Chapter 3: Literature study Phase II - The Evolution of Corporate Governance

The poor performance of large capital projects and lack of formal guiding or steering mechanisms appear to be major shortcomings in the project management fraternity. These shortcomings prompted the need to review and investigate governance principles in the project context, with the eventual objective of establishing a *project governance framework*.

The objective of this chapter is to study and develop a literature base for the logical deduction of a draft project governance framework.

Instead of studying and researching governance from basic and fundamental principles, an approach of adaptation and application of current corporate governance principles to large capital projects is taken. This approach is founded on the belief that corporate development and organisational management thinking and research are at a more advanced level than that of project management. The discipline of project management is thus in a position to learn from corporate developments, but with project management we need to review the uniqueness of projects with respect to operational organisations, adapt good practices and refine a customised application.

In building an argument through literature review, this chapter will follow a sequential approach as graphically explained in Figure 3.1 below.

In order to contextualise the eventual concept of project governance it is imperative to briefly review the evolution of modern-day corporate governance, especially the controlling, legal and governing factors and mechanisms that lead to the development of the concept of a company and the subsequent formalisation of corporate governance. Secondly, the components of corporate governance, as well as its application to an operational entity, are studied. Thirdly, the latest developments in the field of corporate governance are reviewed. This is followed by a discussion of the different approaches to be considered when debating further enhancement of corporate governance and development of a project governance model. The different approaches will be considered when developing the project governance model in the following chapters.

The resultant reasoning of the literature review will provide a key input to the next chapter where the further research strategy and methods are discussed.

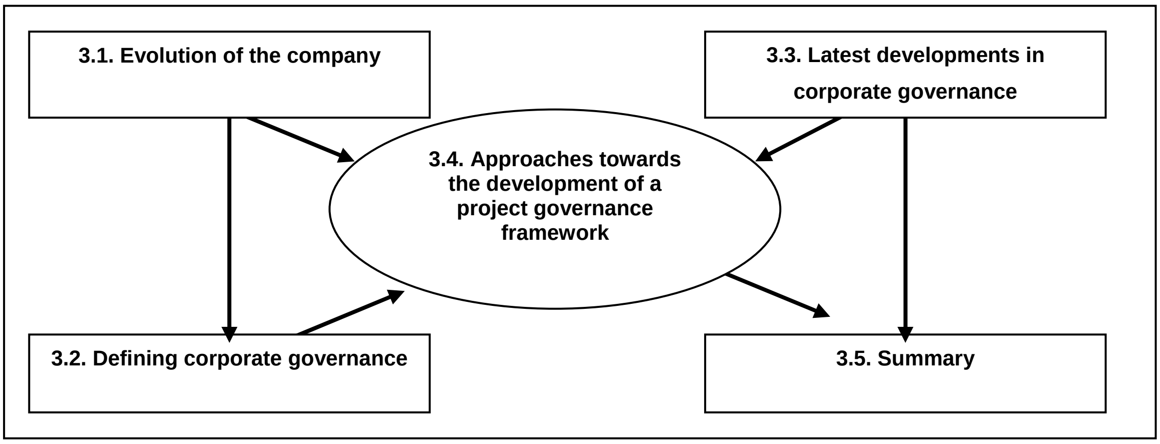

Figure 3.1: Chapter structure

3.1 The evolution of the corporation

According to Micklethwait and Wooldridge (2003:13) the formation of organised business can be traced back 3000 B.C. Merchants, marauders, imperialists and speculators dominated business and public life for many centuries and, although they did not form fully fledged companies, they created powerful organisations that changed commercial life. These organisations developed and implemented various concepts of control and risk sharing and the developments form part of the evolutionary process of formulating corporate governance. This could also be the starting point for the further development of project governance. Figure 3.2 below provides a graphical outline of the process to be discussed and is referred to in detail in the following paragraphs.

3.1.1 The origin of trade agreements

Baskin and Miranti (1997:29) refer to some of the earliest evidence of formal, regulated trading that was found in Mesopotamia, where Sumerian families traded along the Euphrates and Tigris rivers with contracts that rationalised property ownership. The church served as both bank and state overseer. During the period 2000 –1800 B.C. the Assyrians had a formal partnership agreement with church elders, towns and merchants (Jay 2000:49). Under the terms of the partnership agreement, some 14 investors put 26 pieces of gold into a fund run by a merchant called Amur Ishtar, who himself added four pieces of gold. The fund was to last for four years and the merchant was to collect a third of the profits. This arrangement was very similar to modern day venture-capital funds used on specific high risk commercial projects.

The Phoenicians, and later the Athenians, took this form of regulatory capitalism to the ocean, thereby spreading the formation of formal agreements around the Mediterranean (Micklethwait *et al*, 2003:14). The involvement of merchants and traders across country boundaries prompted the Athenians to develop the concept of formal agreements further by starting to rely on the rule of law rather than the goodwill of kings. Even though this development proved to be a significant step in the business separation of king and businessman, Athenian businesses remained small and mostly controlled by a few people. This reminds one much of the entrepreneurial approaches originally taken by individuals who saw opportunity in infrastructure developments.

3.1.2 Privatisation

The Romans were slightly more ambitious. Initially the collection of taxes was entrusted to individual Roman knights. However, as the Empire grew, the levies became too large to be handled by the kingdom itself and by 218-202 B.C. companies (*societates)* were formed in which each partner had a share.

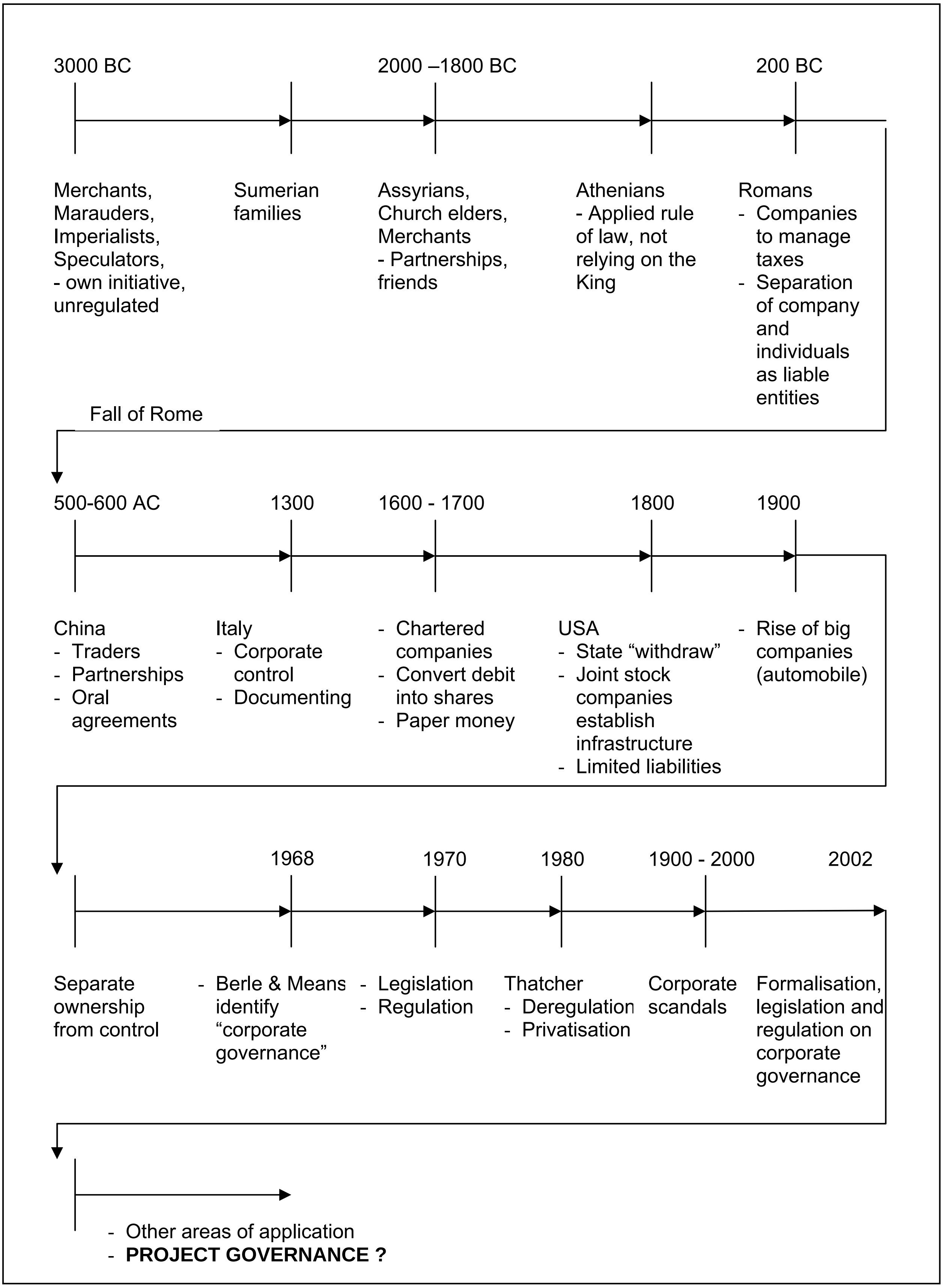

Figure 3.2: The evolution of business relationships towards corporate governance

According to Moore and Lewis (2001:67) these firms later became commercial suppliers of traditionally government-controlled commodities, such as shields and swords for the legions (again a reminder of the entrepreneurial arrangement). These practices remind one of modern-day privatisation of state-controlled activities and assets. Moore *et al.* (2001:97) explained that further vertical development took place through craftsmen, artisans and merchants who formed guilds (*collegia* or *corpora*) and 'sub-contacted' their skills and trade to the *societates*. The managers of the guilds were elected and were supposed to be licensed (Jones, 1974).

Oscar and Mary Handlin (Handlin & Handlin, 1953) refer to the statement made by William Blackstone, the eighteenth-century jurist, that the honour of inventing the formal company "belongs entirely to the Romans". Although an arguable view, the statement bears truth in the sense that the Romans did initiate some of the basic concepts of corporate law, particularly the idea that "an association of people could have a collective identity that was separate from the individuals belonging to the association" (Micklethwait *et al*., 2004:14). They also linked companies to the *familia*, the basic unit of society. The belonging partners, better known as *socii*, seconded most of the managerial decisions to a *magister*, some form of general manager or managing director. The firms also had some form of liability regarding taxes and the associates and were therefore subjected to some form of governance.

When the Roman Empire started to show signs of weakness during the period 500 to 600 AC, the activity of commercial life moved eastward to India, China and the Islamic world. According to Micklethwait *et al.* (2004:15) the prophet Mohammed was a trader during the years 569 to 632.

Until this day it is still unclear why the Chinese and the Arabs lost their economic lead to the West. One can argue that their relative failure to develop sustainable business enterprises contributed to their economic demise. Still, Islamic law allows for a form of flexible trading partnership which lets investors and traders jointly pool their capital. However, the law relies on oral testimony, rather than written contracts. In China's case, the idea of permanent private-sector businesses was mostly undermined by both culture and state interference. The latter proved to be unsuccessful as bureaucracies crept in, thereby stifling any entrepreneurial activity for sustainable economic development. Eventually, it could be argued that China's obsession to look inward proved to be their Achilles' heal (Micklethwaite *et al*., 2004:17). Nevertheless, the groundwork for the conceptual framework of a formal corporate entity, with fixed agreements between participating parties, was firmly established and awaiting further development.

Subsequent to the demise and stagnation of Eastern and Middle Eastern business enterprises, the development of organised business activities moved to Europe - especially to Italy. This fascinating development is well illustrated by the extraordinary life of Francesco di Mari Datini, well documented by Iris Origo (1992) and also mentioned by Micklethwaite and Wooldridge (2003). Datini produced the first well-recorded management database. An orphan from the Tuscan town of Prato, he went to Avignon around 1335 and worked as an apprentice before starting his own *compagnie* as a young man. He was among the first to define a business vision or motto - as well as being among the first to not follow a defined motto. Although his motto was 'For God and Profit', his first venture gave evidence of all but that and included some arms dealing. Later he branched into more noble industries like textiles, retail and jewellery, but eventually returned to questionable practices that included slave trading. However, his original intent of doing well came to the fore when the childless Datini left all his belongings to the poor people of Prato.

Apart from his entrepreneurial flair and active merchandising, Datini was ahead of his time in terms of corporate control. He recorded everything and expected the same from his managers. Currently an archive exists containing more than 150 000 letters, 500 ledgers and 300 partnership agreements, which seems remarkably modern. His management style contained near-daily letters to his managers and suppliers asking for news, numbers and accounting figures and giving reprimands. He even provided formal promotions and allocated responsibilities to positions and provided legal papers for appointments. Even his margins seemed meagrely modern at a mere 9% profit. Datini's management approach and understanding of the corporate world was astonishing for the times he lived in and exemplifies many of the elements captured in the modern day, such as striving for good corporate practices, governance and control. As quoted by the biographer Origi (1992:81): "He believed neither in the stability of government, nor the honesty of any man. It was his fear that caused him to distribute his fortune in as many places as possible, never trusting too much to any partner, always prepared to cut his losses and begin again".

The sixteenth and seventeenth centuries saw the emergence of 'chartered companies' (Micklethwaite *et al.,* 2004:25). This form of company represented a combined effort by government and merchants to regulate and control the riches of the new world opened up by Columbus (1451 – 1506). With established government influence, these companies were the recipients of royal charters, giving them exclusive rights to trade with demarcated regions of the world. This arrangement and influence established the ongoing concern about the political power and interest in corporate decisions, hidden agendas in decision-making, conflict of interest and eventual bribery. Nevertheless, this time of corporate development saw the establishment of well-known, long living companies such as The East Indian Company (that lasted for 274 years) and The Hudson's Bay Company - founded in 1670 and still in existence. Even though there were still numerous small companies operating, the large chartered companies became dominant in the trading world and were the forerunners of parastatals and corporate bureaucracy.

3.1.3 The state and the management of national debt

The caveats created by good government intentions and capitalist greed are best described by some of the earliest recorded financial disasters, commonly referred to as 'bubble bursts'. Probably the single largest financial bubble burst occurred during the early eighteenth century, when the governments of France and Britain used two chartered companies, the Mississippi Company in France and the South Sea Company in England, to restructure and service the cost of debts incurred during the wars that occurred between 1689 and

1714 (Micklethwaite *et al.*, 2004:36). The two companies were used to convert government annuities, which paid fixed interest, into low-yielding shares.

With pure governmental and statutory intentions, the eventual disaster was initiated by a brilliant French mathematician called John Law. According to Ferguson (2001), Law's plan was to 'rescue' France from its rampant inflation, shortage of coins and unstable currency by introducing paper money. Through Banque Royale, Law obtained control over the French money supply, bid for a trading concession and formed the Mississippi Company. Through the newly formed company, Law converted a large portion of the French debt into shares in the company. The Mississippi Company obtained control over the Royal Mint and eventually controlled the entire colonial trade. Building on the seemingly instant success, Law made a quantum leap in his business venture and converted the entire national debt into company shares. The public responded in mass frenzy and even bought shares on call options in order to 'get in on the action'. Within 15 months between 1718 to 1720, the value of bank notes issued by Bank Royale rose from 18 million livres to 2.6 billion livres.

The question of ethics, control, public accountability and eventually governance, come to the fore through one observation quoted by Dickson (1993:84): "It is inconceivable what wealth there is in France now, everybody speaks in millions. I do not understand it at all, but I see clearly that the God Mammon reigns an absolute monarch in Paris."

Law avoided the question of what his company actually did. The frenzy could not last and in early 1720 a large number of investors withdrew their investment in the Mississippi Company and invested in the bull market in London (Dickson, 1993:72). In December 1720 the Bank Royale was forced to abolish paper money and closed down. With a false passport, Law fled to Brussels, leaving France in complete disarray and chaos.

Although using the same mechanisms and tactics as the Mississippi Company, the impact of the collapse of the South Sea Company was not as severe (Micklethwaite *et al.*, 2004:41). The South Sea Company was formed for the same purpose, i.e. that of converting national debt into shares, and was proclaimed in January 1720. By July 1720 the share price rose from £128 to £950, causing a stampede of investors buying company shares. With other stock companies coming to the fore, the South Sea Company directors used their influence in parliament to have an act passed that restricted the set-up of new stock companies. The act was called, ironically, the Bubble Act of June 11, 1720. The act was a disaster for the evolution of the concept of the corporation and inevitably the South Sea Company went under in December 1720. Eventually the government rescued some of the value by nationalising the company, leaving investors with huge losses but saving the financial system.

The reputation of the corporation was in disarray. Sampson (1995:17) quoted Sir Edward Coke complaining that "Companies cannot commit treason, nor can they be outlawed or excommunicated, for they have no souls". Micklethwaite *et al.* refer to Edward Thurlow who added to this criticism by saying "Corporations have no souls to be condemned, they therefore do as they like." (Micklethwaite *et al.,* 2004:41) Recovering from a poor reputation, companies would take about a century before the revitalisation of the corporate identity came from America during the early 1800s.

3.1.4 Separating the state from the company

During the first half of the nineteenth century, the state began to step back from corporate affairs. According the Micklethwaite *et al.* (2004:51-52) the prompt for change was threefold: the impact of railroads, the legal system and politics.

The demand for rail transport required large amounts of capital for rail track development. The state could not fund the development and the entrepreneurial era, as referred to by Millar and Lessard (2002) and discussed in length in Chapter 2, emerged. In the corporate world, the formation of these entrepreneurial relationships led to the concept of joint-stock companies. With their input limited, the state's mandate for control over corporate affairs diminished. The contribution of the legal system to the separation of state and company came in the form of a ruling regarding the status of Dartmouth College in 1819. In the ruling, the Supreme Court found that corporations of all sorts possessed private rights, in which case the government could not rewrite their charters without involving companies.

The last and most significant contributor to the divorcing of state and corporations was political. Concerned that the various states were losing business opportunities, the legislature in New England started to loosen their grip and eventually their control over companies, setting them free to pursue their entrepreneurial drive. This was quickly followed by the Massachusetts state legislature determining in 1830 that companies did not need to engage in public works to be awarded the privilege of limited liability. In 1837, Connecticut accelerated the process by allowing firms to become incorporated in any form of business without special legislative enactment.

3.1.5 Managerial capitalism and limited liability

With the state as, supposedly, protector of public interest and retreating from direct company influence, the question of limited liability appeared. The first link to the concept of governance can be found in the arguments that followed - from the 1830s until modern times - around responsibility and accountability of corporations and later on the individuals responsible for decision-making.

Fuelled by the development of the automobile towards the end of the 19^{th} century, the big company concept, or corporation, was firmly established by the time of the First World War (Micklethwaite *et al.*, 2004:102). Monks and Minow (1995:6) define a *corporation* as a "mechanism established to allow different parties to contribute capital expertise and labour for the maximum benefit of all participants. The primary reason for the corporation's existence is wealth maximisation". The Penguin English Dictionary (1985) defines a *corporation* as "a body made up of more than one person who is formed and authorised by law to act as a single person with its own legal identity, rights and duties". Considering these views, a corporation can therefore be defined as a *legal entity established to group together a number of people who perform synergistic activities*.

Whatever the academic or scientific definition of the corporation, its impact on business and public relationships has become dominant, especially in an ever increasingly capitalist society.

3.1.6 The emergence of the corporate governance dilemma – separating ownership from control

The withdrawal of the state from most of the commercial world and the strong emergence of the entrepreneurial drive provided the platform for modern business societies and the foundation for the developed world, as it is known. From the early 1900s management as a science started to emerge and corporations started looking at various ways to improve operational effectiveness of their businesses.

By 1920 the gradual separation of ownership and direct control started to emerge. The strategic decisions still remained with the owners but they could not attend to all management details in large corporations. Big company founders, including King Gillette, H.J. Heinz and John D. Rockefeller, turned to professional managers to oversee the day-to-day running of their empires (Micklethwaite *et al*., 2004:103). It seems as though the typical company executive, at a strategic level, was classified by professional standards and corporate loyalty during these years. Later on, they appeared to be closely related to corporate obsession and the absolute necessity for annual growth in profits in order to satisfy the faceless shareholder.

King (Institute of Directors, South Africa, 1994) also dates the origin of the public limited corporation back to the nineteenth century. He mentions the schism between ownership and control, with reference to the shareholders as owners of the enterprise and the board of directors as the controlling body of the company. The directors then appoint professional managers to manage the company pursuant to policies established by the board. This separation, and in some instances delegation, of responsibility from directors to managers became contentious with respect to final accountability to shareholders.

Eventually, management of the modern corporation consisted of professional individuals, the so-called officers of the corporation, under the direction of the Chief Executive Officer (CEO). The board of directors, appointed by and representing shareholders, appoints the officers of the company to manage operational activities. A logical deduction could then be that the board of directors, and their appointed professional management team, should all act in the interests of the shareholders, who are ultimately the owners of the corporation and demand maximisation of their interests in the corporation. Figure 3.3 below depicts part of the organisational structure of a typical corporation. Gitman (2003) adds to the reasoning by noting that the goal of the corporation is not to maximise profit, but rather to maximise the wealth of the shareholders for whom the corporation is being operated.

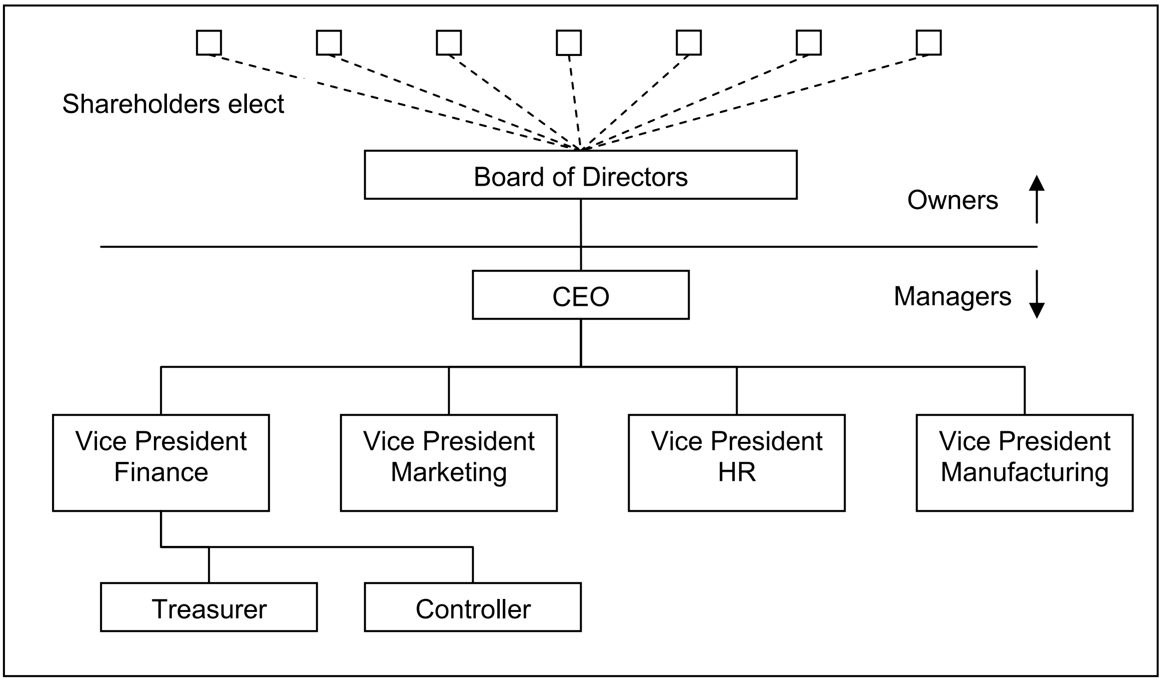

Figure 3.3: A typical corporation

While this might have been true in early corporations where the management team, the board of directors and the shareholders were all inherently the same people, the modern public corporations can have numerous, and sometimes countless numbers of different shareholders, many of whom have little or no influence over the way in which 'their' company is managed. This is due to the small number of shares the typical private investor would keep in relation to institutional shareholders and even some of the company's directors and managers.

In 1932, Adolf Berle and Gardiner Means published the first edition of their book *The Modern Corporation and Private Property (*Berle and Means, 1968)*.* The book was the first to formally observe the distribution of corporate wealth in America and highlighted the observation that more than half the assets owned by corporations were concentrated among the top 10% of all listed companies. For example, AT&T controlled more assets than the 20 poorest states in the USA. However, these new oligopolies were owned not by barons but by millions of ordinary shareholders, mostly voiceless and similar to modern day equity funds or unit trusts. This phenomenon gave rise to the belief that 'anybody's business is nobody's business'. Berle *et al.* (1968:219-229) further argued that the passivity of these millions of shareholders had "frozen the absolute power in the corporate management arena". In economic terms, the interest of the agent was separate from that of the principal. Although theorists always promulgated the separation of ownership from control (Micklethwaite *et al*., 2004:112), Berle and Means were the first to identify corporate governance as a practical problem. According to Micklethwaite *et al.,* in 1942 Peter Drucker, in his book *The Future of Industrial Man,* added his voice to the capitalistic dilemma by arguing that companies had a social dimension as well as an economic purpose. The recognition of the social dimension was the beginning of the 'triple bottom-line' concept prevalent in modern corporate governance policies and which comprises a balanced approach to economic, social and environmental impact and consideration.

During the 1970s big companies were expected to support the post-war consensus and to be more considerate of their stakeholders. The corporate environment became more regulated and in 1971 Richard Nixon introduced another two forerunners of corporate governance elements, namely the Environmental Protection Agency and the Occupational Safety and Health Administration (Yergin & Stanislaw, 1998:60-64). However, frustration with over-regulation soon became apparent and by 1979 deregulation received a major 'boost' when Margaret Thatcher came to power after public resentment over strikes and staggering inflation. Her approach to privatisation was initially greeted with scepticism and was tagged by the Tories as 'corporatisation' (Micklethwaite *et al*., 2004:122-123). But by 1982, privatisation had gained momentum, with the government selling its shares in North Sea oil and gas companies such as British Gas. This was followed by the sale of British Airways and British Steel. Other European companies followed suit with Volkswagen, Lufthansa, Renault, Elf Aquitaine and ENI either wholly or partly privatised. In Latin America and Southeast Asia, governments also sold off telecommunication companies and utilities, albeit to their loyal supporters. The most radical privatisation spree took place in Russia under the leadership of Yeltsin. From 1992 until the turn of the century more than 18000 companies were privatised in Russia.

By the end of the twentieth century, the unregulated business environment saw the emergence and establishment of a breed of corporate managers embracing management concepts and techniques to add to, and defend, shareholder value. Pressure on executive boards for bottom line financial performance increased dramatically and Chief Executive Officers and their Vice-Presidents earned astronomical pay cheques as part of their 'risk compensation'.

3.1.7 The institution of formal corporate governance

In 1991 the London Stock Exchange, the United Kingdom Financial Reporting Council and the British accountancy profession commissioned the Cadbury Commission to investigate and report on "Financial Aspects of Corporate Governance". The Cadbury Committee was born out of the scandals that rocked the UK capital during the late 1980s (Dunlop, 1998). In the USA nearly everything had changed by 2002. Many of the top corporate officials who had graced the front covers of business magazines and journals were facing criminal charges. Corporate accounting scandals plagued some of the most prestigious and largest institutions, namely Enron (Cruver, 2003), WorldCom, Xerox, AOL Time Warner, Tyco and Arthur Anderson. In Europe the same emerged with Ahold, Bertelsmann, Vivendi, SK Corporation, Elf-Aquitaine, Londis and Parmalat being the most prominent offenders. The general public started losing faith in the corporate system and a survey conducted by Seib and Harwood (2002) indicated that more than 70% of American people had no faith nor trust in the corporate world and about 60% believed corporate misconduct was a 'widespread problem'. Something had to be done and by middle 2002 President Bush had signed the Sarbanes Oxley Act (2002), which is arguably the toughest piece of corporate legislation yet to be tabled and which formalises corporate governance into legislature, especially with regard to auditing.

During this period many other countries launched their own investigations (Gillibrand, 2004:6), including Australia (Bosch Report), Canada (Dey Report) and India (Bajaj committee), to name but a few.

Although the end results are clear, namely corruption followed by government 'retaliation' by means of strong legislature, the question needs to be asked: "Where did everything go wrong?" Two schools of thought are evident (Micklethwaite *et al.,* 2004:150-151). The first school includes the Bush administration's belief that corruption resulted from 'bad apples' - the actions that prompted the scandalous behaviour originated from individual greed and not necessarily from a flawed system. The second school of thought adopted the 'rotten root' approach. They believed that the problems originated with privatisation in the 1990s when there was a dramatic weakening in proper checks and balances on accounting and good management practices. Outside directors had compromised their objectivity and independence by having questionable and often conflicting financial relationships with the firms that they were supposed to oversee. Additionally, too many government regulators had been recruited from industries that they were supposed to police. Lastly, the 'rotten root' school of thought believed that auditors had become business advisors rather than mere scorekeepers of shareholders' interest. Eventually, the old 1920s question of aligning the interests of those who manage companies and those who own them re-emerged.

These two schools of thought, especially the 'rotten root' argument, have a strong relation to the large capital project cost overrun dilemma raised by Flyvbjerg (2003:16), referred to in Chapter 1 and repeated below:

"*We therefor conclude that cost overrun has not decreased in the past ten, thirty or seventy years. If techniques and skills for estimating cost overrun in transport infrastructure projects have improved over time, this does not show in data. No learning seems to take place in this important and highly costly sector of public and private decision-making. This seems strange and invites speculation that the persistent existence over time and space and project type of significant and widespread cost overrun is a sign that equilibrium has been reached: strong incentives and weak disincentives for cost underestimation and thus for cost overrun may have taught project promoters what there is to learn, namely that cost underestimation and overrun pays off. If this is the case, overrun must be expected and it must be expected to be intentional.*"

Apart from the two main schools of thought, Bloxham (2002) listed increased stakeholder activism, globalisation and stronger scrutiny of board practices as three of the major changes that organisations of the 21st century had to deal with, and which pressured them into misconduct. Adding to the unravelling of the underlining reasons for misconduct, Dunlop (1998) reasoned that the need for effective and efficient corporate governance procedures became necessary due to:

- Increased large-scale business failure and excessive executive remuneration in the United Kingdom,
- Capital market abuse in the United States, and
- Corporate and political abuse in Japan.

Although it should be accepted that greed and corruption are inherent to any society, mechanisms should be put in place to prevent their occurrence as far as possible, to limit their damage and to punish those who make themselves guilty of such misconduct. The Sarbanes Oxley Act was the USA's way of establishing governance criteria for the corporate environment.

Even though they may differ in their detail, virtually all corporate governance guidelines are entrenched in the fundamentals of corporate scandals and social responsibility.

In summary, the evolution of the corporation always had to contend with what is good, ethical, profitable and responsible. In an unregulated, informal, free-trade environment, trust was the cornerstone. However, the abstract concept of greed found comfort in a capitalistic world evolving towards a point of no return for some of its role players. Government and corporations learned the hard, expensive and embarrassing way, but eventually developed a platform for other management disciplines (i.e. project management) to adapt from.

To provide further clarity on how the principles of corporate governance can be applied to a project management environment, the next paragraphs will unravel the definition, logic, components and mechanisms of corporate governance guidelines.

3.2 Defining corporate governance

According to Drori, Meyer and Hwang (2006), the term governance can be traced to the Greek verb *kubernân,* which means to 'steer a ship or wagon'. The term was also used metaphorically by Plato to designate the governing of men, which gave birth to the Latin verb *gubernare*, which is still found in several Latin-based languages. In the early thirteenth century the French term *gouvernance* appeared, while during the same time the Portuguese used the word *governançã* to refer to politico-administrative processes. During the same time the English started using the word *governance* to refer to the action or manner of governing. Somehow the term remained and is used widely in the context of governing institutions.

In the process of defining *corporate* governance, Smerdon (1998:5) first attempted to define corporate responsibility by means of a 'shareholder theory' that describes the primary responsibility of the directors of a company to act in the interest of increasing shareholder value. The theory goes: "Unless companies look after their suppliers, customers, members of staff and the environment (in other words their stakeholders), shareholder value is likely to suffer anyway, and so a well-run board will have to deal with these interests to ensure long-term corporate health and therefore shareholder value".

According to Monks and Minow (1995:2-10) corporate governance encapsulates "the relationship between the various participants in determining the direction and performance of a corporation". The primary participants in a corporation are the shareholders, the board of directors and management led by the Chief Executive Officer (CEO). The reason for viewing these participants as primary is due to the fact that they are responsible for shaping the corporation's focus, its direction, the level of productivity and competitiveness, and ultimately its viability and legitimacy. The secondary participants include employees, customers, suppliers, creditors and the community who are influenced by the other participants that are of equal importance to the corporation and its activities. In their view, corporate governance promotes a type of active shareholder that has an interest in the conduct and performance of the corporation in which the shares are kept. It is proposed that this interest should promote a level of responsibility on the side of the shareholder, especially in terms of conduct that can impact negatively on the environment and society in which the corporation operates. These actively involved shareholders can also be referred to as *shareowners*. The term reflects not only the involvement of the shareholder but also signifies that the shareholder takes ownership of the shares that he keeps in the corporation, and ultimately of the direction and conduct of the entity. Although easily definable for a private corporation, the question remains as to how these principles are applied to other entities where large capital is at stake, for example public service projects, especially when procurement takes place within the private sector? In such cases, the shareowner may well be the tax paying public and mechanisms of governance may well be functioning in a different format.

Naidoo (2002:2) refers to corporate governance as the responsible leadership of companies. She refers to responsible leadership as being transparent, answerable and accountable to the company's identified stakeholders. She notes that a company's stakeholders are those groups or individuals who are either directly or indirectly interested in the affairs of the company. Direct interest means direct interest in its financial success (shareholders, creditors and employees) whilst indirect interest means those who are affected by the company's activities (communities and governments). In Naidoo's introduction, the issue of division of ownership of a company and control of a company is highlighted. The 'issue' results in the directors of a company representing the *de facto* owners (the shareholders) in directing and controlling the affairs of the company. Today this is the norm in almost all publicly listed corporations and is also cited as being the core problem of corporate governance. The board of directors (in their policy making) and the officers of the corporation (in the execution of these policies) reveal a general disregard for the influence on the environment and the community of their actions in maximising personal and shareholder benefit.

King (2002:10) defines corporate governance simply as the system by which companies are directed and controlled. He does mention though, that while it is a simple task to state the concept, the various stakeholders who have involvement in corporate governance in modern corporations have made it more complicated. King attributes this increased difficulty in the establishment of corporate governance to changes that the modern day brought in the corporation, especially the introduction of professional managers and the controlling shareholding changing from families to institutions.

According to the Penguin Reference Book (1985), corporate governance is concerned with "keeping the balance between economic and social goals and between individual and communal goals". Thus, corporate governance attempts to address not only financial control, but also a number of other issues, such as social and environmental responsibility (King, 2002:92).

It is therefore reasonable to deduce that corporate governance was established to address the growing concerns of institutional shareholders with the way in which the companies they hold shares in are managed, and to address the transparency, accountability and responsibility of the company's board of directors. Corporate governance was subsequently expanded into a practice by which companies are managed and controlled. According to Smerdon (1998:21) this practice includes:

- The creation and ongoing monitoring of a system of checks and balances to ensure a balanced exercise of power within a company;
- The implementation of a system to ensure compliance by the company with its legal and regulatory obligations;
- The implementation of a process whereby risks to sustainability of the company's business, are identified and managed within agreed parameters; and
- The development of practices that make and keep the company accountable to the broader society in which it operates

While corporate governance is practically still in its infancy, a large amount of literature is available on the topic, albeit not all of this is at an advanced level of peer reviewed research publications. These include practical applications and guidelines for implementation into corporate organisations.

However, throughout the review of the evolution and development of corporate governance, it became clear that the principles have not been applied extensively in other areas of strategic and operational conduct. This observation further strengthens the argument that perhaps the time is opportune to investigate its application in other forms of management disciplines, such as project management.

In order to further prepare the adaptation of corporate governance to project management, the next paragraphs explore the current state of corporate governance in a more detailed and practical way.

3.2.1 The components of corporate governance guidelines

As mentioned, the single goal of a corporation is to maximise shareholder wealth. Originally, corporate governance provided guidelines for proper corporate conduct for the protection of stakeholders' interests and shareholder value. Further developments saw a more formal control approach through the specification of actions that the officers of a corporation and the board of directors of the corporation have to take to achieve these objectives.

In some countries, corporate governance has been taken to a level where the guidelines and controls are enacted by federal laws. One such example is the Sarbanes Oxley Act of 2002 (The United States of America, 2002), an act proclaimed by the Congress of the USA.

Whether corporate governance is enacted by law or only a set of best practice guidelines (as in the case of the King Report in South Africa) depends largely on the maturity of corporate governance in each specific country. Nevertheless, in both situations, corporate governance aims to regulate the same activities. The differentiating factor is the extent to which leverage is available to ensure conformance to the proposed guidelines.

Currently there is no evidence of a universal set of corporate governance 'guidelines', 'rules', or 'laws' applicable to all countries and their organisations. In fact, a number of corporate governance models exist. These can be divided into: the Anglo-Saxon model (Dunlop, 1998:7) which is a combination of what is adopted in the Americas and the United Kingdom; the German model that is found in a number of European and Scandinavian countries; and the Japanese model (Monks *et al.,* 1995:276). Although firmly established in most developed countries, each country is still very much in a stage of internal investigation to establish some form of ultimate practice.

Although it is not the purpose of this study to provide a critical review of the differences between corporate governance practices in various countries (for that reference is made to the extensive work by Mallin (2005), which provides a thorough analysis of corporate governance developments in various countries around the globe), the paragraphs below provide an overview of the difference in approach by two countries, namely the USA and the Republic of South Africa (RSA). The reasons for reviewing the two specific countries are:

- The USA is considered to be a well developed country, while the RSA is classified as a developing country. While most developed countries have well-established corporate governance policies, the developing countries still lag in the formulation of their policies. The RSA could be considered as 'more advanced' in formalising corporate governance guidelines in the developing world and therefore the country's corporate governance guidelines will be referred to extensively in the comparative discussion.
- A secondary reason for selecting one country each from the developed and developing world is that it is assumed that the different levels of development and sociological needs might influence the approach taken to formulate a 'common' corporate governance approach.
- Lastly, the significance of looking at both approaches stems from the fact that, in a globalised environment, the question of whose corporate governance guidelines must be applied and what the mix should be, could prove to be a distinguishing factor, especially when management structures are assembled.

In the large capital project environment it is quite common that the developed countries provide substantial funding, become partners / joint ventures, or provide direct investment in these undertakings. The questions of governance, in what format and level, could potentially have a positive or devastating impact.

3.2.1.1 Corporate governance in the USA

Given recent corporate scandals and fraudulent financial reporting in the USA, the Sarbanes Oxley Act of 2002 (the 'Act') concentrates mostly on financial disclosure and reporting activities. Without analysing the detail, the indexed content of the Act is given in Table 3.1 below. The purpose of the table is to illustrate the strictness of financial and auditing principles that dominates the intent of the Act. The format and contents of the Act are significant and a key input to the eventual development of a common and generalisable project governance model.

Table 3.1: Contents of Sarbanes Oxley Act of 2002

Title	Section	Description
I		PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD
	101	Establishment; administrative provisions
	102	Registration of the Board
	103	Auditing, quality control, and independence standards and rules
	104	Inspections of registered public accounting firms
	105	Investigations and disciplinary proceedings
	106	Foreign public accounting firms
	107	Commission oversight of the Board
	108	Accounting standards
	109	Funding
II		AUDITOR INDEPENDENCE
	201	Services outside the scope of practice of auditors
	202	Pre-approval requirements
	203	Audit partner rotation
	204	Auditor reports to audit committees
	205	Conforming amendments
	206	Conflicts of interest
	207	Study of mandatory rotation of registered public accounting firms
	208	Commission authority

	209	Considerations by appropriate State regulatory authorities
III		CORPORATE RESPONSIBILITY
	301	Public company audit committees
	302	Corporate responsibility for financial reports
	303	Improper influents on conduct of audits
	304	Forfeiture of certain bonuses and profits
	305	Officer and director bars and penalties
	306	Insider trades during pension fund blackout periods
	307	Rules of professional responsibility for attorneys
	308	Fair funds for investors
IV		ENHANCED FINANCIAL DISCLOSURES
	401	Disclosures in periodic reports
	402	Enhanced conflict of interest provisions
	403	Disclosures of transactions involving management and principal stockholders
	404	Management assessment of internal controls
	405	Exemption
	406	Code of ethics for senior financial officers
	407	Disclosure of audit committee financial expert
	408	Enhanced review of periodic disclosures by issuers
	409	Real time issuer disclosures
V		ANALYST CONFLICT OF INTEREST
	501	Treatment of securities analysts by registered securities associations and national securities exchanges
VI		COMMISSION RESOURCES AND AUTHORITY
	601	Authorisation of appropriations
	602	Appearance and practice before the Commission
	603	Federal court authority to impose penny stock bars
	604	Qualifications of associated persons of brokers and dealers
VII		STUDIES AND REPORTS
	701	GAO study and report regarding consolidation of public accounting firms
	702	Commission study and report regarding credit rating agencies
	703	Study and report on violators and violations

	704	Study of enforcement actions
	705	Study of investment banks
VIII		CORPORATE AND CRIMINAL FRAUD ACCOUNTABILITY
	801	Short title
	802	Criminal penalties for alternating documents
	803	Debts non-dischargeable if incurred in violation of securities fraud laws
	804	Statute of limitations for securities fraud
	805	Review of Federal Sentencing Guidelines for obstruction of justice and extensive criminal fraud
	806	Protection for employees of publicly traded companies who provide evidence of fraud
	807	Criminal penalties for defrauding shareholders of publicly traded companies
IX		WHITE-COLLAR CRIME PENALTY ENHANCEMENTS
	901	Short title
	902	Attempts and conspiracies to commit criminal fraud offences
	903	Criminal penalties for mail and wire fraud
	904	Criminal penalties for violations of the Employee Retirement Income Security Act of 1974
	905	Amendment to sentencing guidelines relating to certain white-collar offences
	906	Corporate responsibility for financial reports
X		CORPORATE TAX RETURNS
	1001	Sense of the Senate regarding the signing of corporate tax returns by chief executive officers
XI		CORPORATE FRAUD AND ACCOUNTABILITY
	1101	Short title
	1102	Tampering with a record or otherwise impeding an official proceeding
	1103	Temporary freeze authority for the Securities and Exchange Commission
	1104	Amendment to the Federal Sentencing Guidelines
	1105	Authority of the Commission to prohibit persons from serving as officers or directors
	1106	Increased criminal penalties under Securities Exchange Act of 1934
	1107	Retaliation against informants

The Act has brought, and will continue to bring about, significant change in corporate governance, accounting and, ultimately, the financial markets - both in the United States and internationally. The Act fundamentally changed how audit committees, management and external auditors carry out their respective responsibilities and interact with each other. The Act builds on existing United States Securities and Exchange Commission (SEC) and US stock exchange (i.e. the NYSE, AMEX and Nasdaq) requirements by tightening restrictions, expanding disclosures and toughening penalties.

The most telling change may be that the Act represents a new era of public regulation in the capital markets sector. Unlike in South Africa, the United States Congress has concluded that public confidence can best be restored through greater government involvement. This involvement has led to specific requirements for affected parties with regard to corporate responsibilities, auditor regulation and independence, and financial reporting, as well as having enhanced (in some cases) new civil and criminal penalties for corporate fraud.

The primary aim of the Act is to protect investors by improving the accuracy and reliability of corporate financial and audit reporting and disclosures. However, corporate governance in the developing environment had a different onslaught, as explained in the next paragraph.

3.2.1.2 *Corporate governance in South Africa*

The initial King report (King, 1994), whilst also born out of a need to protect investors, embraced an inclusive approach that looked, not only at the financial and regulatory aspects of corporate governance, but advocated an integrated approach in the interests of a wide range of stakeholders. The report was released in 1994 and recognises that corporate governance initially had to do with accountability and transparency of a corporation's professional management team and board of directors in terms of financial conduct and reporting, but boldly hinted that governance models had to include the effect of the corporation's activities on its environment and on communities. According to the report "... the concept of directors' reports being directed solely to shareholders is changing into a report to all stakeholders. Society now expects greater accountability from companies in regard to their non-financial affairs, for example in relation to their employees and the environment." (King, 1994:4). The revised King Report, namely King II (2002), further developed the inclusiveness of the governance approach with specific reference to the *triple bottom-line*, which included the creation of economic, environmental and social value.

As opposed to the strong financial disclosure and auditing focus of the Act, the King II Report (King, 2002) has a more social orientation, as illustrated in the table below (Table 3.2). Again, the index of content of the King II Report is used to highlight the essence of the content.

By merely looking at the two indexes, there are clearly differences in the approach to corporate governance in the Act and King II. The differences emanate from the respective country's history and corporate experiences during the preceding decade. In order to improve the understanding of the differences between the two approaches, a direct comparative review is given in the next section.

Table 3.2: Contents of the King II Report

Section	Chapter	Description
1		BOARD OF DIRECTORS
	1	Role and Function of the Board
	2	Role and Function of the Chairperson
	3	Role and Function of the Chief Executive Officer
	4	Role of the Executive and Non-Executive Officer
	5	Director Selection and Development
	6	Board and Director Appraisal
	7	Disqualification of Directors
	8	Board Committees
	9	The Business Judgement Rule
	10	Role and Function of the Company Secretary
2		RISK MANAGEMENT

	1	Introduction and Definition
	2	Responsibility for Risk Management
	3	Assimilating Risk to the Control Environment
	4	Application of Risk Management
3		INTERNAL AUDIT
	1	Status of Internal Audit
	2	Role and Function of Internal Audit
	3	Scope of Internal Audit
4		INTEGRATED STABILITY REPORTING
	1	Introduction and Scope of Review
	2	Stakeholder Relations
	3	Ethical Practices and Organisational Integrity
	4	Safety, Health and the Environment (SHE)
	5	Social and Transformation Issues (including Black Economic Empowerment)
	6	Human Capital
5		ACCOUNTING AND AUDITING
	1	Auditing
	2	Non-audit Services
	3	Legal Backing for, and the Monitoring of, Compliance with Accounting Standards
	4	Information Technology
	5	Accessibility of Financial Information
6		COMPLIANCE AND ENFORCEMENT
	1	Introduction
	2	Legal Mechanisms
	3	Enforcement of Existing Remedies
	4	Principles of Disclosure
	5	Role of the Media
	6	Encouraging Shareowner Activism
	7	The Role of Organised Business
	8	Enforcement in other Jurisdictions

3.2.1.3 Key differences between Sarbanes Oxley Act and King II

Throughout the 20th century, many countries experienced economic downturns, failures, corporate scandals and even corporate collapses. This necessitated governments developing and implementing corporate governance mechanisms, either as guidelines, codes or even as law. Mallin (2005) provides a comprehensive review of the different approaches taken by various countries in establishing governance principles that will address general and country specific circumstances.

What is evident from corporate governance developments is the systematic progression away from looking solely at concerns surrounding financial reporting and disclosures to items that impact the larger society and environment, the so-called ‘triple-bottom line’ (economic, social and environmental). It is also this very aspect that proves to be the distinguishing factor between the King II approach and the Act.

The following paragraphs provide a summary of the key differences between the Act and King II as described by the Institute of Directors (IOD, 2002). A comparison is also given in tabular format in Table 3.3 that compares specific items listed.

3.2.1.3.1 Board of Directors and Audit Committee

King II, as opposed to the Act, covers a broader scope, ranging from corporate governance to the responsibilities surrounding total corporate citizenship. The responsibility of corporate citizenship becomes the core function of the board in the King II code.

A key driver behind the Act was the restoration of investor confidence and therefore the focus on responsibilities lies more with the Audit Committee, while simultaneously relying on existing SEC rules and USA stock exchange requirements and proposals to address board responsibility, composition and liability.

a) Composition

King II provides fairly clear guidelines and stipulations regarding the composition of the board. The code even states that it would be preferable to have more non-executive executive members on the board, thereby ensuring a broader societal view. Surprisingly enough, preference is also given to a chairperson being independent and non-executive. Appointment to the board should be transparent, with appropriate training and orientation given in preparation for roles and responsibilities.

The Act provides hardly any requirements or stipulations regarding the composition of the board.

b) Responsibility

- *General Responsibility*

King II pertinently states that the board is the focal point of accountability and shall be held liable for the affairs of the organisation. It provides clear guidelines regarding board responsibilities around strategy, monitoring and evaluation, selection and use of technology, performance measures, risk management and succession planning. The board should also establish a formal charter that outlines their commitment and which is published in the annual report.

- *Whistle Blowing Responsibility*

Both King II and the Act incorporate requirements for confidential reporting processes (‘whistle blowing’). The Act stipulates the introduction of this practice more clearly under the Audit Committee’s oversight responsibility.

c) Audit Committee to the Board of Directors

Both King II and the Act stipulate that the board of directors should appoint an Audit Committee for effective internal control systems.

Whereas King II requires that the Audit Committee consist of a majority of independent non-executive directors, the Act requires independence of all members.

King II also requires a level of financial literacy for all the Audit Committee members, whereas the Act stipulates the appointment of at least one financial expert.

Both King II and the Act identifies the Audit Committee's main areas of responsibilities, which include the appointment of external auditors, reviewing the accuracy of financial statements and alignment with the internal audit function, as well overseeing the appropriate regulation regarding the remuneration of external auditors.

3.2.1.3.2 Financial Reporting and Internal Control

Probably the most distinguishing area of difference between King II and the Act can be found in the guidelines and prescriptions on financial reporting and controls. Coupled with requirements for auditing, the Act provides for much more stringent directives in terms of financial controls and the regular reporting thereof in specific formats.

a) Financial Reporting Responsibility

The King II approach to financial reporting aims to establish an environment within which the board takes overall accountability for the financial affairs of the organisation. This includes assurance that the Board reports the affairs of the organisation accurately to all stakeholders. Apart from accurate representation, specific responsibilities are prescribed in terms of:

- External auditing
- Internal controls and risk management
- Applicable accounting standards
- Adherence to the Code of Corporate Practice and Conduct, as established and agreed upon by the board.

Supporting transparency and communication to stakeholders, King II also recommends regular assessments and reviews regarding the operational activities of the company, as well as indications of future direction and strategy of the company.

The Act imposes a much more stringent approach to financial management and holds the Chief Executive and Chief Financial Officer fully accountable for the financial affairs of the company. The Act requires these officers to certify that a company's quarterly (for domestic US companies) and annual SEC filing fully comply with the Exchange Act and that the information contained in the reports fairly presents, in all material respects, the company's financial condition and results of operations.

Failure to comply with this certification carries direct criminal penalties of up to 20 years imprisonment and fines of up to US$ 5 million.

b) Financial Disclosures

Supporting the stringent requirements surrounding financial control, the Act is quite prescriptive regarding:

- The disclosure of non-GAAP activities
- The reporting of off-balance sheet transactions, arrangements, obligations (including contingent obligations) and other relationships of the issuer with unconsolidated entities or other persons that may have a material current or future effect on specified elements of the issuer's financial statements.

c) Internal Controls

Instead of detailing the requirements necessary for internal control, King II adopted an over-arching approach under the banner of risk management. Defining risk management in the context of the corporate environment, it represents the process of identification and evaluation of actual and potential risks as they pertain to a company, followed by a procedure for termination, transfer, acceptance (tolerance) or mitigation of each risk. The reference to, and use of risk management principles is formalised in the SAAS (South African Auditing Standards) 400 “Risk Assessments and Internal Control” (SAICA, 2002), issued by the South African Institute of Chartered Accountants.

In comparison, the Act again allocates ultimate responsibility for internal controls to the level of top management. Monitoring their compliance to the directives, the CEO and CFO have to certify quarterly and annually that the financial results represent a true reflection of the state of the company.

3.2.1.3.3 Accounting and Auditing

King II and the Act differ in their respective approaches to accounting and auditing requirements. Whereas King II handles auditing requirements more on a secondary level, the Act provides specific legislation regarding auditing practices and reporting.

a) Independence

Although King II strongly promotes the highest level of business conduct and ethics for external auditors, it does not prevent or prohibit both consulting and auditing services from the same company. However, it does require the Audit Committee to provide principles for recommending the use of the external auditors for non-audit services, such as management consultancy and corporate finance services.

The Act's independence requirements are more expansive and specific than those in King II. The Act further expands existing SEC and American Institute of Certified Public Accountants (the 'AICPA') independence rules by prohibiting the external auditor from:

i) functioning in the role of management
ii) auditing his or her own work
iii) serving in an advocacy role for the audit client, and
iv) limit the number of years an audit firm is eligible to audit the same company's results.

b) Interaction with Companies

Apart from specifying the formulation and adherence to an internal audit charter, King II adopts fairly open, but mandatory guidelines to inter-company communication. The Act, on the other hand, specifically legislates the manner of communication between companies, focusing on misrepresentation and manipulative and fraudulent statements regarding the state of the company. The Act also specifies the nature of the communication between external auditors and audit committees.

The Act does not contain specific provisions affecting the internal audit function in a company. However, a company's external auditor is precluded from functioning in the capacity of internal audit function, or even in a partially outsourced capacity. The internal and external audit function should also establish formal communication lines.

c) New Attestation Report

Unlike King II, the Act requires the external auditor to issue an attestation report on management's internal control report. Apart from providing a thorough review over the internal control practices of the organisation, the attestation report should also report on material weaknesses in internal control and any material non-compliance.

d) Disclosure

Both King II and the Act require full disclosures on the amounts paid to the external auditor for non-audit services, with a detailed description in the notes to the annual financial statements of the nature thereof, together with the amounts paid for each of the services described. Additionally, the Act requires disclosure of fees paid to a company's principal external auditor for the two most recent years, segregated by audit, non-audit, tax and other services, as well as a description of the nature of the services.

3.2.1.3.4 *Organisational Ethics and Remuneration*

Both King II and the Act seek to influence individual ethical behaviour through requirements surrounding codes of ethics and compensation. Whereas the Act elaborates extensively on financial control and auditing, King II (and, in general, governance approaches from the developing world) focuses additional attention on safety, health, environment, social and socio-economic responsibilities.

a) Code of Ethics

Both King II and the Act, stipulate that an organisation should demonstrate its commitment to ethical behaviour by codifying its standards in a code of ethics.

b) Compensation

The establishment of a Remuneration Committee, consisting almost entirely of non-executive directors, is strongly proposed. Membership of this committee should be transparent and disclosed in the annual report. Companies should also provide full disclosure of director remuneration on an individual basis in their annual report, providing details of earnings, share options, restraint payments and all other benefits. King II further supports performance-related elements of remuneration.

Legislation in the Act goes further, imposing direct accountability on the CEO and CFO. Firstly, the Act prohibits the arrangement or renewal of credit in the form of a personal loan to or for any director or executive officer or their immediate family. Secondly, the Act requires that if, as a result of misconduct, a company is required to make an accounting restatement due to material non-compliance with the financial reporting requirements, the company's CEO and the CFO must reimburse the company for calculated amounts from their personal remuneration.

c) Integrated Sustainability

Again, as opposed to the strong financial, audit and transparency approach contained in the Act, King II emphasises the importance and responsibility of companies to the environments they are operating in. This includes the social and natural components of society. The argument is that unless companies look after their suppliers, customers, employees and the environment in which they operate, shareholder value is likely to suffer any way. This means that a well-run board of directors will have to deal with these interests to ensure long-term corporate health and therefore shareholder value.

King II adopted an approach from a single bottom line to a triple bottom line. The triple bottom line embraces economic, environmental (including health and safety) and social aspects of a company's activities.

- *Economic aspects*

King II warns that it must be constantly borne in mind that entrepreneurship and enterprise are some of the most important factors that drive businesses. Entrepreneurs that take risks and initiatives drive economies. If the shareholder cannot earn an acceptable return on his investment, he will not invest, and there will be no growth in commercial or industrial activity. Without profitability, there would be no enduring interest in a corporation. If there were no investors, none of the other stakeholders would have an enduring interest in the corporation either.

Clearly, the economic side of corporate governance can therefore not be completely neglected, nor should one allow the other interests of corporate governance to overshadow the financial performance of the corporation, as this would negate the necessity for any other stakeholders' interest, or the protection thereof through corporate governance. A successful economy is dependant on successful companies that operate in that economy. The corporate governance system should therefore avoid control that can stifle an enterprise. A participative corporate governance system and companies with integrity is needed.

Sheridan and Kendall (1992:27-51) support this view by stressing the importance of the fact that businesses have to be successful to survive and grow. Governance, like any other aspect of business, has to be considered in the context of its contribution to business success. While the board's function is to act as an agent of the owners (shareholders), and as trustees of their interests, this suggested participative corporate governance promotes the interest of a range of other stakeholders, outside of the primary business drive, namely wealth maximisation. This 'softer' side of corporate governance is summarised as follows (Sheridan *et al.*, 1992:27):

- Fulfil the long-term strategic goal of the owners (wealth maximisation),
- Consider and care for the interests of employees, past, present and future, which we take to comprise the whole life-cycle including planning future needs, recruitment, training, working environment, severance and retirement procedures, through to looking after pensioners.
- Take account of the needs of the environment and the local community, both in terms of the physical effects of the company's operations on the surroundings and the economic and cultural interaction with the local population.
- Work to maintain excellent relations with both customers and suppliers in terms of matters such as quality of service provided, considerate ordering and account settlement procedures.
- Maintain proper compliance with all the applicable legal and regulatory requirements under which the company is carrying out its activities.

- *Safety, Health and Environmental (SHE) considerations*

Shareholders should not only feel obliged and able to cross swords with management who they believe are acting in a way detrimental to the profitable conduct of the business, but should be as concerned about environmental issues, learning from other companies' mistakes and strategies, and providing training to communities in which the company operates. King II highlights that the environmental aspect of corporate governance includes the effect on the environment of the product or service produced by the company. An article in an Asian Development Bank Review publication (2001) shows that the separation of economic growth and environmental concerns has come at a high cost to the environment. It is estimated that by 2020 half of Asia's population is likely to live in the cities, further straining an already inadequate infrastructure for water supply, housing, and sanitation. The poor are often most directly dependant upon forests, fisheries and other natural resources threatened by depletion and degradation. Some of the reasons cited for this phenomenon are excessive reliance on centralised, top-down approaches and inadequate participation of civil societies in environmental management. What does this have to do with corporate governance? The Asian Development Bank article illustrates that a biased approach to the primary objective of a corporation, namely wealth maximisation, can have a detrimental effect on the environment in which it operates, with a knock-on effect on the sustainability of the corporation. Corporate governance should therefore also adopt a balanced approach, taking into account the economic performance and environmental constraints within which the corporation operates to ensure sustainability of the company's business. King II (2002:123) supports this view by providing practical recommendations for safety, health and environment (SHE). These include:

- Business processes and SHE management principles should be integrated.
- Environmental corporate governance must reflect current South African law by the application of the "Best Practicable Environmental Option" standard (defined as that option that has the most benefit, or causes the least damage, to the environment at a cost acceptable to society)

Corporate governance should reflect a committed effort to reduce workplace accidents, fatalities and occupational health and safety related incidents. There should also be regular measurement against an ongoing improvement objective, which should be disclosed to stakeholders.

c) *Social*

Employees, communities, consumer and public interest groups are raising concerns about the performance and impact of corporations on employment practices, pollution, genetic engineering, product safety, essential public services and many other matters. The most serious concerns tend to be over corporate practices in poorer countries, where governance and financial constraints have made it more difficult for legal, environmental, health and safety standards to match those in developed countries.

Corporate governance's higher aim is to provide an international framework on corporate accountability and liability. This would secure the accountability of corporations to citizens and communities in today's globalised economy by establishing:

- Rights for citizens and communities affected by corporate activities;
- Duties on corporations with respect to social and environmental matters; and
- Rules to ensure high standards of behaviour wherever corporations operate.

The approach goes beyond voluntary corporate responsibility initiatives to establish corporate accountability to stakeholder citizens as a legal right. It seeks to help close the democratic deficit created by corporate globalisation by underlying the principles of rights, democracy and equity demanded by communities protesting against corporate globalisation.

South African corporations have a duty to support transformation issues such as black economic empowerment (BEE) and to involve local communities in their activities to support job creation. One of the task teams established to review corporate governance for King II focused on *Integrated Sustainability*

Reporting. They analysed a wide range of complex areas of reporting of a non-financial nature, including ethics and societal and transformation issues, including BEE. While some of these issues have been addressed in recent legislation (Employment Equity Act, Act No. 55 of 1998) as referred to in King II (2002:9), this currently only affects larger companies.

McGregor (2000:10) relates that Corporate Governance touches us all: “We buy gas from a filling station owned by a global company. The food we buy is imported from distant countries and continents … corporate governance impacts on the quality of lives not only of shareholders, but employees and those communities impacted by key corporate decisions.” She continues to paint a picture in which she highlights the social or human side of governance through a definition of corporate governance:

“*Governance is the process whereby people in power make decisions that create, destroy or maintain social systems, structures and processes*.”

She regards the corporate governor (i.e. board of directors) as a significant part of the fabric of our society, agents for change and guardians of existing ways of working. This is often forgotten in the business of making money and responding to a competitive market.

A few corporations make a virtue of internalising costs, believing this voluntary 'corporate social responsibility' enhances their brand and provides a competitive edge. Such a strategy works for corporations that have become relatively accountable to their customers, but it works almost as well for some as a marketing hype veneer that disguises a grim reality.

Governments have supported voluntary corporate social responsibility and some even have ministers with duties to promote it. However, such voluntary action is not common to all companies. Unless all corporations are made equally accountable for their environmental and social impact there remains little incentive for a general improvement in behaviour. What is more, those corporations that want to become more socially responsible are being held back by competitors who can undercut them by continuing to externalise costs and by demonstrating no responsibility. Substituting regulation with voluntary initiatives, has therefore failed to deliver sufficient progress in practice to date.

King II reacts to this dilemma by providing the following recommendations for incorporating social aspects into governance:

- Companies should value diversity of approach, values and the contribution that women and black people bring to the table and should develop mechanisms to positively reinforce the richness of diversity.
- Social investment prioritisation and spending, as well as procurement practices, should take cognisance of the need for BEE and, in particular, the need to empower women.
- Companies should disclose the nature of policies and practices in place to promote equal opportunities for the previously disadvantaged, in terms of them realising their full potential and reaching executive levels in the company.
- The company's policy on investment of corporate funds should be disclosed. In particular, pension funds and institutional investors, both in the private and public sectors, should indicate in a Statement of Investment Principles and Policies or equivalent document the extent to which they take into account socially responsible investment criteria in their investment decisions.

In an extension to the above, King II also provides specific recommendations regarding the development of human capital according to the following guidelines:

- Companies should disclose the criteria by which they propose to measure human capital development and report accordingly on their performance in terms of such criteria.
- Business practice should reflect requirements of human capital development in areas such as the number of staff, with a particular focus on demographics (race, gender and people with disabilities), age, corporate training initiatives, employee development and financial investment committed.

The above paragraphs outline the emphasis of King II on corporate responsibilities beyond financial management. This emphasis is typical of a developing environment and, since large projects often have developed and developing elements and stakeholders, will be of key importance when identifying the key components of a project governance model.

Table 3.3 below summarises the above descriptions and two approaches to corporate governance.

King II and the Act have introduced new and varied corporate governance requirements. Some focus on increased responsibility, whereas others focus on increased accountability.

What is of importance though is that while different institutional investors have their individual agendas domestically and abroad, certain key corporate issues are found to be of common concern – and that it is in the court of public opinion where a company's corporate governance practices, and the business results they produce, will ultimately be judged. With this view, King II summarises the spirit of corporate governance practise as follows:

- Discipline – corporate discipline is a commitment by a company's senior management to adhere to behaviour that is universally recognised and accepted to be correct and proper.
- Transparency – the ease with which an outsider is able to make meaningful analysis of a company's actions, economic fundamentals and the non-financial aspects pertinent to that business.
- Independence – the extent to which mechanisms have been put in place to minimise or avoid potential conflicts of interest that may exist, such as dominance by a strong chief executive or large shareowner.
- Accountability – individuals or groups in a company, who make decisions and take action on specific issues, need to be accountable for their decisions and actions.

- Responsibility – this pertains to behaviour that allows for corrective action and for penalising mismanagement. The board must act responsively to and with responsibility to all the stakeholders.
- Fairness – the systems that exist in a company must be balanced in taking into account all those that have an interest in the company and its future.
- Social responsibility – a well-managed company should be aware of and respond to social issues, placing a high priority on ethical standards.

Table 3.3: Summarised comparison between King II and the Act

Board of Directors and Audit Committee		
	King II	**Sarbanes Oxley**
Composition	• Sufficient size • Comprised of executive and non-executive members • Preferably a majority of non-executives, of whom a sufficient number should be independent • Chairperson should be independent	• Not separately addressed
Responsibility	• Board has ultimate accountability for the affairs of the company • Board should adopt a formal charter describing its responsibility, which should be disclosed annually	• Not separately addressed • Whistle blowing responsibility is assigned to the Audit Committee
Audit Committee to Board of Directors	• Majority must be independent • Majority of Audit Committee members must be financially literate • Various defined responsibilities	• All members must be independent • Must include at least one financial expert • Various defined responsibilities
Financial Reporting and Internal Control		
	King II	**Sarbanes Oxley**
Financial Reporting Responsibility	• Board must report certain items annually regarding the preparation of financial statements and the use of effective internal controls	• Quarterly certification by the CEO and CFO regarding compliance with the Exchange Act
Financial Disclosures	• No specific requirements	• Prohibition of certain non-GAAP information • Required disclosures in

		quarterly and annual reports of all material off-balance sheet transactions and other defined relationships • All material correcting adjustments to the financial statements must be made
Internal Controls	• Internal control considered part of the risk management process • Board must implement and maintain generally recognized risk management and internal control models • Disclosures must be made about the risk management process	• Requirement for quarterly certification by the CEO and CFO regarding their responsibility over disclosure controls and procedures • An annual internal control report prepared by management to be included in annual filings with the SEC
Accounting and Auditing		
	King II	**Sarbanes Oxley**
Independence	• External auditors should observe the highest level of business and professional ethics and should be objective and aware of their accountability to shareholders	• Prohibits defined activities by the external auditor • Stricter partner rotation rules, limits on employment of former external auditors, and prohibition of fees earned by the audit partner for certain non-audit services
Interaction with Companies	• Requires an effective internal audit function with a formal internal audit charter	• Requires mandatory communication between the external auditor and the audit committee
New Attestation Report	• Not separately addressed	• External auditor must issue an attestation report on management's internal control report
Disclosure	• Requires separate disclosure of the amounts paid to the external auditor for non-audit services together with a detailed description of the nature of services	• Requires disclosure of fees paid to a company's principal external auditor for the two most recent years with a description of the nature of services
Organisational Ethics and Remuneration		
	King II	**Sarbanes Oxley**
Code of Ethics	• Standards of ethical behaviour should be codified in a code of ethics • Adherence to this code should	• Must disclose whether a code of ethics applicable to senior management has been adopted

	be disclosed	• Code should be made publicly available and any changes to the code or waivers from the code must be disclosed
Compensation	• Performance-related elements of compensation should represent a substantial portion of the total compensation package • Vesting periods, re-pricing of options and other pertinent information relating to granting of options should be approved by shareholders	• Makes it unlawful for a company to extend personal loans to directors or executive officers • Requires reimbursement to the company by the CFO and CEO of certain compensation received when financial statements are restated
Integrated Sustainability	• Included in business processes • Economic • SHE	• Not separately addressed
Social	• Requires detail regarding inclusion of all local labour and stakeholders	• Not separately addressed

Source: IOD, 2002, PriceWaterhouseCoopers

Even though philosophical, the above could serve as a moral test for corporate practices.

Since the 1990s, the formalisation of corporate governance has created much debate, exploration and research in terms of perfect management practice. With the current models available, academics and practitioners continue to explore shortcomings and best practices to be incorporated in new revisions of the acts and guidelines. The following paragraphs explore some of the latest thinking in the field of corporate governance and provide a brief glance into the future in terms of what may be expected in model updates. By considering the latest developments, this research attempts to develop a model that will be relevant to its time and provide an opportunity to incorporate the most modern thinking available.

3.3 Latest developments in corporate governance

It could be argued that corporate governance is a globally accepted concept and that debate around the topic focuses more on content and application rather than on validity. Gillibrand (2004:5) states that corporate governance guidelines produced by the Organisation for Economic Co-operation and Development (OECD) increase rather than decrease pressure on countries to develop and implement corporate governance guidelines and standards. They strongly encourage the application of good corporate governance as a precondition for international loans to governments for financial sector and other structural reforms as well as equity investment in, and bank loans to, larger companies. Although the pressure is currently on listed companies 'to comply or explain' their corporate governance principles, this requirement is likely to be extended not only to all listed companies, but also to other privately and publicly owned companies and organisations that want to use 'other people's money' (including tax payers') as equity, loans or bonds.

In support of the approach taken in this research, in terms of which a model from each of the developed and developing worlds were studied, the Commonwealth Secretariat convened a group to examine the scope of corporate governance for development and to identify areas where the OEDC principles should be revised to better accommodate the concerns of developing countries as well as emerging markets. In their study, the Commonwealth group identified various areas to be addressed in a developing environment and a summary of this is provided below (Gillibrand, 2004:10-11):

- *Geographical expansion to developing countries:*
  An immediate need was identified to expand the concept to especially pan-African and pan-Caribbean forums. However, the adoption of the principles has been slow since true evidence is still required that positively links good corporate governance with poverty elevation. Thus, the changes to initially stipulated principles in a developed environment

had to incorporate local developmental needs and clearly demonstrate not only financial accountability but also other parameters such as:

- Investment for growth and for employment creation
- Competitiveness for the global market
- Corporate environmental and social responsibility
- Increase in public sector agency efficiency.

- *Sectorial as well as geographical expansion of corporate governance:*
  Up until 2001, the conventional approach to corporate governance regarded this as irrelevant for state-owned enterprises, family owned corporations, public service boards, cooperatives, small and medium enterprises and even the banking sector. According to Gillibrand (2004:11) one of the main reasons was theoretical in that the concepts of corporate governance were based on the principle-agent relationship, which was considered to apply to joint stock companies. Even though this limiting and constraining approach resulted in initial confinement of the concept of corporate governance, extension into other sectors and organisational formats, from private to public, has accelerated since 2001. Again, the realisation of the wider development and application of the principles of corporate governance supports this investigation into its application to the field of project management.

- *Convergence and segmentation of different aspects of corporate governance:*
  Linked to the previous paragraph's plea for sectorial extension of corporate governance is the convergence of different core aspects of governance, which have been running in parallel for the past decade, but now seem to be flowing together into a comprehensive approach to corporate governance. In the past, there was a tendency for segregation between corporate governance, corporate social responsibility, corporate environmental responsibility, corporate citizenship and director professionalism. Again, because of the initial principal-agent relationship approach, focus was mostly on protecting shareholder value through procedural and organisation aspects, bureaucratic structures, systems,

audits, codes and 'ticking boxes'. However, the emerging modern 'inclusive' approach refers to the responsibility of corporate citizenship and highlights the other end of the spectrum. The proponents of corporate social and environmental responsibility consistently talk in terms of stakeholders, while some of the stricter exponents of corporate governance deny that there was any validity whatsoever in the concepts of 'stakeholder', and argued that it served to weaken the essential principle of corporate accountability to shareholders.

The shareholder versus stakeholder debate is active and in a state of flux. Letza, Sun and Kirkbride (2004) provide valuable insight into this debate and its status in mid-2004. Although the general observation is that there is a visible recognition by most organisations to include stakeholders into their governance models (Anglo-American style), there is also notable evidence of countries moving from an inclusive stakeholder model to a more exclusive shareholder model, especially in Germany and Japan (European-Asian style). Even though both shareholder and stakeholder perspectives claim superiority of their models, reality has shown a dynamic shift, with both models becoming increasingly mutually attractive in various aspects.

The above paragraphs highlight the fairly advanced state of corporate governance debate and development. The foundational principles are well established on the basis of responsible and accountable actions by those in power. It is also believed that the current status supports the further development and application of governance concepts in other forms of managerial structures, such as project teams and their management. The following section explains some of the inherent principles and evident approaches to be taken into consideration when developing a project governance model.

3.4 Approaches to the development of a project governance framework

Although it is not the purpose of this research to investigate the validity of each argument, it is believed that a review regarding current thinking and postulations on corporate governance is an important aspect in developing a project governance model. Flexibility towards the development process is required, especially in a project environment where the static conceptualisation of shareholding and stakeholding is less compatible with the fluidity and diversity of practical reality. As explained by Letza *et al.* (2004:257), the current dichotomised and static theoretical approach used in corporate governance research, which presupposes two extreme and opposing ideal models (static versus process driven), cannot fully explain the complexity and heterogeneity of corporate reality. The further development and research in corporate governance, as well as subsequent development of complimentary models for other types of organisations (i.e. temporary project organisation), calls for an inventive and flexible approach. According to Letza *et al.* (2004:258), such an approach should comprise the following:

- *Process rather than static approach:*
  This approach explains and allows for the temporary, transient and emergent patterns of corporate governance on a historical and contextual interface in any society. Corporate governance is completely changeable and transformable and there is no permanent or universal principle that covers all societies, cultures and business situations. It acknowledges that corporate governance models around the globe have developed from their own unique cultural, historical and social circumstances. It also acknowledges that each model will continue to evolve. For example actors in the Anglo-American and German-Japanese governance environments will learn from each other, each taking aspects from the other's model to improve their position in global competitiveness and transparency.

- *A balanced approach:*

  This approach assumes that no extreme model can exist and function effectively, such as a pure shareholding or pure stakeholding model can exist. An organisation is never a purely private or purely public entity. It does not consist purely of physical assets, but also of human beings, shareholders and stakeholders.

- *A relational approach:*

  In order to learn, business relationships must consider corporate relationships and social interactions. Thus, shareholder interest is not independent of stakeholder actions and *vice versa*. An organisation is not independent of its constituents. Separating shareholder and stakeholder interests comes down to over simplification of a social reality.

- *A pluralist approach:*

  Critical to this approach is the recognition that corporate governance is not only conditioned to the economic logic of economic rationality and efficiency, but also shaped and influenced by politics, ideologies, philosophies, legal systems, social conventions, cultures, modes of thought and methodologies. A purely economic and financial analysis of corporate governance is too narrow (Turnbull, 1997:180).

- *A dynamic and flexible approach:*

  Having to continually weigh and adjust the methods of governing in practice, an ideal model cannot be fixed as a 'once-and-forever' solution. According to Hood and Jones (1996), it is a principle of design and management of institutions through explicitly juggling rival viewpoints in a constant process of dynamic tension with no pre-set equilibrium.

- *An enlightening approach:*

  Challenge and transcend habitual, inertial, static and stagnant ways of thinking about corporate governance. As mentioned by Morgan (1997), people are easily trapped by favoured ways of thinking that serve specific sets of interests and consequently our conventional modes of thought may in turn bind and control our views. We need to think outside of the current polarised framework of models. We need to truly understand what corporate reality is, how and why we have constructed it, both collectively in history and in different contexts, and what trends and patterns could most likely emerge in the uncertain future.

In line with the above approaches, some attempts have been made to introduce governance principles into the project management field.

3.5 Introducing governance into the project management field

Supporting the general notion that governance principles should be extended to other fields of management, and especially to project management, some work has been published on the topic in recent years. The work, mostly from study groups and individual authors, covers topics such as the g*overnance of project management,* from the APM in the United Kingdom (APM, 2004), *programme governance* (Reiss*,* Anthony, Chapman, Leigh, Pyne and Rayner, 2006) and *project governance* (Renz, 2007).

Although the document produced by the APM (2004) focuses more on the practice of project management as a management discipline, rather than on describing governance as a strategic function, it does make comparisons between the principles contained in the document and corporate governance guidelines. However, the main focus remains with the responsibilities of the acting project manager.

Reis *et al.* (2006) provide a more strategic approach to the application of governance principles to projects. Although only seen as a small subset of programme management, some important documents are listed and deemed important for programme governance. These documents include strategy documents, the programme brief, the business case, highlight and exception reports as well as the risk register. Reis *et al*. (2006) also make an attempt to illustrate the alignment between corporate and programme governance by introducing a comparative table. A reproduction of the comparative table is given below in Table 3.4 (Programme governance versus corporate governance). In compiling the table, only generic corporate governance clauses were referred to.

Focusing on non-profit organisations, Renz (2007) describes the function of project governance as bridging the gap between corporate governance at the strategic level and project management at the operational level. Instead of addressing the conditions required for a conducive environment within which projects could be managed Renz (2007), proposes a project governance model that aligns project activities with strategic objectives.

Table 3.4: Programme governance versus corporate governance

Issue	Corporate Governance	Programme Governance
Structure of the board	The role of chairman and chief executive should be divided.	The programme board should have a balanced structure, including representation from the key divisions / stakeholders being affected.
Management of the board	There should be: a. regular board meetings b. clear division of responsibility between members, with no single director being allowed unfettered discretion to make decisions c. a formal written schedule of matters for approval by the board.	There should be: a. regularly programmed board meetings b. clear delineation of responsibilities of the programme board c. regular agenda items for review, including projects in the programme.
Board competence	Directors should initially receive instructions regarding their responsibilities following their appointment and additional instructions and from time to time.	Programme directors and other members of the programme board who have no programme or project experience should be trained before taking up their role.
Board membership	Boards should establish nomination committees.	The make-up of the programme board should provide a balanced view of key stakeholders.
Remuneration	A remuneration committee is required and its members are required to have no business or other relationship with the company that could affect the independence of their judgement.	Where the programme director or programme manager has a personal interest, or their company has an interest in one or more of the projects, then this must be declared. The programme director or programme manager should withdraw from any discussion on the project.
Financial controls	The board has a duty to present an assessment of the company's financial position.	The programme board should ensure the production of up-to-date financial and management accounts.

Other internal controls	Directors of listed companies must: a. conduct a review at least once a year and report to shareholders on the effectiveness of the company's system of internal control b. where there is no formal internal control system, annually review the situation and report to the shareholders why the board does not consider such a system necessary and outline other procedures in place to provide information to the board.	The programme management arrangements should include internal controls for: a. financial approval and management b. benefit management c. risk management d. planning and tracking e. change control f. documentation management g. reporting h. programme assurance, including checkpoints and audits.

Source: Reis *et al.* (2006)

The model proposed includes such main components such as:

- Systems management
- Mission management
- Integrity management
- Extended stakeholder management
- Risk management
- Audit management

Although some components, such as extended stakeholder management and audit management, are strongly linked to corporate governance principles, the item's components relate to system breakdown and overall project scope definition. Renz (2007) also proposes a definition of project governance, namely:

Project governance is a process-orientated system by which projects are strategically directed, integratively managed and holistically controlled, in an entrepreneurial and ethically reflected way, appropriate to the singular, time-wise limited, interdisciplinary and complex context of projects.

The project governance model proposed is largely based on the author's rational arguments and not on empirical research.

3.6 Summary

The question of governance is found to be inherent to the evolution of the corporation. Through the centuries, the church, state, individuals and companies investigated and experimented in various ways to build cooperation and collaboration among parties engaging in trade and business. The relationships varied in level of formality, from personal agreements to fixed and formal contracts governed by the power of the church and / or legislation. The modern, capitalist society brought about behaviour that tends to be self-centred, profiteering and even greedy, resulting in various forms of misconduct on a grand scale. With the enormous pressure from shareholders on cooperatives to be profitable and grow on an annual basis, as well as major incentives for management if they achieve their targets, the environment became fertile for new forms of mismanagement and misrepresentation of the reality. This tendency has led to great financial losses for shareholders and investors as well social and environmental misery during the past three decades.

To address this negative trend, various governments embarked on a program to improve the control of corporate activities. This resulted in the formalisation of corporate governance in various formats according to each country's needs. In the developed world, corporate governance models were focused predominantly on financial accountability, transparency and reporting. The most well known example is that of the Sarbanes-Oxley Act in the USA, where strong legislation forces companies to be extremely transparent, especially in terms of board composition and financial and accounting conduct. The main objective of the Act is to protect shareholders and investors in joint stock companies.

As opposed to the developed world, the developing world provides guidelines and not necessarily legislation that focuses on social and environmental issues as well. The developing world's approach is more inclusive and moves beyond shareholders to stakeholder involvement. The different approaches become clear when comparing the two models, one from the developed world (in the Sarbanes-Oxley Act) and the other from the developing world (in the form of the King II Report in South Africa).

The two schools of thought, that of shareholder versus stakeholder interest, is quite evident in corporate governance literature, with a clear observation that the two seemingly opposing approaches are converging in some developed countries, especially in Europe and Asia, which are becoming more stakeholder orientated and developing countries realising the importance of protecting shareholder wealth.

Although fairly mature, the further improvement of corporate governance models requires different approaches for further enhancement. These approaches might well be a mixture of processes, balanced, relational, pluralist, dynamic and enlightening.

The historical development of corporate governance, establishment and formalisation of existing models from the highest, most influential echelons of society and the vibrant, challenging debate on what or who should be included and excluded from governance practices, provides a solid yet flexible base from which to develop the concept further into other forms of managerial arrangements such as project management. It is believed that the time is more than ever opportune to investigate, develop and formalise, as far as possible, a project governance model that is globally applicable and incorporates the cross-country, cross-culture, stakeholder and shareholder approaches and unique nature of the temporary project organisation.

The following chapter discusses the research approach and design considered in the establishment of such a project governance framework.