# COLLEGE OF BUSINESS, PEACE, LEADERSHIP AND GOVERNANCE

## NMMS 509: CORPORATE GOVERNANCE AND BUSINESS ETHICS

## END OF SECOND SEMESTER EXAMINATIONS

## MAY 2021

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## TIME: 7 HOURS

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## INSTRUCTIONS

1. This paper contains **three** questions.
2. Answer **one** question.
3. Start each question on a new page.
4. Each question carries a weight of **100** marks.
5. You have 7 hours to complete and submit your answer to the University Moodle platform.
6. Anti-plagiarism tools will be used to assess your answer for any form of examination misconduct and plagiarised work will be punished in terms University Regulations.

**Question One**

Corporate governance has become a buzzy reform in modern day organisations. As a corporate governance specialist, you are engaged by the Ministry of Small to Median Enterprises to make a presentation on designing and institutionalising corporate governance in small enterprises. Explain how you can apply the principal agent and the stakeholder theories in developing your presentation. Clearly show how the two theories inform how companies are designed, directed and controlled. Use illustrative examples to substantiate your claims.

**Question Two**

Read the following excerpt and answer the question below.

**Steinhoff collapse: a failure of corporate governance**

> In the months running up to December 2017, rumours about the financial health of Steinhoff surfaced. A confidential report was leaked to five entities in September 2017 that highlighted several major issues – potentially fraudulent – at Steinhoff. One of these entities was a German magazine called Manager Magazin (see, for instance, Schwarzer and Clausen 2017); another recipient of the report was Deloitte, the auditors of Steinhoff International. Steinhoff's management called the report in the German magazine 'unfounded' (see for instance Naidoo 2017). Of course subsequent developments make it clear that these were well-grounded statements, rather than unfounded rumours. In September 2017, Deloitte, being the Steinhoff auditors, approached the Auditing Committee of Steinhoff with a request for certain audit evidence (see for instance Thompson 2018). Deloitte South Africa was the Steinhoff auditors for more than 20 years (since before the group listed on the JSE).In December 2015, following the registration of the group in the Netherlands, Deloitte Netherlands took over the audit responsibility in accordance with Dutch law. (Styan 2018). From September 2017 to December 2017 the Steinhoff Audit Committee, which consisted of some of the most highly qualified and experienced audit professionals in South Africa including Drs Steve Booysen (committee chairman), Len Konar and Theunie Lategan, investigated the allegations and searched for the audit evidence required. The Committee urged the CEO of Steinhoff to provide the relevant evidence and was repeatedly reassured it was forthcoming (Thompson, 2018). In our view at least a part of the difficulties at Steinhoff can be attributed to the somewhat unusual nature of its governance structure. Steinhoff is the only company in South Africa that operates using a two-tier board structure, more common in the European business world. It remains a single board but it consists of two distinctly separate tiers. The first tier is the Supervisory Board which was – at the time – under the chairmanship of Dr Christo Wiese, a major shareholder in Steinhoff, and which included several non-executive directors including Bruno Steinhoff. (Styan 2018). The second tier is the Management Board that consisted of only three individuals, all members of the executive management: Mr Jooste (CEO), Danie van der Merwe (COO) and Ben la Grange (CFO). The idea behind this board model is that the management board must report to the supervisory board, which in turn is accountable to the shareholders. The risk with a two-tier board system is the possibility that the management board does not report properly to the supervisory

board and in essence ‘hijacks’ the company (Styan 2018). On the weekend of 2 and 3 December 2017 Mr Jooste travelled to Germany, purportedly to collect the required audit evidence for submission to the Audit Committee and auditors of Steinhoff who awaited his return on Monday, 4 December. The audit evidence in question related to one of the Steinhoff subsidiaries, Steinhoff Europe, an institution registered in Austria and headquartered in Germany. Steinhoff Europe is not audited by Deloitte. Mr Jooste was also the CEO of Steinhoff Europe. Mr Jooste failed to submit the evidence and subsequently tendered his resignation as chief executive. By 5 December 2017 it became clear that the audit of Steinhoff’s financial statements was incomplete. Initially the Audit Committee had planned as an alternative the publication of unaudited financial statements, based on assurances that Mr Jooste would meet the Committee on 4 December 2018 and provide the relevant documentation. As Mr Jooste neither attended the meeting, nor submitted the documentation, the Audit Committee advised the Supervisory Board against the publication of unaudited financial statements. It should be borne in mind that the entire Board of Directors has full responsibility for the financial statements. Mr Jooste sent a note to some senior Steinhoff employees wherein he announced he was leaving the company. This electronic letter disclosed very little information, other than stating that he had made some ‘big mistakes’ (Jooste 2017). The lack of detail contributed to the subsequent decline in the share price and in the prospects of Steinhoff, as it was impossible for investors to put any value on the company. The company was in disarray without a chief executive and without audited annual statements, as Deloitte as auditors refused to sign off on the statements and requested a forensic investigation. Mr Jooste’s resignation as Chief Executive was accepted on Tuesday evening, 5 December and announced after the markets had closed. It triggered a spectacular collapse in the share price. On 5 December 2017 the share was trading at R45.65. By 8 December at 17:00 h, the share was trading at R6.00 per share, where after the share price went into free fall. The Steinhoff group stated in a Sens (JSE News service) announcement on Wednesday, 6 December 2017, that it would publish the audited 2017 consolidated financial statements when it is in a position to do so. In addition, Steinhoff group stated on Thursday 7 December 2017 that estimated impairments amounted to around €6 billion (Sens, 2017).

Since the dramatic developments of December 2017, little additional information about the financial position of Steinhoff has emerged. The leadership has changed dramatically. Only three original board members remain. These are Heather Sonn – who was appointed as the new chairperson at the Annual General Meeting convened in April 2018 – Dr Steve Booysen and Angela Krüger-Steinhoff. (Styan 2018).The Board of Steinhoff appointed audit firm PwC ‘ . . . to conduct an independent forensic investigation to uncover the detail of what went wrong’ (Sonn 2018). Steinhoff also announced that its financial statements for 2015 and 2016 had to be restated and could no longer be relied upon and the release of the 2017-financal statements had been delayed indefinitely (Turner and Orr 2017). The prior year restatement of financial statements of Steinhoff raises serious questions about the conduct of the Board, as these very statements are their responsibility, as well as questions pertaining to the conduct and role of the external auditors who signed off on the statements. The necessity to restate financial statements, for which Board members are responsible, raises several questions about their suitability to serve on any boards. In our judgement, and based on the serious lapses just noted, Steinhoff’s Supervisory Board failed in its duty to discharge its corporate governance, at the very least in relation to exercising due oversight over the management board's activities. Moreover, the Board also issued financial statements that did not reflect accurately the Company's financial position, as is evidenced by the need for prior year restatement of financial statements of Steinhoff. Despite these failures it would appear that the members of the Steinhoff Supervisory Board will not be charged but will be allowed to walk away from the Company without accepting any responsibility (see for instance Haffejee 2018, 2 on this matter). The National Parliament of South Africa held two parliamentary hearings into the Steinhoff meltdown, based in part by the fact that state pension funds had lost in excess of R20 billion owing to the decline in Steinhoff's share price. These hearings were held in Cape Town on 31 January 2018 and 28 March 2018. From testimony delivered it transpired that the investigation into the collapse of Steinhoff will take years. The PwC forensic investigation alone is only expected – at best – to be concluded by the end of 2018. In addition, Mr Jooste refused to attend the hearings. He has not been seen publicly since 4 December 2017. A third hearing has been proposed for August 2018. The Board of Steinhoff called an annual general meeting for shareholders, held on 20 April 2018. Little of real value emerged from this meeting, other than the fact that the company had to sell assets to keep afloat. This included selling stakes in listed companies like KAP and PSG. In addition, the company's total debt amounted to €10.4 billion (R156 billion) while market capitalisation had shrunk to €584 million (R8.4 billion). A flagrant disregarding of good corporate governance and continued failure to accept responsibility of the crisis at Steinhoff emerged from the announcement of the Company's annual general meeting. In the initial announcement of the meeting, it was proposed that ' . . . Steve Booysen and Heather Sonn were to be paid an additional €200,000 and Johan van Zyl be paid an additional €100,000' (Rossouw 2018) for additional work after the crisis broke in December 2017. The additional work relates to the roles filled by the three individuals in the weeks following the resignation of Mr Jooste and the subsequent crisis in the group. This amounted to what may be described as fulltime positions – with the support of the Supervisory board – rather than their regular non-executive roles. The three individuals worked as a task team trying to stabilise the rudderless ship that was sinking fast. Still, if staff members lose money, they are fired. If Board members lose billions, should they be remunerated for extra work? The proposal for the extra remuneration drew strong criticism and it was subsequently withdrawn, but will be put for deliberation to the Remuneration Committee of Steinhoff. At the time of writing, the group has been busy with a restructuring plan for a few months and has appointed a restructuring specialist, Mr Richard Heis (Steinhoff 2018). There has also been increasing amounts of evidence coming to the fore that indicate a massive fraud has in all likelihood been perpetrated over many years.

Source: Jannie Rossouw & James Styan (2019)

**Question:** What critical corporate governance lessons can be drawn from the preceding case?

## Question Three

Effective corporate governance is hinged on complementarities between internal and external mechanisms. Emphasis on one at the expense of the other decimates the whole corporate governance endeavour. Discuss this assertion with the aid of illustrative example.

**END OF EXAMINATION**