based on our findings, direct and indirect involvement with the corporate scene in South Africa, our recommendations are neither final nor exhaustive. They also emanate from our research findings and coalface experience but drew heavily from the views on King II Report on Corporate Governance for South Africa. In fact, it was used as a base from which to build our case for improved composition and effectiveness of boards.

Our recommendations revolved around issues of compliance, enforcement and mandatory practices to ensure effective corporate governance thus board effectiveness. Furthermore, we should not ignore the fact that whilst the King II Report is not in favour of recommendations being legislated (Mervyn King was quoted as saying – *"Legislating the recommendations would be tantamount to corporate suicide"*), legal mechanisms were in place to encourage compliance. There is a whole section in the King II Report outlining recommendations requiring statutory amendment and other relevant actions. The cause for legal enforcement is totally not lost.

Selection of directors, composition of boards and their effectiveness and other related issues highlighted throughout this write-up are major elements of effective corporate governance.

Whilst, we have no doubt that our recommendations would improve corporate governance, through better composition of boards, selection, induction, training and development of directors, well considered compensation packages, structured individual evaluation of board members and appraisal of the board as a whole, an avenue for further research exists. A similar study should be carried out in a much more broader scale. This will enable conclusions to be generalised to all sectors in South Africa.

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