PRACTICAL APPLICATION OF CORPORATE GOVERNANCE PRINCIPLES IN A DEVELOPING COUNTRY: A CASE STUDY

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Abstract

The importance of examining corporate governance in organisations cannot be overemphasised. Corporate governance failure which has resulted from weak corporate governance systems has highlighted the need for research aimed at contributing to the improvement and reform of corporate governance at business, national and international level. A review of corporate governance mechanisms and their practical application in two retail companies in South Africa was undertaken. The research question that informed the study was: What is the nature of corporate governance mechanisms in the South African retail sector? The research design entailed analysis of secondary data, namely Annual Reports and other pertinent documents, and document analysis was used to show what is accessible to the ordinary share/stakeholder and what is not. Data analysis was conducted both qualitatively and quantitatively. With regard to corporate governance mechanisms, the results and discussion show that the two companies have not yet complied with the King II and III codes. Recommended strategies to strengthen corporate governance mechanisms in the South African retail sector should include a commitment to risk disclosure and revamping of the corporate governance structure of the ‘whole’ system.

Keywords: Corporate Governance, Retail Companies, King II And III Codes

1. INTRODUCTION

This article examines the concept of corporate governance principles in South Africa. The term ‘corporate governance’ has been the subject of some controversy, and was rarely used (for example, in discussion of common law) prior to the 1990s. How to ensure that the power of an organisation is harnessed for the agreed purpose rather than diverted in some other direction is a constant theme in corporate governance. Solomon and Solomon (2014) explain that the term ‘governance’ derives from the Latin *gubernare*, meaning ‘to steer’ (usually in relation to steering a ship); this implies that corporate governance involves the function of direction rather than of control. The objective of this article was to analyse the practical application of corporate governance in two retail companies in South Africa. Its purpose was to uncover differences and similarities and make recommendations as far as corporate governance is concerned. The focus question is ‘What is the nature of corporate governance mechanisms in the South African retail sector?’

1.1. Problem statement

According to Monks and Minow (2008) the global importance of corporate governance became dramatically clear in 2002 as a series of corporate meltdowns, frauds, and other catastrophes led to the destruction of shareholders’ wealth, loss of jobs, criminal investigation of dozens of executives, and record-breaking bankruptcy filings. Hence the importance of examining corporate governance in the nation’s companies cannot be overstated.

Corporate governance failure which has resulted from weak corporate governance systems has highlighted the need for research aimed at contributing to the improvement and reform of corporate governance at business, national and international level. Not much company-specific research is being undertaken to establish the extent to which corporate governance reforms have been implemented in the country, although the subject has been given attention in Western countries such as the United States of America (USA) and the United Kingdom (UK). The paper identified a gap in research with regard to the nature of corporate...
governance mechanisms and broader corporate governance agenda namely Corporate Social and Environmental Responsibility (CSER) in South Africa.

Having introduced the thrust of this article, the next section provides a literature review of the construct of corporate governance and related theories.

2. LITERATURE REVIEW

2.1. Corporate governance

Corporate governance reforms were undertaken in earnest from the beginning of the 1990s due to a number of well-publicised corporate problems and scandals in the late 1980s and early 1990s. From questionable earnings to outright fraud, businesses came under increasing scrutiny by shareholders and regulators alike. Corporate problems of the 1980s (as of today) involved creative accounting, spectacular business failures, the apparent ease of unscrupulous directors in expropriating other stakeholders’ funds, and the claimed weak link between executive compensation and company performance (Keasy and Wright, 1997; Mongalo, 2003).

In light of a modern world where many large companies have collapsed due to directors acting in their own self-interest, instances of abuse of corporate power, fraud, criminal investigations, mismanagement and excessive executive compensation have negatively impacted economic systems and undermined investors’ and the public’s confidence in business management.

There is no single accepted definition of corporate governance. In general, corporate governance is an economic, legal and institutional framework in which a corporate is directed and controlled (Friedman and Miles, 2006). Corporate governance, for the purposes of King IV (2016), is about the exercise of ethical and effective leadership by the governing body, which includes four overarching responsibilities of this governing body: (i) providing strategic direction; (ii) approving policy to put strategy into effect; (iii) providing informed oversight of implementation and performance; and (iv) disclosing.


Corporate governance is concerned with the enhancement or fortification of the rules and principles of company direction for the purpose of accommodating the modern environment within which companies operate and the imposition of stricter checks and balances to ... alleviate malpractices by those engaged in corporate decision making.

In South Africa the corporate governance principles apply to ‘affected companies’ as defined in the King II (2002) code - companies with securities listed on the Johannesburg Stock Exchange (JSE). As Mongalo (2003) explains, the term ‘corporate governance’ has come to be associated only with listed companies, although this is not necessarily the case. In this article corporate governance will be defined as:

*the system of checks and balances, both internal and external to companies, this ensures that companies discharge their accountability to all their stakeholders and act in a socially responsible way in all areas of their business activity” (Solomon and Solomon, 2014:14).

Having provided an introduction to corporate governance, the next section entails discussion of a number of theoretical corporate governance frameworks and mechanisms.

2.2. Theoretical frameworks and mechanisms of corporate governance

First we discuss agency theory in corporate governance, followed by a brief discussion of the King codes, mainly King III (2009). A discussion of corporate governance mechanisms is also presented, mainly from a South African perspective. According to Luo (2009) and Luo and Salterio (2014) these mechanisms entail examining the importance of corporate disclosure, internal control and risk to effective corporate governance.

2.2.1. Agency theory

Although the majority of shareholders own, in part, the investee company, they have little to do with running the company; this is the job of the company directors to whom they entrust their funds (Solomon and Solomon, 2014). According to the King codes (II and III), the company is integral to society, particularly as a creator of wealth and employment. The company is the preferred vehicle in which to pool human and monetary capital. These are enterprisingly applied in the expectation of a return greater than a risk-free investment such as a deposit in a bank. Jensen and Meckling (1976) defined the managers of the company as the ‘agents’ and the shareholder as the ‘principal’, and agency theory is mainly concerned with resolving two problems that can occur in this relationship:

- The first problem arises when the objectives of the principal and agents conflict and it is difficult or expensive for the principal to verify the agents’ behaviour; and
- The second is the risk-sharing problem that arises when the principal and agents may prefer different actions because of different risk preferences (Luo, 2009; Luo and Salterio, 2014).

Due to the above, principals are worried about self-seeking managerial opportunism. Hence it is important to consider direct ways in which shareholders can ‘monitor’ company management and help resolve agency conflicts (Solomon and Solomon, 2014).

2.2.2. King III and King IV – ‘apply or explain’

Corporate governance was first institutionalised in South Africa with the publication in 1994 of the first King Report on Corporate Governance (‘the Code’, or King I), replaced in 2002 by King II. The distinguishing aspects of corporate governance reform have been its focus on a stakeholder-oriented, all-inclusive and voluntary, self-regulated approach. King III was launched and was effective from 1 March 2010, and will be replaced by the King IV draft of 2016. Some of the key changes in the King III Report (King III and Institute of Directors South Africa, 2016) are as follows:
• Boards and directors: The majority of directors must be non-executive directors (NEDs) and independent. The Board should be directed by an independent non-executive chairperson;
• Remuneration of directors: Shareholders must approve the remuneration policy, which must be published annually. The chairperson and NEDs must not receive share options;
• Risk management: The concept that risk management and information technology governance and security is inseparable from the company’s strategy and business processes was introduced;
• Compliance with laws, regulations, rules and standards: This is dealt with in a separate chapter and not as a mere function of the Board;
• Managing stakeholder relationships: For the first time this is dealt with as a separate chapter and not as part of reporting on sustainability;
• Mergers, acquisitions and take-over: These are included in the Code for the first time due to changes in the Companies Act; and

Application of the code: King III applies to all entities, regardless of the manner and form of incorporation or establishment.

The above key aspects of corporate governance will be used to analyse the extent to which the two companies have complied with the King III Report.

Also importantly, the King III (page 13) report states that “the legacy of apartheid is fundamentally unsustainable – social transformation and redress is therefore an important aspect and needs to be integrated within the broader transition to sustainability”. Redress together with Black Economic Empowerment has become crucial in South Africa especially in the post-apartheid era. Therefore, composition of each of the companies will be analysed using the number of black directors and women directors to measure board of directors’ transformation.

The Permanent Subcommittee on Investigations of the Senate Committee on Government Affairs, USA Senate (2002) chose to codify a significant part of its governance in an Act of Congress known as the Sarbanes-Oxley Act (SOX). This statutory regime takes the form of ‘comply or else’; in other words, there are legal sanctions for noncompliance. The cost of compliance by American companies with section 404 of SOX, which deals with verification of internal controls, by 2008 was estimated at $264bn since the inception of SOX in 2002 (King III). The 56 countries in the Commonwealth, including South Africa and the 27 states in the European Union (including the UK), have opted for a ‘comply or explain’ basis, in addition to certain governance issues that are legislated. Therefore company directors are required to ‘apply’ their code or ‘explain’ the reasons for not doing so. The JSE Limited requires that listed entities must disclose the extent of their compliance with King II and explain areas of noncompliance.

2.3. Why is good corporate governance important?

Many company directors have opposed the ongoing process of corporate governance, considering these initiatives as slowing down decision making and adding unnecessary levels of bureaucracy and red tape. Richard Branson’s experiment with the London Stock Exchange in the mid-1980s found that ‘excessive’ corporate governance hindered his decision making, slowing down his ability to ‘make things happen’ (Solomon and Solomon, 2014). Nevertheless, there is a growing perception in the financial markets that good corporate governance is associated with prosperous companies (Solomon and Solomon, 2014; KPMG, 2014). For example Luo and Salterio (2014:467) argue that corporate governance reflects and enforces the company’s value and contributes to the company’s legitimacy and the credibility of its decisions and reporting. Luo and Salterio (2014:469) further posit that a well-functioning corporate governance system can also create a competitive advantage and heighten a company’s cohesion, which not only minimises agency costs but streamlines decision-making and stabilises internal operations and management for an individual company. The article turns to the role of auditing as an essential corporate governance mechanism.

In the USA the Permanent Subcommittee on Investigations of the Senate Committee on Government Affairs (2002) commented on the role of the Board in Enron’s collapse, and came to the conclusion that Enron’s Board of Directors was guilty of fiduciary failure; knowingly allowing Enron to engage in high-risk accounting practices; allowing inappropriate conflicts of interest; exercising inadequate oversight of transaction and compensation controls; and failure to protect Enron shareholders from unfair dealings. In South Africa a Commission led by Judge Nel was formed following a public outcry over the collapse of the Masterbond Group in the early 1990s. The Commission’s investigation revealed, among others, an astonishing degree of dishonesty, inefficiency, lack of professional integrity and lack of independence in the collapse of the investment scheme (see Nel Commission Report, 1997).

2.3.1. Benefits of implementing good governance

The following are some of the significant business benefits associated with effective management and implementation of good governance frameworks and mechanisms:
• Economic efficiency - reduced costs, costs avoided such as design for environment, economic innovation and optimal investment strategy;
• Quality management - better risk management, greater responsiveness in volatile markets, staff motivation and commitment, and enhanced intellectual capital;
• License to operate - reduced costs of compliance, planning permits and licences, enhanced reputation with stakeholders, influence with regulator and government;
• Market advantage - stronger brands, customer preference loyalty, lower costs of capital, new product process and services, and attracting the right talent; and
• Sustainable profits - increased market share and enhanced shareholder value.

Implementation of corporate governance mechanisms may require a shift in the existing policies, systems and practices within a business, which would require participative management, with the emphasis on ‘substance over form’.
Implementation steps, according to King III (2009), entail having a long-term, gradual plan; aiming to implement simple and robust objectives; not reinventing the wheel; applying the 80/20 rule (start with big issues); marketing the corporate governance and sustainability concepts; being flexible and realistic; and taking bold steps (King III, 2009; King IV, 2016).

2.4. The importance of auditing

According to Luo (2009:33), independent (internal and external) auditing of corporate affairs is a prerequisite for a discipline-based governance mechanism. Failure of the audit function was one of the principle factors that contributed to the downfall of Maxwell, Barings, and Enron. The UK Cadbury Report (1992:36, para. 5.1) and King II (2002) emphasise that:

*The annual audit is one of the cornerstones of corporate governance … The audit provides an external and objective check on the way in which the financial statements have been prepared and presented.*

2.4.1. Internal audit

The primary goal of internal auditing is to evaluate the company’s risk management, internal control, and corporate governance processes and ensure that they are adequate and well-functioning (King III, 2009). Therefore a company should seek to implement a risk-based approach to internal audit rather than a compliance-based approach that adds little value to the governance. The holding company of healthcare firm Macmed went into liquidation in October 1999 owing 16 banks R1 billion in unsecured loans, making it the most expensive corporate failure in South Africa to date. The holding company’s Annual Reports, which had allegedly been ‘though the corporate governance process’ and had been signed off by the company’s auditors and the audit committee, failed to reflect the extensive funding of the Malesela expansion out of the company’s cash flow (Naidoo, 2003). Furthermore, it came to light that the company secretary of Macmed was an unrehabilitated insolvent (Naidoo, 2003).

2.4.2. External audit

An external audit is an independent examination of the financial statements of an organisation by a third person called an external auditor. The external auditor expresses a fair opinion on the financial statements in accordance with specific rules and laws, because the auditor has knowledge and skills in the accounting and auditing field. An independent external audit evaluates an organisation’s accounting procedures and is intended to certify the financial statements as ‘true and fair view’ rather than ‘true and fair view of a company’s health (Marnet, 2009; Luo, 2009). An underlying assumption is that the auditing process can be impartial and free of bias. Presumably this can be achieved if an auditor of ‘good standing’ ‘watches out’ for potential conflicts of interest and bias.

However, repeated audit failures highlight concerns that assumptions of auditor impartiality and the absence of bias are perhaps somewhat unrealistic (Marnet, 2009). Arthur Andersen, the now defunct former Big-5 accounting company, may provide an extreme example of the intrusion of bias in the auditor-client relationship. The In re Enron Securities Litigation document (Class Action, 2005, February 7) emphasises that Andersen was a repeat offender, with a history of failed audits, conflicts of interest and document destruction in some of the most egregious cases of accounting fraud in history. The KPMG (2014) report indicates that for an audit committee to be effective in upholding stakeholder interests it should do the following:

- Increase the emphasis on risk and control, including levels of authority;
- Demonstrate the Board’s intention to exercise caution in reviewing financial statements;
- Enhance non-executive directors’ knowledge of the organisation’s finances;
- Improve the communication between Board and external auditors; and
- Help to improve the quantity of financial reporting by providing greater focus.

2.5. Other corporate governance mechanisms

2.5.1. Accountability and transparency

Corporate governance involves corporate fairness, transparency, and accountability (Hughes, 2012; King III, 2009; King IV, 2016). Thus accountability is both a key element of as well as a requirement for corporate governance. To achieve this end, an effective information and communication system within an organisation is crucial (Luo and Salterio, 2014; King IV, 2016). Therefore governance issues that should be considered here include: executive compensation, auditing standards, investment decision procedures, rights and responsibilities of executives and directors, and compliance programmes. These issues have a considerable effect on the interests of stakeholders, who have the right to know how such governance issues affect their interests.

2.5.2. Disclosure

Disclosure is critical to the functioning of a capital market. The term ‘disclosure’ means a whole array of different forms of information produced by companies, such as the Annual Report, which includes the director’s statement, Operating and Financial Review (OFR), profit and loss account, balance sheet, cash flow statement, remuneration chapter and other mandatory statements. It also includes all forms of voluntary corporate communications such as management forecasts, analyst presentations, details of the annual general meeting, press releases, information placed on corporate websites and other corporate reports, such as stand-alone environmental or social reports (Healy and Palepu, 2001; Solomon and Solomon, 2014). According to Kim and Verrecchia (1994) academic research indicates that investors perceive a value to corporate disclosure.
2.5.3. **Internal control**

From an agency theory perspective a company’s system of internal control represents another corporate governance mechanism that can be used to align the interests of managers and shareholders. The Rutteman Working Group (1994:1) defines internal control as “the whole system of controls, financials and otherwise, established in order to provide reasonable assurance of effective and efficient operations...”. According to King III (2009) an effective internal control system should enable the company to:

- Identify key objectives and those risks that may impact on business delivery;
- Measure performance of staff, systems, and processes in managing these risks;
- Manage the process through timely and meaningful communication of relevant information available via workable and effective reporting structures; and
- Monitor the effectiveness with which risk is identified, measured and managed.

2.5.4. **Identifying and minimising risk**

Risk is an inherent and unavoidable element in the conduct of any business, hence maintaining the optimum balance between risk and return is fundamental to business success. Every company, regardless of size or corporate structure, must at some level anticipate and plan for the business risks it faces so as to improve prospects for its long-term survival (Boritz, 1990; Naidoo, 2003).

Corporate risk disclosure represents an important, specific category of corporate disclosure. Risk has been extensively addressed in King III (2009); this highlights its significance to a company. The Board should approve the company’s chosen risk philosophy and also adopt a risk management plan (see King III, 2009 and King IV, 2016). The following questions, adopted and summarised in Table 1 from Solomon and Solomon (2014), attempt to present the ‘ideal’ ingredients of a corporate risk disclosure framework.

<table>
<thead>
<tr>
<th>Table 1. Possible ingredients of an ideal corporate risk disclosure framework</th>
</tr>
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<tbody>
<tr>
<td><strong>A Environment</strong></td>
</tr>
<tr>
<td>1. Should risk disclosure remain voluntary or mandatory?</td>
</tr>
<tr>
<td><strong>B Level of risk disclosure</strong></td>
</tr>
<tr>
<td>2. Is the current level of information that is disclosed adequate?</td>
</tr>
<tr>
<td>3. Would increase disclosure help investment decision making?</td>
</tr>
<tr>
<td><strong>C Location</strong></td>
</tr>
<tr>
<td>4. Where in the Annual Report should risk be disclosed?</td>
</tr>
<tr>
<td>5. Is the OFR, for example, the most appropriate vehicle for risk disclosure?</td>
</tr>
<tr>
<td><strong>D Forms of risk disclosure</strong></td>
</tr>
<tr>
<td>6. Should every risk be reported individually or should all risk information be grouped in a general statement for external reporting purposes?</td>
</tr>
<tr>
<td><strong>F Risk disclosure preference</strong></td>
</tr>
<tr>
<td>7. Should all risk be reported with equal importance?</td>
</tr>
<tr>
<td>8. Is there a distinct preference for some types of risk information by users?</td>
</tr>
<tr>
<td><strong>G Investors’ risk attitude</strong></td>
</tr>
<tr>
<td>9. Are investors’, e.g. institutional investors’, attitude toward risk disclosure influenced by their general attitudes towards corporate governance?</td>
</tr>
<tr>
<td>10. Are these investors’ perceptions of corporate governance related to their risk information requirements?</td>
</tr>
</tbody>
</table>

Solomon and Solomon (2014:45) point out that there is a strong link between the above issues (Table 1), since internal control has recently become a central aspect of corporate governance reform.

2.6. **Brief analysis and discussion of the retail sector in South Africa**

The retail landscape is inhabited by a few large competitors with their considerable buying power and scale operations; supermarkets are able to charge lower prices than convenience stores (referred to as general dealers, corner cafés, spaza shops and tuck shops), and as a result command a large share of consumer spending on food. Three South African retailers appeared on the global ranking of the top 250 retailers (National Retail Federation, 2016). According to Crotty and Bonorchis (2006), in the retail industry size is critical – hence most of the retail companies in the country have pursued a growth strategy that has relied heavily on buying size through acquisitions, rather than through a slower process of organic growth. This is especially so because many retailers regard this industry as over-traded.

3. **RESEARCH METHODOLOGY**

This article adopted an analytical and descriptive case study of the phenomenon - corporate governance - within a real-life context (Creswell, 2014). The purpose of phenomenological research is to describe or capture lived experiences (or phenomena). Phenomenology is both a philosophy and a research method (Yin, 2002; Creswell, 2014). The analytical component of this research involves in-depth study and examination of available information in an attempt to explain complex phenomena, namely corporate governance.

The descriptive part of this research provides an accurate portrayal of the corporate governance structure in place at two companies. Descriptive
studies are a way of (1) discovering new meaning; (2) describing what exists; (3) determining the frequency with which something occurs; and (4) categorizing information (Sellitz et al., 1976; Burns and Grove, 2005). Examination of the practical application of corporate governance warrants the use of a case study approach. The real business of case study is particularization, not generalization – taking on a particular case and knowing it well, not primarily as to how it is different from others but what it is and what it does.

According to Yin (2002) selecting the cases for a case study should not simply be a matter of finding the most convenient or accessible site from which to collect data. The selection process needs to incorporate the specific reasons for selecting a particular group of cases. Five candidate companies were screened beforehand. After three months of careful consideration, two retail companies were selected because the intention was to undertake an in-depth analysis of the corporate governance mechanisms. The process involved collecting sufficient data that assisted in deciding whether the two companies met the following subjective criteria:

i. Being among the top listed companies on the JSE, ranked by market capitalization;
ii. Being among the top five influential retail companies; and
iii. Being best suited for the purpose of peer comparison.

In order to maintain consistency, for better comparison, with a critical and independent approach to the subject matter and secondary data, Annual Reports of the two retail companies were analysed. A review of other pertinent documents was done to supplement the Annual Reports, including the two companies' websites and those of non-governmental organisations and the JSE, and corporate governance journals and literature, particularly research policy, government commission reports, books, magazines, prospectuses, and other Internet-published information. The next section outlines the results and discussion.

Data analysis technique

This study adopted an analytical and descriptive case study of the phenomenon – corporate governance – within a real-life context. The purpose of pragmatic phenomenological research was to describe and capture lived experiences. The pragmatic research design adopted provided the basis for undertaking mixed-method data analysis quantitatively and qualitatively. The quantitative data was analysed using MS Excel (this was quite limited), allowing for data interpretation, while the qualitative data was analysed with the aid of NVIVO and MS Word computer software.

4. RESULTS AND DISCUSSION

We now look at the results of comparison of the two retail companies' corporate governance mechanisms. Table 2 below compares the two companies' Boards in order to determine the extent to which the two companies have complied with King III. The total number of directors and the total number of independent directors, as defined by the company, are recorded. The number of black directors and women directors is also recorded. Based on the previous discussion, if the independence of the Board is questionable a 'yes' is recorded and the number of directors in question is recorded. The table records whether or not NEDs were awarded share options, whether or not the Annual Report has a chapter on remuneration, whether or not shareholders vote for executive and NEDs' remuneration, whether share options were treated as part of the remuneration package, and lastly whether the Chief Executive Officer (CEO) is a member of the Remuneration Committee. Given that there were 10 questions, the total possible score was 10 and the lowest 0. In this subjective test each company has to score more than 5 points to be compliant. Company A scored 17% while company B scored 23% in terms of performance with regard to corporate governance.

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Performance</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total number of directors</td>
<td>12</td>
<td>13</td>
</tr>
<tr>
<td>Are there black directors?</td>
<td>Yes - 1</td>
<td>Yes - 2</td>
</tr>
<tr>
<td>Are there women directors?</td>
<td>Yes - 2</td>
<td>No</td>
</tr>
<tr>
<td>Is the Chairman independent?</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Number of independent directors</td>
<td>7 out of 8</td>
<td>5 out of 6</td>
</tr>
<tr>
<td>Is the independence questionable?</td>
<td>Yes - 5</td>
<td>Yes - 3</td>
</tr>
<tr>
<td>Share options for NED present?</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Chapter on remuneration present?</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Seeks approval of shareholders on executive remuneration?</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Seeks approval of shareholders on non-executive remuneration?</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Are gains of share options treated as part of the remuneration package?</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Is CEO is member of Remuneration Committee?</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Total score</td>
<td>2 X 100/12 = 17%</td>
<td>3 X 100/13 = 23%</td>
</tr>
</tbody>
</table>

Table 2. Corporate governance scores
Table 2 confirms the earlier findings that the Boards of both Company A and Company B are remarkably untransformed, since both failed the corporate governance subjective test. Table 2 further shows that even in areas where the companies have scored a point, there is still a lot to be desired in terms of the absolute figures of, for example, women and black directors. There is no woman director on the Board of Company B.

Integrating sustainability and social transformation in a strategic and coherent manner in both companies would give rise to greater opportunities, efficiencies, and benefits, for both the companies and society with regard to board transformation initiatives.

According to Company B approval is sought for NEDs’ pay, but since the company does not have a chapter on remuneration, apart from some notes on the financial statements, the company can be said to be forcing shareholders to vote on an issue that is not well laid out. Also, in the case of both companies, remuneration data are theoretically public, but in reality they are very hard to find. In the words of the then Securities and Exchange Commission (SEC) Chairman, Richard L. Breeden, echoing Harold Williams, his predecessor from the Carter administration in late 1970s: “The best protection against abuses in executive compensation is a simple weapon – the cleansing power of sunlight and the power of an informed shareholder base.”

According to Monks and Minow (2008:275), “Compensation should be seen as one item – and an important one – on the board’s report card”. This does not mean that executives will be paid less, it means that they will be paid better.

The analysis shows that the percentage that could be considered to be truly independent in the two companies is low. This shows that Board transformation is a prerequisite for successful functioning of the two company Boards. The Board should be led by an NED chairman, who should be independent (King III). This is not the case at these two companies.

Analysis of the ownership of Company A shows a concentration of power within the hands of a few individuals (family shareholders-dominated system). According to Mongalo (2003) in companies that have a majority shareholder there is no separation of ownership and control; this implies that a corporate governance issue which really matters is constraining those owning large blocks of shares. Thus an issue that requires urgent attention at Company A is the need to protect minority shareholders. On the other hand, analysis of Company B ownership shows no dominant shareholder. In such a case, Mongalo (2003) contends, the corporate governance issue that matters is the strengthening of managerial accountability standards or reduction of agency costs (Hughes, 2012), since such a company possesses characteristics of the Anglo-American ‘outsider’ or ‘arm’s length’ system of ownership and control. PIC is a major shareholder in both companies (Monks & Minow, 2008). According to King III the inertia of share owners and, more particularly, institutional shareholders is largely responsible for the non-enforcement in terms of the breach of duties by directors and managers.

In both companies the ‘independent’ NEDs also hold other executive positions in other companies (interlocking directorship and inbreeding). One advantage is that the Boards’ members are likely to share inter-organisational views on corporate governance. However, these individuals possess ‘power’ due to centralised decision making across company boards, and hence dominate committee meetings, which discourages the desirable conflict and debate necessary in an organisation. According to King II and III the Board members should manage conflicts of interest, and carefully consider the number of additional chairmanships and directorates that they hold in companies.

In this regard, several director-selection practices should be avoided as they limit the Board’s independence. Examples include celebrity directors with no corporate governance understanding, overly committed directors who serve on eight or ten boards while holding down a full-time job, personal friends of the CEO, and those directors who simultaneously serve as high-priced consultants or suppliers to the corporation.

Both companies have shown an increase in the number of employees; however, since the two companies have been involved in aggressive acquisition, as shown in the Annual Report, it is not possible to determine whether the number has increased as a result of these acquisitions or new additions to the workforce. Given the nature of the consolidation process resulting from these acquisitions, more jobs may have been lost through retrenchment than were created. Similarly, as discussed, it is not possible to determine the nature of these newly created jobs, and whether they are permanent or casual. As Crotty and Bonorchis (2006) contend, this is a form of what politicians and commentators refer to as ‘dual economy’ – the existence of First World executives receiving exorbitant remuneration and the Second World where casuals and flexi-timers earn below the basic survival wage. The Bench Marks Foundation evidence suggests that Company B pays at level 2, and that it must consider improving on wages and consider the ideal of level 5 for a sustainable community wage.

As observed in the results and in the Annual Report information, in both companies attributable profit has increased over the years; since 2004 dividends have been rising and the value-added statement is impressive. With regard to risk, the results show that both companies have recognised that efficient and effective risk management is a requirement of the King II report, which all listed JSE companies have to comply with. Hence both companies have ensured that risk processes and procedures are adequate to identify, assess, manage and monitor company-wide risks. Communication of risk is a significant factor in reducing the cost of capital and raising market confidence.

In general, the two retail companies have not complied effectively with King II and III. This will have an adverse effect on the two companies with respect to the Companies Act and the King IV report of 2016.

5. CONCLUSION

This article has explored corporate governance frameworks and mechanisms mainly from a South
Corporate Governance Committee that ensures that corporate governance structures are in line with national and international standards, and are both appropriate and effective.

Strategies to strengthen corporate governance mechanisms in the South African retail sector should therefore include the following:

- **Risk disclosure.** Better risk disclosure will enable both companies to improve the investors' decision-making process. Risk disclosure can be achieved by providing a separate chapter on corporate risk, such as in an augmented OFR. Improving information flow between the companies and their shareholders represents one effective way of reducing information asymmetry, thereby reducing the agency problem inherent in South African corporate governance.

- **Restructuring of the organisation of corporate governance as a whole.** In both companies the committees must be free to render judgements and act upon what they see without undue management influence. Changes such as the company CEO ceasing to be a member of the Remuneration Committee would afford the committees some degree of independence, as would replacing independent NEDs that have served for more than 10 years. Both companies should address the issue of interlocking directorate and inbreeding, and make changes where necessary for the good of the business.

**REFERENCES:**

16. KPMG (2014), Toolkit for the company Director, KPMG, Johannesburg, ch. 4.