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Corporate Governance Best Practices Vital for Good Corporate Citizenship: Guidance from *King III*

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The debate on the protection of stakeholder interests in corporate governance has been going on for decades. As companies come to dominate more of the planet and its resources, other voices demand to be heard. Furthermore, the proliferation of corporate scandals of increasing size adversely affects not only the shareholders but also stakeholders at large. The issue of protecting stakeholders' interests and managing relations with various stakeholders therefore becomes crucial. This study is based on the premise that the King Reports on Corporate Governance in South Africa have been influential in shaping this constantly evolving subject matter and hence focus is on the King III Report. In particular, the focus is on the King III principles relating to the protection of stakeholder interests and the management of stakeholder relations. The aims are two-fold. Firstly, it is sought to highlight corporate governance best practices that enhances good corporate citizenship. The reason being that there are increasing expectations on companies to operate as good corporate citizens due in part to the influence they have on the lives of various stakeholders. Secondly to determine to what extent King III, given its voluntary nature influences company law in ensuring good governance best practices.

Name of Track: Management

1. Introduction

Traditional corporate governance in South Africa has been based on the shareholder value approach. In terms of this approach, directors are expected to manage a company in the best interests of the shareholders collectively (Havenga, 2005). This approach is however, increasingly being questioned (Esser and Du Plessis, 2007). With the surge of interest in the recognition of stakeholder interests, the argument for imposing wider accountability to companies has gained importance to the extent that it is now true of a modern company that profit, or the need for it, cannot be the only bottom line in the company operation. Companies are now expected to operate in the triple bottom line context and as good corporate citizens, due to the influence they have on the lives of various stakeholders. This paper examines the *King Report on Corporate Governance in South Africa 2009* (*King III*). The focus is on principles relating to the protection of stakeholder interests and management of stakeholder relations. The aims are two-fold. Firstly, to highlight corporate governance best practices that enhances good corporate citizenship. Secondly to determine to what extent *King III* influences company law in ensuring good governance best practices

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The paper is organized as follows. Firstly, a review of literature related to the protection of stakeholder interests in corporate governance is presented. This is followed by a description of the methods used in undertaking this research. A brief discussion on corporate governance and the protection of stakeholder interests then follows. The nature of *King III* is then discussed and is preceded by a discussion on good governance best practices, with particular focus on the stakeholder approach, the triple bottom line approach and good corporate citizenship. A commentary is then provided which is followed by a conclusion.

2. Literature Review

Corporate governance is generally understood to mean the way in which companies are directed and controlled (*Cadbury Report,* 1992). Although Rossouw, van der Watt and Malan, 2002 explicate that it is much too narrow a focus to equate corporate governance with the role of the boards of directors, these and other authors indicate that corporate boards are important to the accountability of corporations and the way corporations comply with the modern ethical and economic demands. Strong and effective boards are thus, valuable corporate assets. Hence the theory is that better managed companies will yield benefits for all (Mongalo, 2003). While the role of corporate boards in managing their companies is a critical aspect of corporate law, one element of this role, and which has been the subject of robust debate for many years is, for whom are they to manage the company (Keay, 2008). It is trite law that a director owes a duty to act *bona fide* in the best interests of the company in which he or she is involved. It has, however, been a vexed question as to what is meant by 'the interests of the company.'

Distinctive corporate governance theories such as the shareholder value theory, the stakeholder theory and the enlightened shareholder value theory give rise to differences in what is considered acting in 'the best interests of the company.' Seen from the shareholder value theory, directors advance the best interests of the corporation by acting exclusively in the economic interests of shareholders (Fisch, 2006; Bainbridge, 2003). The stakeholder approach departs from assumptions underlying the shareholder value approach. It rejects the idea of maximizing a single objective (shareholder wealth), as one gets with the shareholder value approach. In general, the stakeholder perspective is premised on the notion that inclusion from a social, economic and political perspective is valuable, and hence it focuses on fostering the full potential of all contributors (Keay, 2010). The enlightened shareholder value approach encompasses the idea that corporations should pursue shareholder wealth with a long-run orientation that seeks sustainable growth and profits based on responsible attention to the full range of relevant stakeholder interests (Ho, 2010).

When the shareholder value approach, the stakeholder approach and the enlightened shareholder value approach are taken into consideration, a clear answer to what the best interests of the company entails is not easily given. The interests to be considered by the boards of directors may ultimately depend on specific circumstances and the current way of thinking in corporate governance. For instance, in South Africa, there has been a shift in public opinion towards the recognition of a variety of interests that should be considered wider than only those of the shareholders (Shandu, 2005; Esser, 2009; Esser and Du Plessis, 2007). The *King Reports* have been influential in this regard and hence the focus of this study. This study is significant in that while *King III* is not law, and failure to comply therewith will not result in direct liability for directors, it is now imperative that directors comply with *King III*. The rational is that in addition to compliance with the law, compliance with corporate governance best practices is also relevant. With regard to the directors' duty to act in the best interests of the company,[1] corporate governance practices will raise perceptions of the interests which directors should consider. Courts, should therefore, when determining whether a particular director has acted in the best interests of the company, consider whether such director has also complied with relevant corporate governance principles.

3. Research Methodology

A qualitative research methodology has been employed in this study. This method is justified given the nature of the subject under discussion. Qualitative research is by definition exploratory. It is used to define an issue or develop an approach to an issue. It is also used to go deeper into issues of interest and explore nuances related to the issue at hand. More importantly, the method is intended to penetrate to the deeper significance of the topic being researched. One of the main methods associated with qualitative research is the qualitative analysis of texts and documents (Welman, Kruger and Mitchell, 2006). This method has been used in this study. However, the analytical approach was employed. In the context of this study, an analytical approach enables one to gain insights through discovering meanings and understanding the principles behind the concept of the corporate governance by analyzing its depth and complexities. In particular, an analysis of the *King III* corporate governance principles is undertaken with the aim of highlighting corporate governance best practices vital for good corporate citizenship.

4. Corporate Governance and the Protection of Stakeholder Interests

Many corporate failures in recent years have raised serious questions about the corporate governance system in place. It is noteworthy that when issues of corporate governance are considered, the emphasis is usually on the role played by directors in running their companies and the interests to be considered in corporate decision-making. Shareholders' interests are traditionally granted primacy in the management of a company. Thus, the function of directors is to ensure that the wealth of shareholders is maximized to the full. There has, however, been a shift in public opinion towards the recognition of a variety of interests that should be considered wider than only those of the shareholders. The wider variety of interests includes environmental concerns and the interests of stakeholders such as employees, suppliers, consumers and the community. The *King Reports on Corporate Governance* all dealt with and made recommendations to this issue concerning the directors' duty to protect stakeholder interests. King I was published in 1994. Since it was the duty of the King Committee to review corporate governance on an ongoing basis, *King II* was issued in 2002. In view of the (then) anticipated new Companies Act 71 of 2008, a new *King Report* became necessary. *King II* was therefore, replaced by the revised *King III.*

5. King III

King III became effective on 1 March 2010 and, like *King I* and *King II,* it also promotes good corporate governance in South Africa alongside compliance with the law. *King III* applies to all entities incorporated and resident in South Africa regardless of the manner and form of incorporation or establishment and whether in the public, private sectors or non-profit sectors.[2] *King III* operates on an "apply or explain" basis.[3] This is a refinement of the "comply or explain" basis that *King I* and *King II* operated on.[4] The general approach is therefore, one of flexibility. If a company considers that a recommendation is inappropriate to its particular circumstances, it is free not to apply it.[5]

However, *King III* highlights the fact that in addition to compliance with legislation, the criteria of good governance, governance codes and guidelines will be relevant to determine what is regarded as an appropriate standard of conduct for directors.[6] In this regard, the more established governance practices on the protection of stakeholder interests become, the more likely a court would regard for instance, the board's failure to consider the interests of its stakeholders when developing the strategic intent of the organization as not acting in the best interests of the company. Corporate governance practices, codes and guidelines therefore play a crucial role in lifting the bar of what can be regarded as appropriate standards of conduct and "consequently, any failure to meet a recognized standard of governance, albeit not legislated, may render a board or individual director liable at law."[7]

5.1 The Protection of Stakeholder Interests

King III, opts for the inclusive stakeholder approach which aims at the consideration by directors of the interests of all stakeholders and broader accountability. An important aspect of the stakeholder approach is that companies are so large, and their impact on the society is so pervasive that they should discharge accountability to many more sectors of society than just the shareholders (Wallace, 2003). Thus, in terms of the stakeholder approach, the duty of directors is to create optimal value for all stakeholders. *King III* states that stakeholders can be considered to be any group that can affect or be affected by a company's operations.[8] It is noted that this definition is very broad and given the way that trade has developed, it could encompass just about anyone. In this light, the problem which a board may face will be to determine how they are to address the needs of divergent groups. *King III* recommends that the board should time from time identify important stakeholder groupings, as well as their legitimate interests and expectations, relevant to the company's strategic objectives and long-term sustainability.[9] After identifying the most important stakeholders, a company has to develop a strategy and suitable policies of how it will manage its relations with each of the stakeholder groups.

5.2 The Triple Bottom Line

King III observes that the notion of creating value by companies was viewed narrowly as financial value for shareholders. There has however, been a move from the single to the triple bottom line. This change in corporate governance thinking adopts the economic, environmental and social aspects of a company's activities. Boards are now therefore, not only responsible for the company's financial bottom line, but also for the company's performance in respect of its triple bottom line. The triple bottom line approach is based on the notion that the modern business corporation is so ubiquitous in the world that it is undisputed that it affects investors, workers, governments, communities and the environment in which it operates and therefore a need arises for accountability on these aspects. Triple bottom line reporting goes beyond financial results by providing information on economic, social and environmental performance (profit, people and planet). The triple bottom line is based on the premise that reporting on social and environmental outcomes alongside the financial aspects of a corporation's performance would give a more holistic view of the state of its affairs, as well as highlighting the potential risks associated with its operations.

5.3 Good Corporate Citizenship

While a company is an economic institution, it is also a corporate citizen and as such, has social and moral standing in society. There are increasing expectations on companies to operate as good corporate citizens due in part to the influence they have on the lives of various stakeholders. The concept of corporate citizenship flows from the fact that a company is a person and should operate in a sustainable manner. Sustainability considerations are rooted in the Constitution of the Republic of South Africa, 1996 which imposes responsibilities upon individuals and juristic persons for the realization of fundamental rights.[10] The notion of creating a company that can pursue profit at the expense of human rights is therefore, legally untenable as the Bill of Rights applies to companies in a manner that goes beyond mere financial considerations. Corporate citizenship and sustainability therefore, require the boards of directors to adopt a holistic approach to economic, social and environmental issues in their core business strategy.

King III recommends that as a good corporate citizen, the company should protect, enhance and invest in the wellbeing of the economy, society and the natural environment.[11] Furthermore, companies should respect universally recognized fundamental human rights by *inter alia* creating and sustaining conditions in which human potential can develop. This entails liberating people from unfair discrimination and empowering them to take control of their own lives. In the African context, these moral duties find expression in the concept of *Ubuntu*, which is captured in the expression '*umuntu ngumuntu ngabantu*,' meaning 'I am because you are; you are because we are.'[12] Simply put, *Ubuntu* means humaneness and the philosophy of *Ubuntu* includes mutual support and respect, interdependence, unity, collective work and responsibility.[13] The diagram below depicts the link between the triple bottom line and good corporate citizenship.

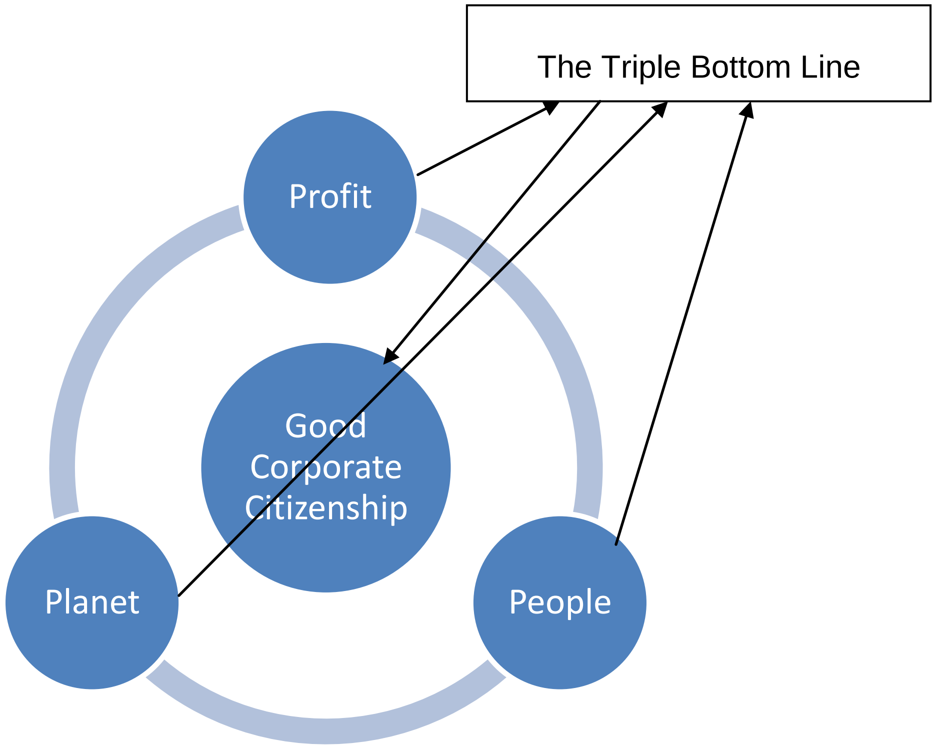

Diagram: The Link between the Triple Bottom Line and Good Corporate Citizenship

It is noteworthy that the triple bottom line, together with the concept of good corporate citizenship, has been major factors in moving corporate governance in the stakeholder direction, by demanding that companies go beyond the creation of shareholder wealth in pursuit of broader objectives such as sustainable growth, equitable employment practices, and long-term social and environmental well-being. The triple bottom line and the concept of good corporate citizenship therefore resonate with the stakeholder approach.

5.4 Managing Relations with Stakeholders

King III provides guidelines on how directors should manage their relations with the various stakeholders. Directors should take into consideration the following guidelines when managing their companies:

i. The board should provide effective leadership based on an ethical foundation[14]

Effective leadership is characterized by the ethical values of responsibility, accountability, fairness and transparency.[15] In terms of the stakeholder approach this entails that directors, as effective leaders, build sustainable businesses by having regard to the company's economic, social and environmental impact on the community in which it operates. Effective leadership also entails that directors when making decisions, reflects on the role of business in society and consider both the short-term and long-term impact of any decision made on the economy, society, and the environment. Effective leaders do not focus solely on company profits at the expense of social and environmental considerations. They are sensitive to the impact of their companies on all stakeholders and give direct rather than incidental consideration to the legitimate interests and expectations of their stakeholders.

ii. The board should appreciate that stakeholders' perceptions affect a company' reputation.[16]

King III states that corporate reputations are formed out of the aggregate perceptions of stakeholders' assessments of the companies.[17] Stakeholder perceptions are shaped by the actions of a company and not only by what it purports to do. Corporate reputation is thus based on how well a company performs compared with the legitimate interests and expectations of stakeholders. With the growing awareness of how important the contribution of reputation is to the economic value of the company, the gap between stakeholder perceptions and the performance of the company should therefore, be managed and measured. The board should take account of and respond to the legitimate interests and expectations of stakeholders linked to the company in its decision-making.

iii. The board should delegate to management to proactively deal with stakeholder relationships.[18]

King III recommends that management should develop for adoption by the board, a strategy and suitable policies for the management of its relations with all stakeholder groupings.[19] The board should oversee the establishment of mechanisms and processes that support stakeholders in constructive engagement with the company and the board. According to *King III*, these mechanisms and processes should be incorporated in the stakeholder policies.[20] The aim of constructive engagement is ultimately to promote enhanced levels of corporate governance. It enables the company and the stakeholders to share their perspectives on the interests of the company. The benefit of constructive engagement is that it provides companies with valuable information about *inter alia* stakeholders' views, external events and market conditions. This can assist companies anticipate, understand and respond to external changes more effectively, thereby enabling the company to deal with challenges more effectively.

iv. The board should strive to achieve the appropriate balance between its various stakeholder groupings, in the best interests of the company.[21]

While the Companies Act, 2008 directs the board to act in the best interests of the company, it does not provide clarity on what is meant by the best interests of the company. *King III* however, submits that the best interests of the company should be interpreted within the parameters of the company as a sustainable enterprise and the company as a good corporate citizen.[22] *King III* recommends that in striving to achieve an appropriate balance between the interests of various stakeholders, the boards should take into account, as far as possible, the legitimate interests and expectations of its stakeholders in its decision-making. [23] They must take into consideration the triple bottom line context in which companies now operates and by so doing will ensure that companies are and are seen to be good corporate citizens.

v. Transparent and effective communications with stakeholders is essential for building and maintaining their trust and confidence.[24]

Good relationships with stakeholders can only be built and maintained if the company *inter alia* provides stakeholders with complete, accurate, honest and accessible information. The quantity of information that the company divulges should, however, be considered with reference to the company's stakeholder policies, any relevant legal requirements and the maintenance of the company's competitive advantage. *King III* recommends that the board should ensure that all stakeholders who have the right to know are informed, that effective feedback systems exist, that the board is alerted in a timely fashion to matters that should be communicated to stakeholders and that processes exist to deal rapidly and sensitively with any crisis.

6. Corporate Governance Principles and the Law

Despite the link between corporate governance principles and the law, it is arguable whether the courts will be keen to hold directors liable on grounds of failure to adhere to voluntary corporate governance codes of practice. As has been highlighted, *King III* is based on the "apply or explain" principle. This has the potential of making finding liability on the part of the director who fails to consider corporate governance practices a daunting task for the courts as reasons for not applying the corporate governance principles can always be furnished. The voluntary nature of the corporate governance codes may account for the relative paucity of cases where courts have relied on the corporate governance codes. In fact, in some cases where the opportunity to consider corporate governance codes arose, the courts simply chose not to consider it. For instance, in the case of *Triptomania Twee (Pty) Ltd and Others v Connolly And Another*,[25] the applicants attacked the emphasis which *King II* placed on the role of the board of directors in general and the role of non-executive directors in particular, by stating that the emphasis in the *King II* was misplaced. The court came to certain conclusions on the facts and did not consider the above mentioned contentions of the applicants. Similarly, in *De Villers and Another NNO v BOE Bank Ltd*,[26] the advocates of the parties relied on *King II* in support of certain arguments but the court did not refer to or deal with *King II* in the judgment in any way.

However, in the case of the *Minister of Water Affairs and Forestry v Stilfontein Gold Mining Co. Ltd*[27] the court relied extensively on *King II*. In this case, the applicant obtained a previous court order with regard to environmental requirements against the respondent which the respondent had to adhere to. In an attempt to escape the consequences of this court order, the whole board of the first respondent resigned, leaving the first respondent unable to comply with the court order, and leaving the applicant in a dilemma since at the time that the application was brought, the second to fifth respondents (the previous members of the board of the first respondent) were no longer the board members of the first respondent. In this regard, the court held that the code of conduct of *King II* was almost uniformly endorsed by the corporate community in South Africa and that the conduct of the respondent directors flew in the face of their responsibilities in terms of the *King II* code of conduct, which they were obliged to implement by virtue of the fact that the respondent was a listed company and consequently had to adhere to the listing requirements of the Johannesburg Stock Exchange. The court therefore held the respondents guilty of contempt of court.

7. Conclusion

Be that as it may, an effort has been made in this study to highlight the corporate governance best practices vital for good corporate citizenship. The study has examined the protection of stakeholder interests and management of stakeholder relations under *King III*. In particular, the stakeholder approach, the triple bottom line and the concept of good corporate citizenship have been discussed. Furthermore, important guidelines which can serve the important function of enhancing healthy relations with stakeholders have been identified. To the extent that the discussed corporate governance best practices enhance good corporate citizenship, they are crucial and it is recommended that companies adopt them.

Endnotes

1 The Companies Act, 2008, section 76(3)(b).

2 *King III* p 17. This may have the effect that entities and stakeholders will require a deeper understanding of governance in order to decide how governance principles and practices should be adopted and implemented in their particular entity – 'the one size does not fit all' consequence.

3 *King III* p 7.

4 The King Committee found the word "apply" more appropriate than "comply" for the following reasons: "The 'comply or explain' approach could denote a mindless response to the King Code and its recommendations whereas the 'apply or explain' regime shows an appreciation for the fact that it is often not a case of whether to comply or not, but rather to consider how the principles and recommendations can be applied" – *King III* p 7.

5 Companies are encouraged to use the guidelines provided in *King III* as a focus for re-examining their corporate governance practices and to determine whether and to what extent the company may benefit from a change in approach, having regard to the company's particular circumstances.

6 *King III* p 8.

7 *King III* p 8.

8 *King III* p 100.

9 *King III* p 100.

10 See section 8 of the Constitution of the Republic of South Africa, 1996.

11 *King III* p 22.

12 *King III* p 23.

13 *King III* p 23.

14 *King III* p 20.

15 *King III* p 29.

16 *King III* p 100.

17 *King III* p 100.

18 *King III* p 101.

19 *King III* p 101.

20 *King III* p 101.

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21 *King III* p 103.
22 *King III* p 13.
23 *King III* p 103.
24 *King III* p 103.
25 *Triptomania Twee (Pty) Ltd and Others v Connolly And Another* 2003 (3) SA 558 (C).
26 *De Villers and Another NNO v BOE Bank Ltd* 2004 (3) SA 1 (SCA).
27 *Minister of Water Affairs and Forestry v Stilfontein Gold Mining Co. Ltd* 2006 (5) SA 333 (W).

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