

CONCEPTUALISATION AND CONTEXTUALISATION OF CORPORATE GOVERNANCE IN THE SOUTH AFRICAN PUBLIC SECTOR: ISSUES, TRENDS AND PROSPECTS

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ABSTRACT

The purpose of this article is to locate both conceptually and contextually corporate governance in the South African public sector. The article is based on the premise that corporate governance is not solely confined to private sector milieu and as such it is incumbent upon public sector organisations to embrace corporate governance with a view to improve their efficiency, effectiveness, accountability and reputation. It further provides a corporate governance framework underpinned by the *King I and King II Reports*, *King Code of Corporate Practices and Conduct* and the *Public Finance Management Act* germane to the public sector setting. The challenges facing Chapter 9 institutions related to their internal governance arrangements and the lessons on the application of corporate governance model adopted by the Department of Trade and Industry are further discussed.

INTRODUCTION

The introduction of the concept and principles of corporate governance in the public sector are rapidly becoming international practice. The government sector has increasingly adapted the principles of corporate governance for the purposes of controlling the activities of organizations that operate as parastatals or public entities and others that function as business units within the broad context of the government sector. Corporate governance has become one of the issues dominating the agenda of many organizations in South Africa and beyond. One of the strategic priorities of the

New Partnership for Africa's Development (NEPAD) requires member states including South Africa to adhere to good governance values including but not limited to political, economic and corporate governance.

This article asserts that public sector organizations are not exempted from corporate governance practices, regulations and principles relative to their private sector counterparts. Corporate governance is the *sine qua non* for well-functioning and financially sound organizations. Corporate governance in South Africa became topical and critical through the publication of the *King I Report in 1994*. Subsequently, companies and public enterprises began to situate corporate governance within their realm with a view to become ethical, effective, efficient, accountable and responsive.

In the public sector both the publication of the *King I and King II reports, the Protocol on Corporate Governance for the Public Sector* as well as the enactment of the *Public Finance Management Act, 1999* (Act of 1999) gave impetus to the agenda aimed at fostering and practicing good corporate governance within the public sector in its entirety.

KING REPORTS

Synopsis to the King reports

In 1994, the *King Report on Corporate Governance* (King I) was published by the King Committee on Corporate Governance, which was headed by the High Court judge, Mervyn King. The first report was published during a time of political change in South Africa, when the majority of the population had to be introduced into the mainstream economy. It was the first report of its kind in the country and it was aimed at providing the highest standards of corporate governance possible (Dekker, 2007:1).

Corporate governance in South Africa was institutionalised by the publication of the *King Report on Corporate Governance* in November 1994, which has subsequently been superseded by the King Code of 2002. The Code of Corporate Practices and Conduct contained in the King II Report applies *inter alia*, to State-Owned Enterprises (SOEs) and agencies that fall under the *Public Finance Management Act, 1999* (Act 1 of 1999) (PFMA).

The *Protocol on Corporate Governance* in the public sector published in 2002 provides guidance specifically to the public sector, taking into account the unique mandate of the SOEs, including the achievement of socio-politico-economic objectives of the Government. It should further be understood that the principles of the protocol only amplify and do not supersede or conflict with those contained in the *King Code* and that the Protocol should, in fact, be read in conjunction with the *King Code*.

The Government as a major shareholder in SOEs faces a wide range of risks associated with the operations of SOEs, including financial, reputation, political and operational risks. SOEs are expected to report and account for their performance to the relevant executive authority in respect of financial and non-financial matters, but at the same time they also need to maintain their independence in the conduct of their duties and be free from day

to day involvement by the executive authority (Protocol on Corporate Governance in the Public Sector, 2002:6).

The *King Code of Corporate Practices and Conduct* provides specific guidelines for corporate governance. The report applies to all companies with securities listed on the JSE, banks, financial and insurance entities, as well as public sector enterprises and agencies that are subject to the PFMA and the *Municipal Finance Management Act, 2003* (Act 56 of 2003) (MFMA) including any department of state or administration in the national, provincial or local sphere of government (King Code 2002).

The *King Code of Corporate Practices and Conduct* and the *Protocol on Corporate Governance* in the public sector provide particular reference to the following areas:

- who should be on the board?
- functions of the board
- distinction between the chairperson and the chief executive officer
- role of directors
- remuneration committee
- allocation of share options
- board committees
- evaluation of directors
- dealing in securities
- business ethics and organisational integrity
- annual reports and general meetings
- the company secretary

CONCEPTUALISATION OF CORPORATE GOVERNANCE

Essentially, governance was not a public service term by origin. It is traced originally to business, having a domain in company law. In business terms, governance is commonly referred to as *corporate governance*, a mechanism to ensure that a company is strategically organised to render day-to-day profit-based activity. In principle, if the governance set-up is not well inclined to corporate strategy, the company will make a loss. The essence of corporate governance can be found in the pursuit of a situation of checks and balances, which gives the stakeholders the possibility of complementing and controlling each other (Verdeyen and Van Buggenhout, 2003:1).

Equally, there is a pressing need to import across sectors, the concept of governance in the public service machinery to make sure that, as in business; it will efficiently render day-to-day public services. The concept of *corporate governance* can therefore be valuable in the public fraternity, although there are no shareholders in an economic sense in the welfare, healthcare and social security institutions (Verdeyen and Buggenhout, 2003:1).

Corporate governance is the system by which business corporations are directed and controlled. The *corporate governance* structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and spells out the rules, and procedures for making decisions on corporate affairs. By doing this, it also provides the structure

through which the company objectives are set, and the means of attaining those objectives and monitoring performance (OECD April 1999).

In its narrowest sense, *corporate governance* refers to the formal system of accountability of the board of directors to shareholders. In its broadest sense, *corporate governance* refers to the informal and formal relationships between the corporate sector and its stakeholders; and the impact of the corporate sector on society in general (Cronje, 48:2007).

Corporate governance embodies processes and systems by which corporate enterprises are directed, controlled and held to account (Protocol on Corporate Governance, 2002:5).

Corporate governance is concerned with the enhancement or fortification of the rules and principles of company direction for the purpose of accommodating the modern environment within which companies operate and the imposition of stricter checks and balances to curb or alleviate malpractices or wrongdoings by those engaged in corporate decision-making (Mongalo, 2003:185).

Verdeyen and Van Buggenhout (2003:48) consider corporate governance as a model of rules governing mechanisms of the decision-making process, and the mechanisms of control and liability. The rules relate to principles such as disclosure; openness and information; transparency; legitimisation; participation; checks and balances.

In the private sector, the relationship between an organization and its owners (shareholders) is arranged by electing a board of directors. This board determines the strategic direction of the organisation in collaboration with its management and oversees the subsequent activities of the organization to ensure that they are in line with the strategic plan. In order to enable them to perform this dual role, the board has designed a number of mechanisms over the years. These include tools for risk management, strategic management, audit committees and a well-structured internal audit unit (Minnar & Bekker, 2005: 62).

Clearly, corporate governance is a multi-faceted concept. It encompasses different dimensions that provides for accountability, transparency, ethics and stakeholder management.

SALIENT AREAS RELEVANT TO THE PUBLIC SECTOR

The code applies to the following business enterprises (hereinafter referred to as the "affected companies"):

Public sector enterprises and agencies that are subject to the Public Finance Management Act, 1999 as amended (PFMA) and the Municipal Finance Management Act, 2003 (MFMA) including any department of the state or administration in the national, provincial or local sphere of government or any other functionary institution: exercising a power or performing a functioning in terms of the Constitution, 1996 or a provincial constitution, or exercising a public power or performing a public function in terms of any legislation, but not including a court or judicial officer.

Boards and Directors

The Board is seen as the focal point of the corporate governance system. It is ultimately accountable and responsible for the performance and affairs of the company. Delegating authority to board committees or management does not in any way mitigate or dissipate the discharge by the board and its directors of their duties and responsibilities. The board must give strategic direction to the company, appoint the chief executive officer and ensure that succession is planned. The board must retain full and effective control over the company, and monitor management in implementing board plans and strategies. The board should ensure that the company complies with all relevant laws, regulations and codes of business practice, and that it communicates with its shareowners and relevant stakeholders (internal and external) openly and promptly and with substance prevailing over form. The board should consider developing a corporate code of conduct that addresses conflicts of interest, particularly relating to directors and management, which should be regularly reviewed and updated.

Chairperson and Chief Executive Officer

The *King Code of Corporate Practice* provides that there should be a clearly accepted division of responsibilities at the head of the company, to ensure a balance of power and authority, such that no one individual has unfettered powers of decision-making. Given the strategic operational role of the chief executive officer, this function should be separate from that of the chairperson.

Directors

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 individuals can dominate the board's decision taking. The board should establish a formal orientation programme to familiarise incoming directors with the company's operations, senior management and its business environment, and to induct them with 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 risks. New directors with no or limited board experience should be developed provided with education opportunities to inform them on their duties, responsibilities, powers and potential liabilities.

Board meetings

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). Efficient and timely methods for informing and briefing board 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. The board should regularly review processes and procedures to ensure the effectiveness of the company's internal system of control, so that its decision-making capability and the accuracy of its reporting are maintained at a high level at all times.

It is important to note that in the realm of public organisations, the corporate governing board usually comprises the executive authority (political office-bearer) and senior management.

Barrett (2000) presents what he labels *elements of governance of public sector entities* as follows:

Public governance. Public organisations should be governed on behalf of the public (communities). Public corporate governing bodies should therefore ensure that the primary mandate of the organisation under their governance is properly executed, with outcomes to be optimised within the framework of affordability (value for money).

Management structure. The corporate governing body should establish appropriate organisational management structures that would enable the co-ordinated and disciplined execution of a specific policy mandate entrusted to them for implementation.

Strategic and business planning. The corporate governing body should determine strategic direction for the organisation under its guidance. It should also ensure that strategies decided on are properly executed.

Risk management. Risk management is one of the single most important functions of the corporate governing body. Thus, risk identification, response and monitoring should be undertaken as part of managing risk facing public organisations.

Compliance and control. The corporate governing body should put in place appropriate methods and measures to ensure compliance with policies, rules and procedures, as well as appropriate control structures to review progress with the implementation of the organisation's core functions.

Audit. The corporate governing body should ensure that appropriate audit structures both in terms of the internal and the external audit functions are in place to optimize organisational performance appraisal and organizational control.

Values and code of ethics. The corporate governing body should determine the core values that will characterise the formal organisational culture and should reflect these officially in a code of ethics for the organisation under its governance.

In the public sector setting, the composition of governing bodies is crucial, given the intricate relationship between government organisations and their political controllers (the executive authority). Minimum requirements would be a political appointee, responsible for leading the governing unit (board) and ensuring that the policy aims of government are well-executed. Strategic management skills would be another prerequisite; as would functional expertise. Such governing boards should strive to oversee the implementation of all relevant legislation and to achieve the agreed outcomes (Minnaar & Bekker, 2008:67-68)

Barrett (2000) further identifies the following requirements:

- Strong members who are independent of management, who have appropriate orientation and who bring an appropriately diverse set of experiences, competences, skills and judgement to the governing body.

- A strong leadership within the board from outside directors. The complex nature of the activities of modern government organisations would make the co-opting of experts from outside the specific organisation a necessity.
- A chief executive officer who understands the role of the governing body and who is openly supportive of building a culture that is conducive to governance.

INSTITUTIONAL GOVERNANCE ARRANGEMENTS WITH SPECIFIC REFERENCE TO CHAPTER 9 INSTITUTIONS

The Report of the *ad hoc* Committee on the Review of Chapter 9 and Associated Institutions (commonly referred to as Asmal's report), released on 31 July 2007, noted a number of common problems concerning the institutional governance arrangements of the various bodies under review. The Committee observed that internal conflicts have to some degree undermined the effective operations and efficiency of some of the institutions. The Committee is of the view that the absence of clear lines of authority within the commissions, between the commissioners and the secretariat has worsened this tendency.

The Committee notes that section 36(2)(b) of the *Public Finance Management Act* 1999 as amended requires that a chief executive officer must be the accounting officer of that institution. However, the chairperson or head of a commission or institution is either explicitly or implicitly mandated to provide overall leadership and direction for the institution. There is a *lacuna* in the PFMA, as amended, regarding the definition of executive authority. Because in the PFMA, constitutional institutions are not covered in the definition of executive authority, the National Treasury furnished a definition by regulation (i.e. the Treasury Regulations). However, some of the Chapter 9 institutions were unaware of the proviso in the Treasury Regulations and this contributed to a large extent, to the tensions and often the paralysis between chief executive officers and chairpersons of commissions (Committee Report, 2007:32).

The Committee recommended that where appropriate legislation is not clear, such legislation must be amended to clarify the lines of authority between the chairperson of a commission or head of an institution and the chief executive officer as well as between chairpersons of commissions and other commissioners.

Suffice it to state, corporate governance requires proper checks and balances and sound decision-making framework among the key decision-makers or players involved in an institution. The absence of a system that governs decision-making usually creates tensions and paralysis as apparent from the findings of the Committee.

LESSONS IN THE DEPARTMENT OF TRADE AND INDUSTRY (DTI)

According to Newsome (2002), the generic responsibilities of governing boards entail amongst others, the need to provide strategic direction for the activities of the institutions; exercising control over organisational operations and direction; enforcing legal and regulatory compliance by all members of the organisation; the

promotion of organisational integrity and ensuring that the governing body is sufficiently informed to make the required decisions.

It is within the context, that the Department of Trade and Industry has effectively developed a unique corporate governance model with a view to meet its mandate. The model is informed by requirements of both the King I and II reports and the quest to operationalise corporate governance within the context of DTI.

The DTI has established two important governance structures, namely, the Executive Board (EXBO) that is chaired by the Director-General of the Department and an Operations Committee (OPSCOM) that is chaired by Deputy Director-General responsible for Group Systems and Support Services coupled with the secretariat in the same division. Members of OPSCOM include all chief operations officers of the different strategic business divisions of the department (Terms of Reference for OPSCOM, 2006).

The corporate governance model simply clarifies the roles and responsibilities of both EXBO and OPSCOM. OPSCOM was established as a consequence of the need to separate strategic policy and operational decision-making in the Department, with EXBO dealing with strategic issues and operational decision-making mandated to OPSCOM. OPSCOM is governed by *Terms of Reference* that cover an array of issues, notably, functions of OPSCOM, principles and core values, membership and composition, procedural arrangements and a code of conduct. Interestingly, the *Terms of Reference* for OPSCOM are reviewed on a periodical basis through assistance of external expertise aimed at drawing best practices related to corporate governance.

The DTI corporate governance model serves as one of the best practices that can be of value to other public institutions contemplating to develop and apply corporate governance. Further, the development of corporate governance Charter that is specific and unique for public institutions can address internal tensions, dynamics and organisational dysfunctionality apparent in certain quarters.

CONCLUSION

The relevance and significance of corporate governance in the South African public sector remains cogent. This article has essentially provided a corporate governance framework underpinned by the King reports, the King Code of Corporate Practices and the PFMA pertinent to public sector organisations. It is, therefore, critical for public organisations to espouse and practise corporate governance values as dictated to by the *King Code of Corporate Practices, Protocol on Corporate Governance* and the PFMA. Evidently, the generic responsibilities of corporate governing boards outlined by both Barrett and Newsome are germane to public sector organisations. It is, therefore, incumbent upon public sector organisations to embrace corporate governance for the purposes of improving their efficiency, effectiveness, accountability and reputation.

The demands for accountability, effective and efficient use of public resources emanating from the members of the public, civil society and international finance institutions require public organisations to put in place appropriate systems and structures informed by the corporate governance principles and values and subject these to periodic

review in order to adequately meet the expectations and needs of the public. To this end, corporate governance reforms in South Africa will continue to shape and influence the direction, management and operation of both private and public sector organisations in line with continental and international best practices.

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