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Corporate Governance Framework®

ARTICLE

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TANGIBLE BENEFITS OF A CORPORATE GOVERNANCE FRAMEWORK®
Article by Jene' Palmer

Forward thinking organisations have realised that corporate governance does not merely fall into the portfolio of the Company Secretary. Indeed, the draft King IV Report on Corporate Governance for South Africa 2016 ('King IV'), describes corporate governance as "the exercise of ethical and effective leadership by the governing body" of an organisation. Why then is corporate governance still viewed by many organisations as a process which increases bureaucracy and drives a 'tick box' exercise?

Perhaps the explanation lies in not understanding and appreciating the value which can be unlocked by implementing a purpose-built Corporate Governance Framework® which is tailored to the organisation. Empirical research supports the fact that good corporate governance translates into tangible and sustainable benefits for the organisation. Some of these benefits are set out below.

TEN TANGIBLE BENEFITS OF A CORPORATE GOVERNANCE FRAMEWORK®

1. *Delineating the accountabilities of the board and the responsibilities of senior management*

Although the board is ultimately accountable for good corporate governance, a well-considered Corporate Governance Framework® will clearly identify those governance matters for which the board is accountable, including those for which the senior management of the organisation are responsible. Importantly, the focus is on ensuring a common understanding of the governance structures and processes within the organisation.

In the draft King IV Report, the board is called upon to 'set the tone at the top' and to inculcate an ethical culture and furthermore leading by example. The application of a Corporate Governance Framework® underpins the effective and ethical leadership of the organisation by unequivocally emphasising the organisation's culture and acceptable standards of behaviour.

2. *Providing a high level view of the extent of adoption of governance and operational policies across the organisation*

The Corporate Governance Framework® provides the board and senior management a singular schematic view of the governance areas ('components') which are important to the organisation and its strategy. In addition -- in its simplest of form -- it gives a high level view (on a simple red, amber, green ('RAG' methodology) basis) of the extent to which all these components of governance are being efficiently and effectively monitored, managed and controlled.

Importantly, each area of governance within the organisation needs to establish basic standards of conduct and transparency. In determining these standards, consideration must be given to compliance with legal requirements as well as best practice guidelines. Performance measurement, costs and efficiencies also form part of the governance evaluation process.

Implementing the governance framework is not a once-off exercise which results in a static assessment. It needs to evolve as the business matures. In order to ensure that the governance framework remains up-to-date, the board will need to put in place processes which will ensure access to relevant, timeous and appropriate information which may impact on the governance (RAG) status of each component within the Corporate Governance Framework®. As organisations are strategically unique from each other, so too are their governance frameworks. Expectedly -- given the fact that these differentiators between organisations exist and their business processes are dynamic -- it stands to reason that an organisation's Corporate Governance Framework® will always be subject to change, thereby assisting the board and management with the alignment of their risk appetite, risk tolerance and business process decisions.

3. Improves top-level decision-making processes

The Corporate Governance Framework® will assist the board to prioritise those components of governance which require immediate attention, and facilitate appropriate decision-making in this regard (by for example using the RAG methodology).

Empirical studies on Latin American firms indicate those organisations who have adopted good corporate governance practices produced better operational results in terms of profitability (as noted by return on equity) than their Latin American peers. Similarly, a study based on Australian mid-cap companies, also demonstrates a strong link between an organisation's governance and associated performance. Whilst the causality of the link between governance and performance is frequently debated, there are a number of examples of the prominent corporate failures (such as that of African Bank Limited) which have been directly attributed to poor governance.

In a rapidly changing business environment, there is no doubt that having access to transparent and timeous information and being able to identify which governance areas to focus on first, will be invaluable in enabling the organisation to weather tough economic storms, amongst other unforeseen events (i.e. Blackswans). Expectedly, improved decision-making will not only translate into better risk management and improved financial returns, it also has direct bearing upon the organisation's sustainability.

4. Better control environments

In terms of the draft King IV Report, the governing body must ensure that assurance results in "an adequate and effective control environment". This requires a combined assurance approach to the management of the effectiveness and integrity of internal controls and information used for reporting and decision-making.

The Corporate Governance Framework® forms part of the fifth line of defense in a combined assurance model and can be used to confirm to the board and/or its committees, the level of assurance associated with each important component of governance. Armed with this information, the board and/or the committee in question will be better positioned to take decisive action to address high risk areas. Such action may include, but is not limited to forensic audits, extended internal audits, revised operating procedures and policies.

5. *Reducing the cost of capital*

The increased level of transparency which accompanies good corporate governance stimulates perceived investor confidence. Stronger operational results and the improved ability to make decisions transforms into increased access to capital and debt financing.

Empirical studies indicate that organisations practicing good corporate governance are more capable of maintaining higher financial leverages than those which do not subscribe to good corporate governance. In addition, investors are prepared to pay a premium for shares of a well-governed company.

6. *Attracting good, talented and experienced directors*

A strong board comprises different personalities with a wide range of experience and perspectives. The Corporate Governance Framework® allows the chairman to harness the power of such diversity and create value for the organisation by adopting a balanced, disciplined approach to performance management and proactively attending to critical risk management areas.

Access to up-to-date independently reviewed governance information is critical to incoming non-executive directors as it provides them with information to make a quick assessment of the overall sustainability of the organisation, including its level of compliance with relevant legislation. Such information is vital to candidates when deciding whether or not to assume the potential liabilities associated with a non-executive directorship. If too many critical components of the Corporate Governance Framework® are marked in red (in terms of the RAG methodology) the non-executive candidate is more vulnerable to incurring personal liability for a breach of his fiduciary duties.

Similarly, the chairman could also use the governance framework as an induction tool when appointing and orientating new non-executive directors and company secretaries in order to put them in a position to more quickly deliver value to the organisation.

7. *Holding directors accountable*

A clearly defined and tailored Corporate Governance Framework® enables the board to quickly adopt a stakeholder-inclusive approach, by overseeing the opportunities and risks within the organisation. Board members are required to evaluate and consider the legitimate and reasonable needs of all stakeholders when establishing and identifying those governance components which are important to the organisation. The governance framework provides a mechanism for stakeholders (in particular investors) to more easily hold the board accountable for managing the organisation in a responsible and sustainable manner.

By referring to the schematic representation of the Corporate Governance Framework®, key stakeholders can, at a glance, identify those governance components which are important to the organisation. They can also quickly assess the extent to which areas of mutual interest are being appropriately addressed, as well as gain an overall impression of the organisation's sustainability.

8. Improves strategic and performance management

King III and indeed the draft King IV Report requires the governing body to 'lead the value creation process' by appreciating that strategy, risk and opportunity, performance and sustainable development are inseparable elements.

By establishing and implementing a Corporate Governance Framework®, the board is compelled to methodically consider and evaluate the global environment within which the organisation is operating. This will include identifying the resources and capital required to operate the business in the medium to long term economic context. Moreover, the governance framework will further assist the board in some of the following ways - understanding the regulatory environment governing the business; leveraging technology from a production, distribution and communications point of view, and identifying and managing the reasonable interests of all stakeholders in the business. All these components are essential elements of a robust strategic plan.

Closely linked to the strategic plan is the implementation of performance criteria, and this must be factored at both the organisational and individual level. Such measurements are critical to assessing the successful execution of the strategic plan (and sustainability of the business) and they will form part of defining and implementing an organisation's Corporate Governance Framework®.

9. Improves enterprise wide risk management

Although the Corporate Governance Framework® helps to identify governance components requiring urgent attention, it should not be substituted for a corporate risk register. The latter is integrated into a Corporate Governance Framework® as a subset of each governance component. The risk register records the granular details of the risks, impact thereof and associated action plans for each governance component and area of business – as such it can inform the RAG status of a governance component.

The Corporate Governance Framework®, however, provides a holistic structure for governance processes starting with the board and strategic management, and extending to operations via the management level and the supply chain. The governance framework presents a singular high level view of the concentration of risk within the organisation. Such information can also be invaluable when evaluating an acquisition, or preparing for the organisation's next phase of growth.

10. Facilitates integrated reporting

The availability of a Corporate Governance Framework® makes it much easier for an organisation to provide relevant, concise, holistic and timeous information on the strategic direction, performance, risks and opportunities facing the business. By focusing and reporting on material items -- and how these are inter-linked -- the board is able to foster a culture of transparent and meaningful communication and in so doing, continuously build a relation of trust with each of its key stakeholders.

In addition, organisation's are advised to regularly conduct independent reviews of their Corporate Governance Frameworks® so as to lend further assurance and credibility to the information being provided to stakeholders by way of their annual integrated reports.

The benefits of adopting a structured Corporate Governance Framework® are tangible and there is no doubt that through its application, the board is better equipped and empowered to add value to all stakeholders through a process of continuous improvement and review. As such, the governance framework is an effective management and monitoring mechanism which can benefit all stakeholders over the lifetime of the organisation as it continues to evolve to suit the organisation's needs.

By incorporating the Corporate Governance Framework® into the strategic and operational management of the organisation, corporate governance is no longer relegated to being a "tick-box" exercise. Instead, through the practice of good corporate governance, the board and its senior management are empowered to exploit their competitive advantage which drives the organisation's overall sustainability.

Footnote: The Corporate Governance Framework® is a registered trademark of CGF.

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Through CGF's Lead Independent Consultants, our professional consulting capabilities extend to;

– strategic management consulting, business re-structuring, executive placements, executive coaching, board assessments and evaluation, out-sourced company secretrial functions, facilitation of Corporate Governance Awareness workshops, workplace wellness, IT governance through to Enterprise Risk Management (ERM) consulting and CIPC services.

CGF's services cater for large corporates, small and medium sized businesses and state owned organisations. To find out more about CGF, its Lead Independent Consultants and Patrons access *www.cgf.co.za* or *www.corporate-governance.co.za*

Further Contact Information:

Terrance M. Booysen (CEO)
CGF Research Institute (Pty) Ltd
Office: (011) 476 82 64 / 1 / 0 Cell: 082 373 2249
Email: tbooysen@cgf.co.za
Twitter: @CGFResearch