



BOARD GOVERNANCE IN SOUTH AFRICA

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The objective of this Spencer Stuart study was to review the state of corporate governance in South Africa through the eyes of some of the most experienced and respected board chairmen, investment experts and governance thinkers in the country. Over a four-week period at the end of 2008 we spoke at length to 15 people whose views are representative of a cross section of leading South African businesses, including both listed companies and state-owned enterprises, from a range of sectors. We hope that this report will be both informative and thought-provoking for business leaders inside South Africa as well as those abroad who take an interest in South African business affairs.

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Introduction

15 years have passed since publication of the *King I Report*, whose purpose was to promote the highest standards of corporate governance in South Africa. Coinciding with the birth of the new South African democracy, the scope of King I went far beyond the financial and regulatory aspects of corporate governance to include social, ethical and environmental best practice. This was a far broader remit than the UK's influential *Cadbury Report* which had come out two years earlier and which served as both catalyst and inspiration for new governance codes around the world.

The 1994 King I framework, with its emphasis on the triple bottom line, was needed because the majority of South African citizens had effectively been excluded from the mainstream economy. King I was informed by the notion of “universal adult suffrage” and equal rights for all citizens which would be enshrined in the Constitution two years later. This broad-based,

inclusive approach, which continues to this day, unashamedly places social responsibility at the heart of the corporate governance agenda and is almost unique to South Africa.

Governance is an evolving process; when the *King II Report* appeared in 2002 it broke new ground with its emphasis on “integrated sustainability reporting”. Although still based on the principle of comply or explain, the *King II Code of Corporate Practices and Conduct* raised the stakes for businesses in areas such as health and safety, environmental impact, corporate social investment (CSI), diversity and the development of human capital. Today, black economic empowerment (BEE) and other aspects of the social transformation agenda continue to have a profound effect on South African businesses and their boards. ■

Governance in South Africa today — an overview

The general consensus among participants in our study is that governance has improved significantly in recent years, with boards taking a more professional approach to governance, especially in larger listed companies that come under the greatest public scrutiny. Boards in South Africa have to deal with greater complexity than their counterparts in Europe and North America, and increasingly face the spotlight as pressure to enhance governance standards mounts from shareholders, government, the media and other pressure groups.

The number of truly progressive boards — those at the cutting edge who go beyond the letter of the law, strive for excellence and pay close attention to governance trends elsewhere in the world — is probably relatively low. This is not altogether surprising, given that the legislative and regulatory framework in South Africa is increasingly forcing boards to focus on compliance, thus limiting their effectiveness in more strategic and advisory areas. One chairman regretted that legislators do not have a better sense of reality: “Lawmakers are not business people and need to be more practical.”

Boards are finding that more and more time is being taken up dealing with the ramifications of legislation — such as the Company Laws Amendment Act, the new Companies Bill and, in the case of state-owned enterprises, the Public Finance Management Act — in addition to governance code recommendations and listings requirements. The governance burden on dual-listed companies is even greater. It is therefore incumbent upon chairmen to ensure that boards

do not become so preoccupied with governance that they are deflected from “the business of the business”, as one chairman put it.

“One needs to distinguish between the state of governance (ticking all the right boxes) and the effectiveness of boards, because they are two different things.”

King III

Time has moved on since King II and many of the issues it dealt with that came under the bracket of “comply and explain” have since become legal requirements. The introduction of King III in early 2009 raises the bar on governance yet further and addresses a wide range of issues. These include the appointment of a senior independent director on boards where there is an executive chairman, a tighter definition of director independence where a shareholding is involved, greater emphasis on disclosure over executive remuneration, and clarification on the role of the non-executive director.

The introduction of a senior independent director (SID) on a board may not be to everyone’s liking, but it is a logical step that has proved worthwhile in the UK (since the 2003 Combined Code) and in the US (with the advent of the lead or presiding director in the US, recommended by Sarbanes-Oxley). The existence of the SID primarily serves to counterbalance an executive chairman who may be disposed to dominate a board and potentially gives the non-

executive directors a senior figure around whom they can rally if their concerns are not being adequately addressed on the board. For those South African companies that already have an independent deputy chairman, this should not be a difficult transition.

There is a strong case for giving greater prominence to the internal audit function and making it more risk-centric.

After initial reservations in both the UK and the US, it is now generally recognised that the existence of a SID is an important factor on a board — even one where the roles of chairman and CEO are separated. The SID also plays an important role in the evaluation of the chairman and in determining remuneration.

“Governance is about transparency. Unless you have that, you are broke.”

Committees

The role of committees has become more important in recent years, as the focus on the recruitment of directors, executive remuneration and audit/risk has grown. King III will recommend that all boards have not only an audit and remuneration committee but also a risk committee; it will also provide guidelines on who should chair and populate committees.

There is a strong case for giving greater prominence to the internal audit function (“one of the right arms of the board when it comes to assurance”) and making it more risk-centric. In order to recruit members and enable them to carry out their responsibilities audit committees must be confident about the existence of adequate internal controls and a sound risk framework. Elevating the status of the head of internal audit will help in this regard.

Pressure on boards

The growing tide of legislation and the tightening of governance codes inevitably place more pressure on boards. Add in a recession, and there has never been a more daunting or indeed risky time to be a board director. Shareholder activism is on the increase and these days organised labour focuses on far more than just employee welfare issues (for example, demanding to know who is making money and on what basis).

Several chairmen commented that the competition issue has become a serious burden on directors who are liable for anti-competitive behaviour that could well take place several layers down the organisation.

Further pressure on boards arises from the need to address transformation issues such as BEE and gender representation (both of which directly affect board composition), the broadening of the share register and corporate social investment. We explore these issues later in this report.

The transformation agenda

It is hard to overstate the role of business in helping to bring about social transformation in South Africa. In the words of one chairman, “governance, strategy and sustainability are inseparable” and it is incumbent upon every business to play its part — and be seen to play its part — in the transformation process.

Corporate social investment has become almost inextricably linked with strategic business opportunity. Companies can no longer ignore these issues, especially given the requirement to prepare a transparency and accountability report explaining to stakeholders the impact the company has had on its community and stating what they are doing to promote the positive and mitigate the negative.

One chairman commented that: “I don’t think an organisation or a board in South Africa could get away with showing outstanding results without also demonstrating that they are addressing transformation issues. You would definitely get into trouble.”

Corporate social investment has become inextricably linked with strategic business opportunity.

Another chairman remarked that it is impossible to stick one’s head in the sand and hope the issues will go away: “The unions will definitely hold you accountable for transformation, so will the government. Companies hoping to be

awarded a tender must be able to demonstrate that their suppliers score highly on transformation, which in turn has a domino effect on procurement processes across industry.”

People are less likely these days to refer to the social bottom line and the environmental bottom line as “non-financial”. For a business, addressing social, environmental and commercial sustainability effectively could be the difference between surviving and perishing. ■

The composition and role of the board

Board composition

Chairmen agreed that the most manageable size for a board is around 12 directors. However, with the proliferation of committees and a requirement that the audit committee, for example, comprise solely of independent non-executive directors, boards are only getting larger.

Achieving the necessary balance while maintaining a reasonably-sized board is a challenge for any chairman, let alone the chairman of a bank or of another highly regulated company: “It’s much easier to have a cohesive team with a small board. However, to meet the code in terms of demographics and gender balance and to populate all of the committees that a bank has to have, we’ve found that we can’t manage with less than twenty people. It is difficult to run such a large board as a team.”

This raises the question of whether it is appropriate or desirable for executives to be board members, over and above the CEO and CFO. We encountered differing views on this. Some chairmen took the view that executive directors tend not to pull their weight on a board since “it is hard to be difficult and open and challenging when your boss is looking at you.” Others prefer to have one or two additional executives on the board because their presence can help non-executives calibrate the views of the CEO, even if adding directors creates a mathematical problem given the requirement for independent non-executives to be in the majority. The obvious compromise — one that we would recommend in the interests of keeping boards to a

manageable size — is for divisional heads to attend meetings at which their portfolio is being discussed, or even to attend all board meetings, but be recused as necessary.

The role of the board

Although one or two chairmen voiced a degree of skepticism over how much value a board can add to a company when the composition of its members is increasingly determined by socio-political considerations, most chairmen were clear that the board should — and does — play a critical role in motivating and challenging the executive team, while ensuring that the highest standards of governance are upheld and acting as custodians of wealth for stakeholders. All were agreed that the board should review and advise, but not be operational (except in a crisis as needs dictate).

One chairman noted that there is a tendency for boards “to become so preoccupied by governance that they don’t lift their eyes and look at the big issues that affect the business in a way that is helpful yet challenging to management.” Another pointed out that the hardest thing on a board is to achieve a “robust engagement” where the management are receptive to being challenged and the members of the board are happy to challenge: “If you can get that formula to work you have a good environment. But if there’s a barrier where the management resents the intrusion and the non-executives feel threatened because they don’t have the same level of knowledge as the executives, then the system is broken.”

Strategy

There is a familiar complaint that because governance issues get in the way, not enough of a board's time or intellectual capital is devoted to strategy. "Issues of the day" tend to crowd out the discussion on strategy; the responsibility lies with the board chairman to ensure that sufficient time is allocated to debating strategy on a regular basis, preferably early on in a meeting.

The broad consensus is that the task of formulating strategy rests with the CEO and executive team who are steeped in the business and have deep knowledge of the trends taking place in the industry. The role of the board is to probe the CEO, reach a full understanding of the strategy and the thinking behind it, ensure that the proper financial resources and talent are allocated to achieve the strategy and, in the words of one chairman, to "hold management noses to the grindstone so that they deliver, because although executives can be brilliant at developing strategies, many are poor at implementing them."

Complete alignment between management and the board on strategy is essential. Without it there will be division and mistrust on the most fundamental aspect of a company's future success and nothing could be more destructive. A robust discussion may be required and this may not always please the executive team, but it is vitally important for non-executive directors to be fully engaged in settling on a strategic direction for the business. Perhaps the most critical aspect of the board's involvement is that, having agreed the strategy, they must make sure that management is held accountable to deliver on it. As one chairman remarked: "The strategy itself provides a benchmark against which the board can determine the effectiveness of the executive."

Most boards hold one separate strategy meeting each year which often lasts 2-3 days and involves input from a broad group of senior executives. One chairman typically allocates three days for the presentation and discussion of strategy and, initially at least, encourages all directors to consider the foundation on which the strategy should be built: "I like to have two sessions: at the first we invite an outsider to discuss global issues, the economy, how that impacts what we are doing. We then distil out of that a number of assumptions for putting together our plan. Having agreed the assumptions we give them to the executive to work on a five-year strategic plan. Then the whole board meets again to agree which way we're going. At the meetings in between, we're basically discussing the implementation of that strategy. However, once a year you have to stand back and ask, 'does it still make sense?' Just as the global economic environment changes in ways that nobody can anticipate, so we need to develop different assumptions."

"We try and make the point that strategy is not an annual event."

The role of the board chairman

There is little doubt that the chairman's role has grown substantially in recent years, both inside the boardroom — orchestrating the board's activities and ensuring its effectiveness — and outside with shareholders and the wider stakeholder community.

Aside from focusing on governance issues and supervising the implementation of strategy,

one of the most critical aspects of the chairman's role involves 'soft skills' that cannot be codified. Good chairmen pay a lot of attention to constructing the agenda and keeping the boardroom discussion focused. To some extent, the value of the discussion will be a function of how well the chairman is able to bring everyone's point of view to the surface and eventually achieve consensus. Managing the boardroom debate can be a difficult process and has a lot to do with the make up of the board and the intellectual rigour and emotional intelligence of the chairman: "I've seen some very good sessions but I've also seen some very poor ones; it is all down to the chairman. Dynamics are important and a really effective chairman will facilitate and guide the debate, making the strategic discussion a value-adding one."

"It's quite a challenge to run the meeting effectively, pay attention to all the nuances and drive the content."

The chairman must be able to remain detached while drilling down into the detail, encouraging a variety of views and bringing all the non-executives into the discussion, particularly those who are new to the board or to the non-executive role. With the relatively high number of inexperienced directors in South Africa, chairmen cannot afford simply to wait for contributions; they need to direct questions at specific board members, especially those still developing in their roles. "People can be shy and reserved, afraid of making fools of themselves, but they are there for a reason and the board needs to have their input."

The relationship between the chairman and the CEO sets the tone and is critical to the success of the board: "If the chairman and CEO are fighting, what then happens is that the relationship between the executive and the rest of the board fractures. You find people in camps and then the whole thing falls apart." One chairman remarked that there is no room for ambivalence in the relationship: "You should be fully supportive of the CEO until the point when you believe there is no alternative but to fire him or her. Anything in between will send out negative signals and have a severely detrimental effect on the board."

One chairman considered it his responsibility to protect the chief executive from the myriad of stakeholder forces (many of them ideologically charged) that can bring undue pressure on executives and distract them from the task of executing strategy. Several chairmen commented that they now find themselves interacting regularly with the wider community of stakeholders, whereas in the past their exposure to outside parties was limited to answering shareholder questions at the AGM. Chairmen in South Africa are also having to learn to manage and respond to the challenges presented by shareholder activists who are becoming increasingly vocal.

Chairing a state-owned enterprise

Several people we spoke to had experience sitting on, if not chairing, both private and public sector boards. The complexity and pressure involved in chairing a state-owned enterprise (SOE) are unique and require diplomacy, patience and strength of character: "Few people have the temperament, or indeed the inclination, to take on such a role. Nowhere

will you have to deal with a more potent cocktail of political, social, environmental and financial imperatives than in a state-owned enterprise.”

The biggest factor affecting the execution of chairman responsibilities in a SOE are the terms and conditions laid down by the Public Finance Management Act. One chairman referred to “the onerous responsibility” that emanates from being owned by one composite shareholder that is not a business and is not entrepreneurial: “They are motivated by painful things like ideology. We are an enterprise and the state-owned bit is an adjective. We are an enterprise and must be allowed to behave as such. As chairman you have got to be firm and be seen as independent as well as acting that way at all times. It is not easy.”

The profile of the non-executive director

Starkly contrasting views were expressed over the ideal profile of the non-executive and the nature of the role. Some chairmen argued that the most valuable directors are the ones who bring a specific area of relevant expertise or substantial business experience, preferably both. Others were less concerned about the business experience, believing that those whose who come from different spheres can be more valuable because they have “plenty of wisdom and common sense without the barrier of too much knowledge of the business.”

One person argued that the ideal non-executive director should be an “informed novice”, analogous to parliamentarians in a democracy keeping a weather eye on the president and the executive. Having informed novices on the board puts the onus on the executive team to

present their case in such a way that a layman will understand: “The typical board member should not have the burden of too much knowledge on the subjects that are raised at the board meeting, but instead act like a jury.” He did not believe that boards need non-executive directors for their particular skills — that is the role of professional advisors. Objectivity and wisdom, he argued, were the most valuable assets.

“The role of the chief executive is crucial in making the board work — he must be neither a dominant figure nor cynical about the value of the board.”

One chairman regretted that governance codes and practices prevent companies having people who know the business sitting on the board because they are not considered independent. “Would you rather have an ex-employee who knows the business and be satisfied that he understands that his role has changed and he is no longer a manager — or have a group of non-executives who know nothing about the business but satisfy the criteria for independence, even if they contribute nothing? I think the rules of board composition have been designed by people who don’t understand how a business works.”

The reality is that boards of South African companies must have a diverse mix of experienced non-executives and novices to ensure that the torch is passed from one generation of directors to the next. In the hands of a good chairman, the two groups can complement each other well and enhance board debate rather than detract from it.

Independence

The issue of independence is one that chairmen feel strongly about. As criteria for independence become stricter, so it gets harder to find qualified, experienced and knowledgeable directors capable of making a significant contribution to board affairs. In the relatively small economy of South Africa, cross-directorships are common and it can be difficult for people to define where their interests lie.

“The idea of sharing responsibility is embedded in company law — fiduciary responsibility applies to all directors and trumps the notion of independence.”

Some see contradiction built into the very idea of independence. Since by law all directors are supposed to share equal fiduciary responsibility, it could be argued that whether or not someone is independent is a moot point. As one chairman put it: “If a person is designated as a shareholder representative they can’t simply pursue their particular interests during a board meeting. Their primary responsibility must be to the company.”

“If you have no point of view you have no business on any board. There are many who have objectivity and independence of mind who would be found wanting by the criteria.”

Almost more important than satisfying set criteria for independence is the need for independence of mind, something that a nominee director can possess to the same degree as the most independent of non-executives. “If you get the right type of person with integrity and moral courage on a board, the rules really don’t matter,” observed one chairman. “I have found that non-executive directors who are deemed not to be independent are often just as effective, if not more so, than directors who are independent but do not have the right make up or the courage to do the right thing all the time.”

Not everyone subscribes to the idea that independence of mind is the key consideration. Being seen to have independence on the board is critical: “Intellectually, you can separate things, but the reason we have governance is so that the next person can believe in what we’re doing and that it is fair and transparent.” ■

Finding directors for South African boards

Shortage of non-executive talent

The shortage of talent in South African boardrooms is worrying many chairmen. Legal liability is becoming more onerous and with it the threat of reputational damage. The pool of experienced directors is already small, so the growing risks make it even more difficult to attract high-calibre board members.

In the case of SOEs, captains of industry are reluctant to serve on boards because of legislation that makes directors personally responsible for what is defined in the PFMA as “fruitless and wasteful expenditure”. “It’s a double whammy,” said one chairman about the difficulty of finding the right people: “There are enormous liability issues plus a shortage of people. Under the new Companies Bill directors can be prosecuted if they should have known about anti-competitive behaviour in the group. Making directors responsible for things they can’t possibly know about is counter-productive.”

One of the unintended consequences, according to one chairman, is that “many of the people who are now prepared to serve on boards are ill-equipped for the task”. There is a strong cadre of black business people with the potential to become outstanding non-executive directors, but in the eyes of some chairmen many of them do not yet have the experience or seniority that would make them truly effective in the boardroom. How boards choose to fill the gap between those who are approaching retirement and the younger generation is critical to the sustained success of companies and their boards.

Not everyone is so pessimistic about the shortage of boardroom talent. Transformation imperatives have accelerated the opportunities for a whole generation of women and black South Africans. “It is so empowering to people,” says one chairman: “They move into the boardroom and they learn. Take a talented person from a different discipline, put them on the board and take charge of teaching them the economics and finance of the business. You will find many worlds open to you that you couldn’t otherwise access. If there is a weakness in our system it’s that we’re trying to use the same people over and over instead of giving a breakthrough to those without the experience.”

“Crippling legislation is creating huge pressure. There are many potential board members who would rather paddle their own canoes than serve on the board of a listed company.”

Initiatives such as the director training programmes run by the Institute of Directors are starting to have a beneficial effect in developing the new generation of directors and bringing them up to speed (the IoD is launching a professional qualification for directors and promoting a director internship programme that involves setting up mentoring relationships with experienced directors).

There is little doubt that the broadening of the candidate pool of non-executive directors is

both necessary and desirable. The sooner this candidate pool expands the better, as it cannot be good for South African business to have such a small universe of directors who end up sitting on multiple boards. Directors can easily over-commit themselves and reach a point of diminishing returns when it comes to preparing for and contributing to endless board meetings. In the words of one chairman: “Beyond six directorships and you’ve got problems; people lose impact. How many boards someone sits on is a crucial consideration when I hire a new director. There are too many floaters out there and I want to know whether a person is going to add perspective or not.”

“Race and gender diversity is important, but we also want diversity of scale. What’s needed is a tapestry of expertise that gels together so that value flows out from the board.”

Diversity

There was broad agreement among the chairmen we spoke to that the quality of debate on South African boards has improved — “particularly in those companies that insist on appointing directors not for their token status but for their ability to make a substantive contribution.” Some of the more mature, highly experienced boards that lack diversity are in danger of missing out on trends and opportunities in society. Having a broad mix of backgrounds — what one chairman described as “a kaleidoscope of knowledge” — can be a genuine source of competitive advantage for a company.

Many of the newly appointed black non-executive directors have a background in human resources or public service and are particularly strong on some of the ‘softer’ issues that boards have to face, such as transformation and gender issues, and their presence on boards has enhanced the debate. Many new directors do not come with the ‘hard skills’ of an engineer, an actuary or an accountant, but their contributions are still greatly valued.

Despite this, some chairmen feel there is still such a disparity of experience on boards that it will be years before the newer, less experienced generation of directors can speak with authority at board meetings, and that this places an extra burden on the more experienced directors. In our conversations we detected an element of frustration that some non-executive directors are being promoted into these roles too quickly, echoing concerns about promotion within the executive ranks.

The reality is that the accelerated development that accompanies black economic empowerment is part of the development phase that companies in South Africa must go through. Those that fail to introduce sufficient diversity onto their boards will suffer the wrath of activist shareholders and inflict reputational damage on their businesses, so there is no alternative but to address the issue in a positive light.

As one chairman pointed out, a less experienced board member can have plenty to offer: “Their contribution might be to provide insight into, say, the ANC policy, or where they think regulation might be going, or what the unions are thinking, rather than on hard core strategy — that will take time.”

International representation on South African boards

It is likely that more and more boards will seek out directors who can bring an international perspective as companies look for specific expertise, plan to expand their business in markets abroad or just need another experienced hand who cannot be found at home. This is a trend that can be seen on UK and US boards and as much as anything reflects the sweeping tide of globalisation.

The jury is out on whether bringing international directors on to South African boards is entirely effective. They are usually based in Europe, Asia or North America and due to the huge travel commitment involved are less likely to sit on committees and may not be readily available for the frequent meetings that accompany an event such as a major acquisition. They are likely to be less involved or aware of what is happening in the company from day to day and, as a result, they may end up on the periphery of the board. Some would argue that their specialist knowledge can be acquired through other means.

Many chairmen are prepared to put up with the disadvantages in the belief that the right international director can be a significant boon, particularly if the person has recently come out of an executive role. There are other benefits, too: “It is an advantage when it comes to dealing with diversity because international directors tend to be able to say things that South African non-executives are not prepared to say, which injects some additional honesty into the boardroom.”

Succession planning

Succession planning should be top of mind for every board, but there appears to be a lack of consistency on this issue. Most boards have a reasonable line of sight on executives at the executive committee level and just below; a few will make it their business to look further down the organisation.

Succession planning mostly falls within the ambit of the remuneration committee (or a nomination committee if there is one), although one chairman insists on making “manpower issues” the main item for discussion at one full board meeting per year. In any case, the remuneration/nomination committee should develop a strong relationship with the head of human resources who will be an important ally over succession planning.

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Another chairman remarked that looking a couple of layers below the executive team in South African companies is “a nightmare — just one empty box after another”. For this reason, boards should be careful about allowing people to remain in the same management jobs for too long. Longevity is inevitable when there is a general skills shortage, but the practice of rotating executives to allow others to gain experience — something that is common in the US — could be a useful way for South African

companies to give high potentials valuable exposure to different aspects of the business.

CEO succession should be the most critical concern for boards, which should always ask themselves what the right profile for the CEO should be, bearing in mind what point the company is at in its evolution. One chairman felt that the automatic impulse to look outside the organisation when an unexpected succession event takes place is a mistake, especially in a complicated international business where

finding an external replacement within six months will be practically impossible.

If a company has a dominant CEO, it can be extremely difficult to groom a successor, which is another argument for the separation of powers between chairman and CEO. The problem may not go away, but with a non-executive chairman in place there is a better chance that action will be taken to prepare the way for a successor. ■

Executive remuneration

Executive director remuneration, and that of the CEO in particular, is a highly charged issue around the world and South Africa is no exception. These days, few companies escape public scrutiny over levels of executive pay and many provoke outrage. Whether this public opprobrium is justified or not, boards cannot afford to take the matter lightly. Considerable damage can be inflicted on a corporate reputation as much by a poorly presented case as by an indefensible pay award. As in other markets, the heat is on the remuneration committee as never before. It is one of the most highly scrutinised committees of the board and is often chaired by someone with little remuneration experience. One observer commented that it is difficult for boards to argue against high increases in executive remuneration because of the quality of information that they see, but that should not be an excuse for a conscientious remuneration committee.

Several of the chairmen we interviewed felt that rewards are running away from performance, the irony being that full disclosure of executive pay has ultimately had an inflationary effect. Those calling for greater transparency must recognise that this unintended consequence is hard to reverse, especially given the shortage of leadership talent in the country.

The two issues that remuneration committees must address particularly carefully are that of performance-related pay, and the differentials between the highest and lowest paid workers. Both areas are full of pitfalls and offer rich pickings for pressure groups and the media.

Pay for performance

No one would argue that pay must be closely linked to performance, but unfortunately that principle does not solve the problem on its own. Even the most defensible remuneration pack-

ages can be highly complex and hard to explain, and South African boards must take account of the fact that objections to remuneration tend not to be articulated in a sophisticated way.

One chairman argued that one of the biggest risks that any South African company runs is the failure to incentivise or compensate leaders properly: “This can have a severe effect on shareholder wealth — so it’s not just a question of worrying about people being overpaid, it’s also a question of not keeping up with the market.”

Incentivising management through stretch targets, for example, is both rational and laudable, but when an executive cashes in a large number of options that have outperformed even the most optimistic forecasts, it is easy for critics to simply point to the number, ignoring the fact that reward often lags. If a large payout happens in a year that has been disappointing for the business, the optics are even worse. For this reason, remuneration committees must not only construct packages that are watertight from a performance standpoint, but also anticipate the consequences and be prepared to provide the market with a clear, robust explanation. Even then it may not be able to avoid adverse publicity.

Other factors influencing pay include the alignment of interests between management and shareholders (to avoid short-termism, for example) and the level of personal risk that executives carry.

Pay differentials

The media in South Africa inevitably looks at executive pay through the eyes of the lowest paid workers and some chairmen also saw the importance of putting executive pay into context by comparing the gap between the lowest and the highest paid, “after all, absolute numbers are meaningless.”

“We look at the peer group and if their pay goes up, our pay goes up.”

One chairman acknowledged that in most markets the multiple between what the highest paid and the lowest paid earn is growing all the time, but recommended that remuneration committees benchmark the pay differential in different industries to see which sectors are addressing inequality most effectively. ■

Board evaluation

While there is no obligation for them to do so, chairmen are starting to employ outside facilitators to handle their board evaluation every second or third year in the belief that an objective assessment of board performance can be revealing and constructive. Each chairman decides what process is most appropriate for the board, for example: “We conduct annual evaluations: the first year is a self-evaluation process, the second is more focused on committees and the third involves a formal evaluation with an outside facilitator.”

Of the three possible elements — individual assessment, objective evaluation by a third party and an evaluation of collective board performance — by far the most controversial is peer review. Some non-executives object on the grounds that they have taken up the directorship as an interest, they are not well rewarded and therefore do not see why they should be assessed in this way. But as one chairman pointed out: “Performance does need to be measured and peer review can be extremely powerful — it keeps the board on its toes.”

“Directors need to know that if they sit down, demolish a mountain of biscuits and make no contribution their colleagues are watching them closely.”

Needless to say, board evaluation is only truly effective if both the chairman and the non-executives are prepared to put its recommendations into practice. One of the most helpful outcomes can be identifying training needs particularly among new, empowered directors. ■

Director induction and training

New directors, particularly those who have not sat on boards before, must be prepared to devote considerable time to learning about the business, the sector, corporate governance and their role as a non-executive. The learning curve for new directors is steep, but they should have proper support from the company and the opportunity to spend plenty of time with the chairman.

Some boards run separate programmes for induction and continuing education and vary each according to the skill and experience level of individual directors. These can range from

site visits to seminar-style sessions where, for example, industry trends and terminology are explained.

One chairman who could see the value in training and mentoring nevertheless warned that a board should not see itself as a training mechanism: “We have a major induction programme for our directors and I think that if they wished to be better informed or helped with various things they only have to ask. We don’t run courses for directors but we certainly try to make sure that they understand what is going on.” ■

Looking ahead

The chairmen we spoke to for this study were agreed unanimously that uncertainty in the lead up to the 2009 elections was having a debilitating effect on business sentiment. Taking a long-term view of a business has been made more difficult by an environment in which so many decisions have been put on hold.

There is serious concern about the outflow of people and skills resulting from crime and an unsettled political situation. The brain drain is now also affecting significant numbers of black executives and directors who are seeking opportunities outside South Africa.

Several chairmen bemoaned the fact that business leaders who are able to see the issues

for what they are and who can articulate their concerns are remaining “painfully quiet”. “A big issue in this country is what I would call the politeness barrier. People are not really prepared to say what they think, particularly about the macro economic and political issues in the country. People maintain their dignity but refuse to put their head above the parapet because they’re going to get shot — the result is a conspiracy of silence.”

One chairman was confident that stability would return in the near future: “There seems to be quite a level of pragmatism coming through from government which could turn out to be relatively settling for business. I’m not at all despondent about what the future holds.” ■

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Our office in Johannesburg is staffed with a highly diverse team of South African consultants and researchers who have an intimate knowledge of the South African business landscape. We have excellent relations with the full spectrum of South African business and government leaders and work on both public and private sector assignments.

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BUHLE MASITHELA

bmasithela@spencerstuart.com

T +27 11.707.9460

MPHO SEBONI

mseboni@spencerstuart.com

T +27 11.707.9480

KEAMOGETSE (MOULA) NYOKA

mnyoka@spencerstuart.com

T +27 11.707.9484

CHRIS VAN MELLE KAMP

cvanmellekamp@spencerstuart.com

T +27 11.707.9485

Worldwide offices

Amsterdam

T 31 (0) 20.305.73.05
F 31 (0) 20.305.73.50

Atlanta

T 1.404.504.4400
F 1.404.504.4401

Barcelona

T 34.93.487.23.36
F 34.93.487.09.44

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F 86.10.6505.1032

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F 571.618.2317

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F 1.617.531.5732

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F 32.2.732.19.39

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F 36.1.394.10.97

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F 54.11.4313.2299

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F 1.403.538.8656

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F 1.312.822.0116

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F 1.214.672.5299

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F 971.4.426.6501

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F 49 (0) 69.61.09.27.50

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F 41.22.312.36.39

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F 1.713.658.8336

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F 44 (0) 20 7298.3388

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F 1.310.209.0912

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F 34.91.561.42.75

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F 61.3.9654.4730

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F 52.55.5281.4184

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F 1.305.443.2180

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F 39.02.782452

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F 46.8.534.801.69

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F 43.1.36.88.777

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T 1.202.639.8111
F 1.202.639.8222

Zurich

T 41.44.257.17.17
F 41.44.257.17.18

For copies, please contact Sharlene Cooke on +27 11.707.9481 or scooke@spencerstuart.com.

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