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Corporate Governance within the
South African Banking Sector, with a greater emphasis on the
'Big Four' (ABSA, FNB, Nedbank and Standard Bank).

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ZN MIYA

DEDICATION

This dissertation is dedicated to my wife, Nothemba (Tembi) and our children, Lusando (Sando) and Nonela (Noni), for their understanding and support during all the hard work in putting together this research.

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I certify that, except as noted above, the report is my own work and all references used are accurately reported

Signed:

EXECUTIVE SUMMARY

As a developing country, South Africa has an elaborate banking industry and therefore a world-class payment system. In some areas, the industry is on a par with first world countries, if not better. The favourable economic and market conditions allow South Africa banks enjoy better margins than their better-placed peers throughout the developed world and this has made the sector the envy of their foreign counterparts. The four largest banks in South Africa, ABSA, First National Bank (FNB), Nedbank and Standard Bank, hold 84% of the sector's assets and liabilities. The four banks further hold 80% of the industry's capitalisation. These statistics are a reflection of how dominant these banks are within the industry.

The South African banking industry holds assets to the value of R1.627 billion and liabilities of R1.5 billion. The combined capitalisation of the banking sector amounts to R122m. This high ratio of liabilities to capital (leverage) is a worldwide phenomenon within the sector. This is brought about by the fact that deposits held on behalf of clients are classified in the balance sheets of these institutions as liabilities. This great disparity between liabilities and capital results in a need for greater regulatory oversight and good corporate governance within the industry. The industry has in the recent past, however experienced several bankruptcies, which were blamed on corporate governance failures. Banks involved include ABSA(Unifer), Regal Treasury Bank, Nedbank and Saambou Bank.

It is from countries and in companies where emphasis is placed on good corporate governance that the major part of investment funds will flow, in the form of foreign direct investments (FDI). Evidence of good governance is therefore particularly important in developing economies, which look to developed economies for much needed capital with which to stimulate domestic economic growth. There is also a growing weight of expectation on organisations to operate as good corporate citizens.

The publication of the King Report on Corporate Governance for South Africa 2002 (the 'King Report 2002') and the Myburgh Report 2003 signifies the importance the South African authorities place on good corporate governance within the business environment. The Myburgh Report was a document purely focused on the South African banking sector, with the five major banking groups in South Africa being asked to seek an independent review of certain corporate governance aspects of their businesses. The purpose of the review was to measure the extent to which the South African banking industry complied with international standards and norms of good corporate governance and best practice, and to ensure that the South African banking industry's credibility as a competitor in the global market was maintained. It sought to establish to what extent an adequate and effective process of corporate governance had been established and maintained, and to what extent the Board of Directors within each group monitors the process. The sector is again receiving international attention, with Barclays Bank wanting to increase its presence in South.Africa. This has been seen as a "vote of confidence" in the country, its economy and the financial sector.

This cross-sectional study of four banks seeks to explore how effective the banking sector has been in implementing the principle of good corporate governance as espoused in the King Report 2002, the Banks Act 94 of 1999 (the Act) and the recommendations contained in the Myburgh Report. The research will further seek to determine what impact this has had on the individual banks and/or the industry. The researcher decided to limit this research to the four principal banks in South Africa because they hold such a dominant position in both the South African economic and financial spheres. Other banks are mere followers.

The research develops an argument that accepting and implementing principles of good corporate governance coupled with living up to such principles impact positively on an organizations ability to increase shareholder value. This is reflected by increased profitability and/or an increase in share prices. The researcher adopted a positivistic methodology due to the limited time and resources at his disposal (Collis & Hussey,2003:61)

The notion of good corporate governance has been brought to the fore by recent high profile corporate scandals such as those involving Enron and Worldcom. The topic is currently widely and intensely debated in corporate boardrooms and the press. Academics have with continued research added their perspective on what good corporate governance entails and the benefits that can be derived from such governance by a business, its shareholders, the country in which it operates, and the economy.

The literature review has been carried out on Corporate Governance, the South African banking / financial sector, the profiles of the four banks in question and globalisation. Globalisation is of particular interest to this research because South Africa has since 1994 become a global player and its financial sector must be foremost in enabling the country to transcend into a developed, first world country.

In total 16 face-to-face interviews were undertaken, with 24 questionnaires completed and assessed. Structured interviews were conducted with company secretaries and three directors of each bank in order to gain greater insight to the topic. One branch manager and one staff member at each bank were randomly selected to complete the questionnaire. No interviews were undertaken with the managers and staff. The branch managers and staff members were included in order to verify whether the corporate governance principles practised at board and executive management levels were in fact filtering down to operation levels within the organisations.

The research shows that banks are well on their way in ensuring that the structures required (form) to ensure conformance with the Code of Corporate Practice and Conduct incorporated in King II are in place. In the institutions researched, these are in one way or the other encoded in rules, regulation or policies. . The research also sets out to determine whether the industry is not over-regulated and if so, which regulations are viewed as unnecessary, poor or damaging.

The benefits of this research are that it will provide an indication how far the banks have progressed in making good governance an integral part of their culture. In banks, corporate governance needs to be an intrinsic part of each organisation's culture and value system.

RECOMMENDATIONS

Banks hold a central position in both the economic and financial spheres of society. The Business Roundtable, an association in the United States of CEO's contends that the substance of good corporate governance is more important than its form, "The adoption of a set of rules or principles or of any particular practice or policy is not a substitute for, or does not itself assure, good corporate governance". With banks holding a unique position in society and/or any economy, it is also required of banks to comply with the form of corporate governance required by the Bank's Act, No.94 of 1990 (Banks Act) and the King Report 2002. Shareholders, depositors, the regulators and all other stakeholders seek the assurance that, as a minimum, banks also meet corporate governance standards in regard to form. Any bank that fails to comply with the form of corporate governance runs the risk of suffering damage to its reputation.

The tenets of good corporate governance make business sense and as such should radiate from the top of any organisation to the bottom. Ordinary staff, who are tasked with the day-to-day activities in support of good corporate governance are not acutely aware of their contribution to this end. Middle management and senior management should be given basic training on corporate governance, and the will then be tasked with ensuring that such knowledge is passed on.

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CHAPTER 1

1. INTRODUCTION AND ORIENTATION

Good corporate governance is the foundation upon which healthy organisations are built. It sets the tone to how organisations operate and behave, both internally and to the external market generally. A comprehensive corporate governance framework addresses the following:

- the role and responsibilities of the board of directors;
- the reliability of financial reporting, effective supervision of risk management and an integrated framework of internal controls;
- the accounting and auditing environment; and
- the ethical tone for the organization and the transparency of its conduct, corporate strategy and direction, and the monitoring and measurement of performance against goals.

The King Report of 2002 has introduced new and varied corporate governance requirements. Some are focused on increased responsibility, whilst others concentrate on increased accountability.

1.1 PROBLEM STATEMENT

It is important for banks to introduce and comply with the recommendations contained in the Code of Corporate Practice and Conduct (the Code) incorporated in the King Report 2002, recommendations contained in the Myburgh Report on Governance and as envisaged in the Banks Act 94 of 1990 (the Act). King II embodies corporate governance standards to which all companies should progressively aspire. The real test however lies in whether the principles are truly practised throughout an organisation.

Shareholders, employees, government agencies and regulators want to know every detail about the organisation, especially with regard to the governance, accountability, self regulation, policy compliance and the overall power relations and delegation (Yakasai, 2001).

Those that throw caution to the wind and decide not to pursue the tenets of good corporate governance need to take note of the damage they inflict to society, as expressed by Arthur Levit, a former Chairperson of the United States Securities Exchange Commission: "If a country does not have a reputation for strong corporate governance practices, capital will flow elsewhere. If investors are not confident with the level of disclosure, capital will flow elsewhere. If a country opts for lax accounting and reporting standards, capital will flow elsewhere. All enterprises in that country – regardless of how steadfast a particular company's practices may be – suffer the consequences"(Institute of Directors, 2002).

South Africa is but one of a number of emerging markets seeking to attract foreign capital. It is however not easy to distinguish itself from the common perceptions of the continent as a whole – Africa, a "Dark Continent". Events in Zimbabwe have illustrated this fact. The publication and subsequent adoption of the principles of the King Report 2002 have provided some means of differentiating the country and its business environment from it neighbours. South Africa has earned world-wide recognition for it initiatives, with its neighbours lagging behind. The intent of the initiative was, and remains, the enhancement of corporate governance and investor protection in South Africa.

South Africa has had its fair share of corporate bankruptcies, across all sectors of its economy, with most invariably leading to the destruction of shareholder value. The failure of a bank however has more profound implications and could lead to the collapse of a country's financial system and the integrity of its capital markets.

South Africa has in the past decade had several bank failures. In 2002, Saambou Bank Limited ('Saambou') the seventh largest bank in South Africa. was placed under curatorship. Following on Saambou's collapse, there was a run on BOE Bank Limited('BOE'). Saambou was liquidated, with separate business units thereof being sold off to different financial institutions. Nedbank on the other hand acquired BOE. These failures were symptomatic of organisations with ineffective risk management processes and procedures. This caused the Registrar of Banks to confirm that approximately one bank a year had failed in South Africa in the past decade due to its corporate governance failures.

Risk management is a vital part/component within the overall process of corporate governance. It is a continuous process of proactively identifying, evaluating and managing actual and potential risks and best serves to ensure that risks identified are controlled, eliminated or managed appropriately.

Banks, financial and insurance organisations were specifically mentioned in connection with conformance with the recommendations contained in the report. The King Report 2002 asserts that substance should take precedence over forms. It is in view of the above that it is required of banks also to comply with the form of corporate governance required by the Bank's Act, regulations and the King Report 2002. Assurance that banks meet the corporate governance standards regard to form is sought by all relevant stakeholders. Any bank that does not comply with the form of corporate governance runs the risk that of suffering damage to its reputation.

There is consensus in the literature that indeed many corporate failures are in fact corporate governance failures. With banks holding a unique position in society, it is incumbent on them to strive to ensure that they subscribe to the tenets of good governance.

1.2 THE IMPORTANCE / BENEFIT OF THE RESEARCH

The core issues in corporate governance include the composition of the Board of Directors, the activities/responsibilities of members, the role of nominal directors and the use of independent auditors (Yakasaai, 2001).

The financial services industry holds a very special position in any economy. The importance of the industry dictates that all those involved support all efforts to enhance the industry's image and its reputation. Adhering to the principle of good corporate governance is but one way in doing so. Banks, by their nature, are important contributors to economic prosperity. Should they fail, economic progress suffers.

This research will determine how far the South African Banking community has progressed in implementing the recommendations contained in the King Report of 2002, the impact this had on their bottom line and above all, on goodwill. The research will also seek to determine what could be improved or added to the current set of recommendations in order to strengthen corporate governance in the ever changing business landscape in South Africa's fledging new democracy.

The knowledge gained will confirm that the integrity of Banks in South Africa still ranks amongst the best in the world, a critical requirement in attracting foreign direct investment.

1.3 PURPOSE / OBJECTIVES OF THE RESEARCH

The aspect of corporate governance in banks is of interest to government, depositors, shareholders and the public at large due to the catalytic roles of banks in any country. The purpose of this research is to ascertain whether the South African banking sector continues to pursue the tenets of good corporate governance and the effects this has had on the individual banks, the industry, the economy and the country. The research will therefore be descriptive in nature. Accordingly the following will be undertaken:

- a study to determine whether effective due processes of good corporate governance are being maintained as recommended by the King Report 2002;
- what innovations have come to the fore in an effort to exceed the standards as proposed in the King Report 2002. (The recommendations are minimum standards of compliance sought and nothing prevents institutions from exceeding the standards as well as comply with global governance principles of best practices);
- composition of the boards;

- how deliberate risk management is being pursued, in an attempt to assess whether any specific methodology is applied in the management of risk as banks by their nature are in the business of risk;
- what other challenges the banks are facing in the global arena, in which they now find themselves,
- an attempt to pinpoint / identify potential corporate weaknesses / inconsistencies, for future investigation;
- an investigation as to whether the industry is not over-regulated; and
- lessons learned.

It must be noted that this research does not specifically examine the practice of ethics. Ethics is but one dimension of good corporate governance and it refers to generally accepted principles or judgments of what is right and what is wrong, good and evil, moral and immoral. In organisations, ethics are standards of behaviour expected of people who work for organisations and one could find these standards reflected in organisational policies, employee codes of conduct and in value statements. Ethics therefore sets the tone and context in which the governance system operates in terms of the principles, norms and standards that exist in organisations.

1.4. METHODOLOGY

The following paragraph sets out how the research was conducted. It was conducted as a cross-sectional investigation into the banking sector of South Africa. Non-probability sampling (purposive sampling) was used for this research where expert knowledge was sought from company secretaries and directors. The research sets out to ascertain the progress made by the South African banking industry in adopting the tenets of good governance as recommended in King II, the Banks Act 94 of 1990 and the Companies Act 61 of 1973

Due to the limited research undertaken in corporate governance within the banking sector of South Africa to date, an exploratory investigation was appropriate. The focus was thus on quantitative, though qualitative measures, in the form of interviews were utilised with the view of enriching, corroborating and expanding on the responses received by way of questionnaires.

The primary method for eliciting information from respondents was a questionnaire, whilst secondary sources were used to strengthen the researcher's understanding of the topic – Corporate Governance within the Banking Sector. The listed headings are used to elaborate on the research design.

- Why was certain data collected ?
- What data was collected ?
- Where was the data collected ?
- When was the data collected ?
- How was the data collected ?
- How was the data was analysed ?

1.4.1 Why certain data was collected

The focus of the investigation was on corporate governance within the South African Banking Sector. The target population thus constituted the 38 banks currently operating within the sector, some with foreign representative offices outside the Republic. The 38 banks also made up the study's sampling frame. Purposive sampling was used to select the actual banks investigated, namely ABSA, FNB, Nedbank and Standard Bank. These banks are market leaders in the sector and as such set the tone within the industry. Other smaller banks are mere followers.

1.4.2 What data was collected

Both primary data and secondary data was necessary. Primary data was collected by means of questionnaires, with the responses thereafter corroborated by way of interviews with the company secretaries and three directors of each bank.

Secondary information and data was obtained by reference to the existing body of knowledge. Primary sources used included King II, the Myburgh Report, the Banks Act, academic journals and other books and publications, specific to corporate governance within the banking sector. The respective banks' financial reports also provided more recent information on corporate governance.

1.4.3 When the data was collected

The sources of primary information were senior executives within the respective banks. This included the secretaries and directors of these companies. Company secretaries are tasked with providing guidance on governance matters whilst the directors, through the board are accountable. Lower level staff, in the form of a manager and a report were also canvassed.

The directors and company secretaries of the respective banks generally occupy offices at the organisation's headquarters. This was the ideal setting for the interviews, as the respondents were more comfortable and thus more co-operative and amenable to difficult and sensitive questions. The interviews were granted and proceeded during normal working hours.

1.4.4 When the interviews were conducted

It was not easy to schedule interviews with the company executives and directors. It was the individual company secretaries who were most helpful in arranging and securing appointments with these individuals. They have busy schedules throughout the year. One had to contend with the times and dates that they were able to accord the researcher.

1.4.5 How the data was collected

The most appropriate tool for data collection for the exploratory research was a questionnaire, comprised mostly of closed questions. The questionnaire was provided in advance to all respondents. The document was forwarded electronically to the company secretaries, who then transmitted it to those directors who had agreed to assist. The company secretaries were extremely helpful in breaking the ice, encouraging and securing co-operation and participation from the directors. This applies to the completion of the questionnaires and subsequent interviews undertaken.

1.4.6 How the data was analysed

The completed questionnaires provided quantitative data. Such data was analysed by noting the frequency of an occurrence. This data analysis method provided a useful summary of how the banks fared in their governance practices. The frequency scores were then transposed to bar charts in order to provide for easier dissemination of the findings. At the instance of the interviews, a tape recorder was used after obtaining permission from the interviewee. Data was analysed through content analysis. The theme was used as a unit of analysis. Such recordings provided greater insight into the process of corporate governance within each bank.

The questionnaire formed the basis of this research. This tool had several advantages and a few disadvantages. The advantages are listed below.

- Questionnaires are easy to administer. They were transmitted electronically (e-mailed) at the instance of this research.
- It is a low-cost option, with one person able to distribute a questionnaire to many respondents simultaneously.
- Questionnaires provide for anonymity.
- Questionnaires allow respondents time to think about questions.
- Questionnaires also provide for rapid data collection.

Personal interviews provide for the advantages listed below.

- They elicit good co-operation from respondents once a rapport has been established.
- The interviews provide greater insight into actual governance practices within the individual banks at the instance of this research.

Both methods of interaction have their individual disadvantages. Questionnaires administered to respondents have the problems listed below.

- There is a probability of a low response rate.
- They do not provide for interviewer intervention, allowing for probing and explanations.
- Questionnaires cannot be long and complex.

Personal interviews suffer from the disadvantages listed below.

- Interviews require highly trained interviewers in order to extract maximum effectiveness and benefit.
- Not all respondents are always available or accessible at short notice.
- A longer period is needed for collecting data/information, a factor that contributes to higher costs or delays, if not properly provided for.

1.4.7 Data Collection

In total, 16 structured interviews were undertaken, with 24 questionnaires completed and assessed. All the respondents were required to respond to the questions by rating on a scale of 1 (Yes) to 5 (No). Face-to-face interviews were conducted with company secretaries and three directors of each bank in order to gain greater insight into the topic whilst discussing their responses to the questions. One branch manager and one staff member at each bank were randomly selected to complete the questionnaire. No interviews were undertaken with the managers or staff members requested to complete the questionnaires. The interviews were decided upon in order to corroborate and expand on the information provided by the respondents.

1.5 RESEARCH QUESTIONS

The questionnaire was adapted in order to provide answers to critical aspects within an effective corporate governance process. The research questions are linked to the objectives mentioned in the preceding chapter. The researcher assumes that the people interviewed and completing the questionnaires can and will make good judgments. The survey strives to provide a detailed insight into the progress made by banks, individually and collectively in developing and infusing a culture of good corporate governance. The survey will further help to enhance and refine the process by identifying emerging best practices. The approach to assessing progress made will be a balanced one, taking into account both qualitative and quantitative aspects and the evolutionary nature of the industry.

1.6 WHY THE 'BIG FOUR' BANKS

The sample design of the companies studied was purposive. Another criterion, market capitalisation was used in selecting the banks. The South African banking sector is comprised of 38 registered banking institutions with a total capitalisation of R122m, R1.627 billion in assets and R1.504 billion in liabilities. ABSA, First National Bank, Nedbank and Standard Bank (Big Four) dominate the sector. The big four together account for R1.366 billion of the sector's assets and R1.266 billion of the its liabilities. These banks are also in direct competition with each other, with each bank striving to capitalise on any competitive advantage it can muster. Being the first to conform to the tenets of good corporate governance provides such a window of opportunity. The four banks make up 10.5% of the population of this research, a sample size that can be reduced without sacrificing precision.

The four banks jointly control the South African banking sector by whatever measurement parameters, be it total assets, liabilities, investments, employment, market capitalisation, market share, profits and above all, the creation of wealth. The banks have in many areas a distinct competitive advantage over other operators in the industry, due to their sheer size and representation. The dominance of the banks is reflected in the following statistics and accompanying graphical representations.

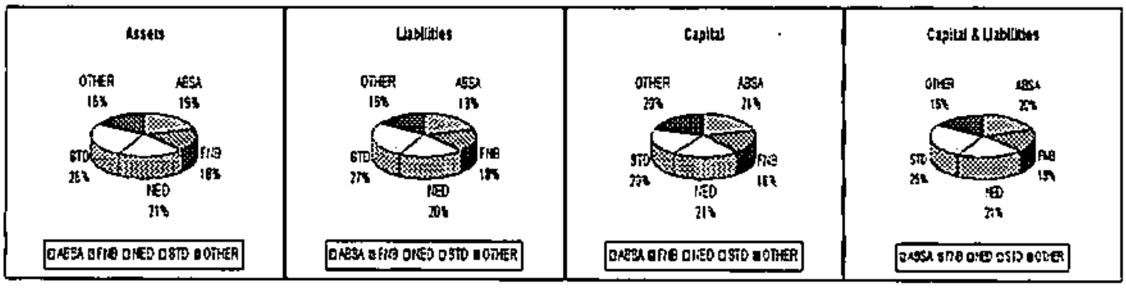
TABLE 1.6

Total DI Returns

Bank	Assets (000)	Liabilities (000)	Capital (000)	Capital & Liabilities (000)
ABSA	316 445	292 596	25 849	318 445
First National	291 607	269 965	21 642	291 607
Nedbank	333 490	307 544	25 946	333 490
Standard	420 744	395 924	24 820	420 744
Other	264 349	238 212	24 137	262 349
Total	1 626 635	1504 241	122 394	1 626 635

Source: South African Bank Statistical Bulletin – December 2004

Market Share



At the end of 2004 the four main banks:

- held 84% of the sector's assets and liabilities, with the remaining 16% accounted for by the remaining 34 banks; ABSA, First National Bank, Nedbank and Standard Bank accounted for R1.362 billion of the sectors assets and R1.266 of the sectors liabilities;
- accounted for 80% of sector's capital base; and
- though not reflected in the accompanying charts, foreign bank participation stood at 8.7% of total sector assets.

This reflects the direct contribution these banks make to the stability of the sector. A failure of any one of them could lead to great instability in the financial markets and the economy of this country. The tenets of good corporate governance should therefore be pursued by these banks with all the vigour and good intentions they stand for.

1.7 MEASUREMENT

A questionnaire/interview schedule was used to obtain responses from the respective banks' company secretaries, three directors and two staff members, comprising a manager and a junior staff member. To corroborate the information received by way of the completed questionnaires, the author also interviewed the company secretaries and the director. The questionnaire coupled with a tape was used to record the responses. In total 24 questionnaires were completed and eight interviews undertaken. In all instances, permission was sought from the interviewee for the use of the recorder.

CHAPTER 2

LITERATURE REVIEW

2.1 GLOBALISATION

South Africa is viewed by most as the "springboard" into the untapped markets of sub-Sahara Africa and beyond. South Africa thus requires amongst other things a well-developed and sound financial system/sector that will cater for increased transnational financial transactions that accompany globalisation. With South Africa in the forefront in supporting the initiatives of the New Partnership for Africa's development (NEPAD) of the development of Africa by Africans, it has all the more reason to set the tone with regard to what good corporate governance is. It however has to raise the standards when it comes to ensuring that the South African banking sector complies with world-class standards of good corporate governance.

South Africa has accepted the challenge to be in the forefront of what the president terms, the "African Renaissance". It is therefore incumbent on the business fraternity to embrace the notion of good corporate governance now that South Africa has been recognised as a worthy global player. Banks, as major players and intermediaries in transnational transactions, have to comply with all major best practices, legislations and rulings to ensure that the sector remains globally relevant and competitive.

2.2 RISK AND RISK MANAGEMENT

2.2.1 Risk

Banks are in the business of risk and are thus exposed to a variety of risks, both internal and external, domestic, national and international. The risks can be categorised into three broad groups, namely credit, market and operational risks. Some of the risks are unique to the banking industry whilst others are not.

To ensure stability within the sector, banks are obliged to retain a certain amount of money in reserve to cover all possible risks it may face in the future. This requirement to hold a certain amount of regulatory capital was first set out in 1988. The Basel I capital accord set out the first internationally accepted definition, of and the minimum requirement for, bank capital. The international benchmark was pegged at 8%. In South Africa the regulators set the minimum capital ratio at 10%. Banks had to hold capital equivalent to 10% of their assets, with less risky assets such as mortgages and sovereign loans carrying a reduced risk rating (Joffe, 2005).

The new capital accord (Basel II), due to be implemented in January 2007, will change the way banks allocate capital to their various lending activities, tailoring it more closely to the risks involved in each lending. Regulatory changes according to Basel II are based on three mutually reinforcing pillars: capital requirements, supervisory review and market discipline. The risk-based capital requirements are the major focus of the accord. The accord was designed to allow some banks to determine capital costs by using their internal risk-management model. In theory, this could mean that Basel II could change pricing in the market significantly, with the new regime being more risk sensitive. Each client is likely to be charged a rate of interest commensurate with its risk profile.

The purpose of Basel II is to protect banks and all other participants within the financial system from systemic failure of the banking sector in the wake of globalisation and over lending. The new regime will be more risk sensitive than the current flat rate of 10%. The key objectives of the accord are to:

- enhance the safety and soundness of the banking system;
- achieve a convergence of economic and regulatory capital allocation;
- achieve a comprehensive and sensitive approach to measuring risk and capital requirements; and
- vary capital requirements between banks with different risk profiles and sophistication.

The new rules are about best banking practices and will provide for better management information systems (MIS) and a streamlined management of risks and opportunities.

A survey carried out to ascertain the readiness of the South African banking industry for implementing the Basil II regulatory framework discovered the factors listed below.

- Sixty-six percent of South African banks were partially prepared for the implementation of Basel II.
- Banks viewed Basel II as an opportunity to enhance risk management.
- All banks had a credit and operational risk management function, including credit and operational risk committees, but more attention was being paid to credit risk than operational risk.
- The industry had a regulatory monitoring and decision process for credit risk, there was, however, a need to introduce similar processes for operational risk.
- Most banks were not averse to the increased market transparency and disclosure that Basel II would require or bring along .
- The banks also indicated their willingness to assist in the development of a regulatory framework for operational risk management (Mynhardt, 2003).

2.2.2 Risk Management

Risk management is the identification and evaluation of actual and potential risk areas pertaining to a business and the subsequent and continuous development of programs that are aimed at reducing any loss before it occurs, either by controls and assurance measures or by financing and insurance measures (Hendrickse & Hendrickse, 2004). The process entails the planning, arranging and controlling of the activities and resources to reduce the effects of all risks to levels that can be tolerated by shareholders. The process uses internal controls as one of the measures to mitigate and control risk. There exist two main methods to manage risk, namely risk control and risk financing. Modem risk management seeks to optimise the relationship between these two concepts.

The Code and the King Report place great emphasis on risk management. To this end, the board has been tasked with the overall responsibility for risk management and control within an organisation on an ongoing basis. This implies that it should ensure that risk to the organisation are identified, evaluated and managed on an ongoing basis. A dedicated Risk Committee should provide support in the discharge of its responsibilities in this regard, but the buck stops with the board. The board should also ensure that adequate and appropriate internal and external risk reporting mechanisms are in place.

Identifying key risks should entail systematic, documented assessment of the processes and outcomes surrounding the risk and should address exposures at least to the following:

- physical and operational risks;
- compliance risks;
- credit and market risks;
- business continuity and disaster recovery;
- technology risks; and
- Human resource risks.

Risk should be managed pro-actively. There should be recognition of the need to manage both the opportunity aspect of risk and its potential "downside". The principle of "the higher the risk, the higher the return" should always apply. The Board of Directors has the responsibility to ensure that the organisation runs an appropriate degree of risk in its activities. Failure to take enough acceptable risk in pursuit of financial gain, is as reprehensible as taking too much.

It is only regular reporting by management to the board that will assist the board in fulfilling its mandate for risk management. Such reports should provide a balanced assessment of significant risks and the effectiveness of internal control. Significant control weaknesses, including the impact the latter have had, or may have had and the actions taken to rectify the weaknesses, should be reported.

At the very least directors must disclose in a company's annual report that they are accountable for the process of risk management and that an effective process has been instituted and the process is reviewed on a regular basis. They should further provide specific assurances as to procedures that will enable continuity in the event of a disaster. The effectiveness of the overall system of internal control also needs to be disclosed.

2.3. CORPORATE GOVERNANCE

2.3.1. Defining Governance

Corporate governance is key to any business that wants to be a force in the local and global business arenas. The word governance is derived from Latin "gubernare", and means to steer. The Oxford Dictionary defines "governance" as the study of how people, acting on behalf of others, take decisions and how they report the basis and impact of their decisions (The Pocket Oxford Dictionary, 1990:319. Corporate governance can thus be defined as the application of the broader study of governance in the corporate arena.

Governance represents the means by which direction and control are applied to the stewardship of an organization's assets – tangible and intangible, financial and non-financial – in the pursuit and delivery of the primary objective of sustainable value creation. It is essentially a function of leadership and direction within an organisation; appropriate risk management and control over its activities, and the manner in which meaningful disclosure relating to its activities is made to shareholders and other stakeholders. The King Report 2002, on the other hand, describes corporate governance simply as, "the system by which companies are directed and controlled".

Corporate governance is concerned with holding the balance between economic and social goals, and between individual and communal goals, the aim being to align as nearly as possible the interest of individuals, corporations and society. Corporate governance goes beyond the financial and regulation aspects of governance. It addresses the interests of a wide range of stakeholders and it espouses the fundamental principle of social, ethical, environmental and good financial practices. Corporate governance is the mechanism by which values, principles, management policies and procedures of any company are manifested in the real world. It refers to the entire system by which companies are managed and monitored and encompasses the manifestation of personal beliefs, values and ethics, which configure the organisational values, beliefs and ethics and hence the action of parties internal and external to the organisation.

Corporate governance hinges on four cardinal values, namely: fairness, accountability, responsibility and transparency. Recommendations contained in the King Report 2002 about board compositions, risk management, director's duties, internal audit and so on are merely mechanisms for ensuring that corporations adhere to these four cardinal values.

- FAIRNESS: implies giving due considerations to the interest of all stakeholders of a company. This has implications for the composition of board in order to overcome any bias in favour of a particular constituency of stakeholders. The King Report 2002 has for this reason advocated for a mix of executives, non-executives and dependent directors. The same principle applies to gender and race.

- ACCOUNTABILITY: refers to the ability to explain and justify one's actions. Boards should be able and willing to disclose and explain their actions to stakeholders. Effective two-way communication and engagement with stakeholders is a prerequisite for accountability. The phrase also describes the intra-corporate relationship resembling a constitutionally mandated federal system of checks and balances.

- RESPONSIBILITY: refers to the obligation of the board to take good care of the assets of the company and of the investments and interests of its stakeholders. A responsible board will protect its material assets and its reputation. It will also institute machanisms that will give its stakeholders recourse, should they be harmed by the actions of the corporation.

  The phrase also refers to the duties of individuals and groups within the enterprise who may be held responsible for the corporation's conduct.

- TRANSPARENCY: refers to the ease with which outsiders can gain a reliable view of the company's actions and decisions. This concerns disclosure of its performance risk and its performance on social and environmental issues.

The true spirit of corporate governance only emerges when an organisation adheres to the four cardinal values mentioned above. There is also agreement around the world that good corporate governance is based on these four values. Corporate governance systems however differ concerning to whom they should be fair, accountability, responsible and transparent. Systems that only focus on shareholders in an effort to maximise their returns are known as exclusive governance systems. Those that include all stakeholders are known as inclusive systems.

Stakeholders are usually classified into four categories. The first is the shareowners, the second is contractual stakeholders such as employees, customers and suppliers; the third is non-contractual stakeholders, such as local communities, the media, special interest group and the final category is the state.

The King Report 2002 is a sequel to the King Report on Corporate Governance (King I) issued in 1994 by the King Committee, headed by Mervin King, a corporate lawyer and former High Court judge. The decision to proceed with King II was based on the fact that Corporate Governance is a dynamic process. The reports are initiatives of the Institute of Directors in South Africa and the JSE Securities Exchange. Both sought to improve corporate governance in South Africa by providing a blueprint in that regard. They also sought to provide to provide guidance on corporate matters. From the inception, King I incorporated a code of corporate practice (the Code) that looked beyond the corporation itself by taking into account its impact on the larger community in which it operates.

King II set out to expand on the inclusive approach, first adopted and propagated in King I. Rather than simply focusing on financial aspects of governance, as the case is in the United Kingdom's Cadbury Code, King II decided on an integrated approach, that considered all stakeholders and approached reporting on an integrated basis. Such an integrated approach sets out to address social, economic and environmental factors.

The JSE has adopted the King principles in its listing requirements. It is mandatory for listed companies, banks, financial entities, insurance companies, public sector enterprises and agencies, including any department of state or administration in national, provincial or local spheres of government or any functionary or institution.

Judge Mervin King however believes that a principle-based approach to Corporate Governance is more effective than rules. He contends that it is easier to get around rules than to get around principles and that it is therefore futile to legislate against dishonesty.

The King Report 2002 is regarded as the world's most progressive inclusive model of corporate governance. This has persuaded more foreign institutions to invest in South Africa, because they believe that the country is among the best, if not the best when it comes to corporate governance in emerging economies (Barrier, 2003).The report recognises that obligations to shareholders are paramount; it however holds that long-term sustainability of the corporation depends on its responsiveness to the interests of all its other stakeholders.

There are other reasons the report opted for an inclusive approach to corporate governance namely and these are listed below.

- The first is the value system underlying South African society. Reference is made to the value system of ubuntu (African humanism), which signifies a commitment to coexistence, consensus and consultation.
- Corporations have a great influence in society, with modern corporation often having a more immediate impact on citizens than the state. They often determine, in one way or the other, but to a greater extent than the state, the quality of individual and community life

2.3.1.1 THE TRIPLE BOTTOM LINE (SUSTAINABILITY)

There is a realisation that companies can no longer act independently from the societies and the environment in which they operate. In addition to financial information about past performance, investors increasingly value information concerning the corporation's future prospects, opportunities and risks as well as non-financial information about "intangible assets" that may be important to the competitive performance of the corporation. This statement was made in a report by the business sector Advisory Group on Corporate Governance.

Reporting on non-financial matters can reveal what drives the underlying or future value creation within an enterprise, thereby giving stakeholders an indication of its future performance that will sustain the enterprise. The concept of sustainability in a business context means the achievement of balanced and integrated social, economic and environmental performance, referred to as the " triple bottom line". It was introduced as a way of trying to ensure that companies harness corporate greed for the greater good of the communities and country in which they operate. The concept looks at economic, social and environmental performance under the umbrella of a company's corporate governance framework. It is also the cornerstone of integrated sustainability reporting, which has become an integral part of the King Report 2002.

Companies are increasingly expected to grow their businesses and meet the human needs of societies around the world, while at the same time reducing the environmental and social footprint of their operations and products. Any organisation's long-term success is inextricably linked to the sustainable development of these communities, both social and economic. Organisations are also reliant on these communities for resources, potential markets and goodwill or "licence to operate", which allows it to exercise its activities without unwarranted outside interference.

Boards should therefore ensure that organisations adopt an appropriate focus on the social and environmental aspects and impact of their operations that together determine stakeholder perception of their standing as a good corporate citizen. This in turn provides a measure of its reputation and ongoing sustainability.

This is particularly relevant in South Africa at this juncture, in relation to black economic empowerment (BEE), HIV/AIDS, occupational health and safety, the advancement of previously disadvantaged individuals, environmental management and the development of human capital. This stems from the notion that South African companies should in one way or another contribute positively towards improving their impact on the South African populace.

2.3.2 WHY THE NEED FOR CORPORATE GOVERNANCE

Good governance is the foundation of good business. There is consensus throughout the corporate world that corporate governance is a business imperative, whilst also making good business sense. Any organisation, be it private or public, foreign or local that decides to turn a blind eye to good corporate governance practices will be at the mercy of market forces to their own detriment.

Corporate governance also serves to align shareholder objectives and managerial incentives. Shleifer and Vishny (1997) point out that the majority of evidence proves that, within the exclusive approach to corporate governance, managers do not always act in the best interest of shareholders. If left to their own devices, they would first proceed to satisfy their own interests. This conclusion follows from research in the area using the event study methodology and demonstrates the need for a series of measures to close the gap between the interest of shareholders and management. Reasons for good corporate / business governance include those listed below.

- It changes ones attitude and responsibilities to business - directors become responsible to all stakeholders.
- It guides one to conduct the affairs of a business with honesty and integrity
- It leads one to be sensitive to the needs of all affected persons, including the business, stakeholders, shareholders and society.
- It forces one to ensure that there are necessary built-in checks and balances from the top of an organisation to the bottom – not to constrain, but to control success.
- It ensures that the business is under control and encourages open and transparent communication within and outside the business.
- Governance forms the bases for rewards based on performance and results and not based on individual presence, position or title.

- Governance punishes those who defraud the business and holds them personally liable for their misconduct.
- Business governance encourages the business to establish high principles that drive the code of conduct accordingly to ethical and equitable values.
- Governance is not aimed at frustrating leadership, but at encouraging participative, performance-based leadership.
- Business governance creates an over-arching goal for all - sustainable development is achieved where there is performance with conformance.
- Governance is no guarantee of business success, it will however over time produce better operating results.

The separation of ownership and control that exists in the corporate world, in one way or another leads to a conflict of interests. A board of directors owes a fiduciary duty of loyalty to the corporation and its shareholders. Courts have characterised the duty of loyalty as the rule that requires an undivided and unselfish loyalty to the corporation demands and that there should be no conflict between duty and self-interest. Bureaucrats, directors, managers may include amongst other things, consumption of prerequisite, leisure time, staff numbers, shirking or empire building. Such actions impose costs on shareholders, should they not derive any benefit there from.

This divergence of shareholder objectives and managerial incentives gives rise to agency problems. Agency problems occur when the shareholders (principal) lack the necessary information or power to monitor and control their agent (managers/directors). Jensen and Meckling (1976) concluded that a potential cost of agency arises when the manager owns less than 100% of the firm's residual cash-flow. Jensen and Meckling (1976) further point out three areas of agency costs that create conflict between shareholders and management, namely managerial desire to remain in power (management entrenchment), managerial risk aversion and managerial use of free cash flow.

Many corporate collapses have, as their root cause, a conflict between the objectives of the corporation and those who act as custodians of the corporation's assets and undertakings, the directors and senior executives.

At the same time there is no guarantee that conformance to good corporate standards will ensure increased profitability. But what is certain is that in companies that do, the interests of all stakeholders are being looked after, and this is a good recipe for ensuring sustainable business activity and thus its perpetual existence for the benefit of all stakeholders.

There have recently been insight into how market forces deal with corporations that decide not to pursue the principles of good corporate governance. In the case of Enron, commentators describe the demise of the company as a case of total moral bankruptcy. Its demise also led to the demise of Arthur Andersen, the auditing firm contracted to Enron. Cases similar to Enron include Worldcom.

Closer to home, mention can be made of Regal Treasury Bank Ltd, ABSA Bank Ltd and Nedbank Ltd, where some impropriety at executive level led either to the demise of the institution or a loss in shareholder value. It is instances such as these, where corporate greed is the common denominator that brings the notions of corporate governance, ethics, values, morals and integrity to the fore.

2.4 CORPORATE GOVERNANCE WITHIN THE BANKING SECTOR.

Many issues in corporate governance transcend industries, irrespective of product or regulation. The banking industry is, however, unique in many ways. Banks are publicly chartered to garner the common wealth for the general benefit of society. Banks are the lifeblood of any economy. The social contract that accords privileged status to banks requires, in turn, that banks operate with integrity to garner the common wealth for the general benefit of society. Banks, as conduits of the monetary policy in any country are critical components in the creation and distribution of a country's wealth. It is therefore important that they uphold in spirit and in deed, the notion of good corporate governance.

The industry throughout the world is heavily levered and is subject to a great degree of regulatory oversight. The increased role of the regulator serves to modify the traditional manager / stockholder relationship. The regulator acts as an agent of the depositors to ensure the safety and stability of the banking system. Market discipline, considered the universal solution to the agency problem, has limited scope in banking firms where their assets are insured, either directly or indirectly or by way of guaranteed support from central banks, with the largest banking institutions regarded as being "too big to fail". Regulatory bodies must approve any transfer of ownership in the industry. In South Africa, the Minister of Finance must approve such transfers, after receiving and reviewing recommendations from regulatory bodies. This also applies to mergers within the industry. Prowse (1997) and Mester (1989) note that these restrictions on potential buyers reduce the disciplinary role played by takeovers or mergers and have increased the importance of regulatory supervision as a disciplinary and control mechanism.

Diamond and Dybig (1986) showed that banks are distinguished from other firms in their capital structure in two ways.

- Banks tend to have seemingly little equity relative to other firms. Banks have a capital structure that features 90% or more debt financing.
- Most liabilities are in the form of deposits, which are available to their creditors /depositors on demand while assets often take the form of loans that have longer maturities.

Banks as financial intermediaries are special in their production of liquidity, by holding illiquid assets and issuing liquid liabilities, banks create liquidity for the economy. Macey and O'Hara (2003) however revealed that a collective-action problem with the liquidity production function can arise with depositors since banks only keep a proportion of their deposits at any given time. If depositors demand the return of their deposits simultaneously, the demand cannot be fulfilled. A mismatch between deposits and liabilities creates a problem in the form of a "bank run" which is a collective-action problem for the depositors.

In America, the Banking Act of 1933 was enacted to create the Federal Deposit Insurance Corporation (FDIC), which gave the federal government the power to insure consumer deposits in qualified banks. It is believed that the creation of federal deposit insurance is a factor in effectively preventing bank runs. South Africa, through the national treasury, is set to introduce legislation setting up a deposit insurance scheme for South Africa's Banks. The deposit insurance scheme idea goes back as far as 2001, when the Davies Report on the ABSA "lifeboat" said that South Africa urgently needed an effective and well designed scheme. Deposit insurance however brings along with it a phenomenon termed "moral hazard" - the increased regulatory costs as the shareholders and managers of insured banks are "given" incentives to engage in excessive risk-taking. One thing is certain, as has been shown in America: deposit insurance solves the collective-action problem among bank depositors. It eliminates the incentive for any single depositor to rush to demand repayment of his/her deposits.

Macey and O'Hara (2003) argue that commercial banks pose unique corporate governance problems for managers and regulators, as well as for claimants on the firms cash-flow, such as investors and depositors. Proponents of corporate governance of banks have two distinct views: the Anglo-American model of corporate governance and the Franco-German approach to corporate governance. The Anglo-American model takes the view that the exclusive focus of corporate governance should be to maximise shareholder value. The interests of the other constituencies should be ignored, unless management is legally required to take the interests of others into account. The Franco-German approach to corporate governance considers corporations to be "industrial partnerships" in which the interests of long- term stakeholders – particularly banks and employee groups - should be accorded at least the same amount of respect as those of shareholders. There is an expanded version of the Franco-German model, with directors expanding the scope of their fiduciary duties beyond shareholders to include all stakeholders, this includes creditors – (their depositors).

Banks in developing countries have harsher economic, social and legal realities to overcome. Good corporate governance is thus important and necessary in these countries for the following reasons listed below.

- Banks have a profoundly dominant position in developing-economy financial systems and are important engines of economic growth (King and Levine 1993a, 1993b; Levine 1997)
- Banks in developing economies are the most important source of finance for the majority of firms, as financial markets are still underdeveloped.
- Banks are usually the main depository for the economy's savings as well as providing a generally accepted means of payment.
- Many developing economies have recently liberalised their banking systems through privatisation / disinvestments and reduced the role of economic regulation, with the consequence that managers have obtained greater freedom in how to run their banks.

These factors, coupled with the unique nature and position banks hold, whether in developed or developing countries, require that a broad view of corporate governance be adopted for banks – a governance framework that takes into account both shareholders and depositors.

In South Africa, where legislation regarding deposit insurance has not been enacted, great reliance is placed on local banks to voluntarily subscribe to good governance practices. Several instances of misgovernance have occurred within the banking industry since 2000.

2.4.1 RECENT INSTANCES OF CORPORATE GOVERNANCE LAPSES WITHIN THE SOUTH AFRICAN BANKING SECTOR

Several banking failures have occurred in South Africa with subsequent investigations ascribing such failures to corporate governance failures. These failures involved ABSA / Unifer, NedBank, Regal Treasury Bank (Regal) and Saambou Bank. What follows is a brief synopsis on these corporate governance.

2.4.1.1. ABSA / Unifer

Unifer was one of South Africas' largest microlender, with ABSA holding a controlling stake therein. ABSA initially held about 53% of Unifer. This stakes grew and by 2001, ABSA had increased its stake to 61.3%. Established banks were attracted to the industry by the margins that could be extracted. However there were inherent risks and malpractices within the unregulated industry. The introduction of regulations specific to the industry led to the demise of many small operators within the industry, including Unifer.

The business model within Unifer allowed independent brokers to earn commissions up to 20% on each loan extended. The micro lender also had a "decentralized credit policy" with the brokers able to approve and grant loans. This "policy" led to widespread abuse and fraud. Brokers adopted selling strategies that ensured they maximized commission income. These strategies ignored basic principles, with loans extended to individuals with adverse credit histories. The loans were also extended with no regard to the individual's risk profile or ability to repay. Screening criteria were also substandard or at tomes non-existent. It was purely a matter of lending as much as you would to each borrower. Some borrowers were granted multiple loans in order to keep such loans below the R10k Usury Act limit, as this would allow high interest rates to be charged. This led to many borrowers over-extending themselves and rendering the recovery of such loans difficult. This led to a loan book that was mostly substandard.

This led to a R3 billion credit line extended to Unifer in 2000 to help grow lending being drawn down rapidly and exceeded in 2001, a factor that warranted investigation. No questions were asked nor concerns raised by the directors of Unifer, some appointed by ABSA. This was akin to gross incompetence and blatant negligence on the part of the board of directors. To allow R250m per month to be drawn into a system that was not properly investigated was reckless on the part of ABSA. Management became answerable to themselves. Money was siphoned to broker networks with family connections. Management Information Systems (MIS) in support of Risk Management were ineffective. Unifers' computer system could only identify a loan that was in arrears

3 months after a client missed a payment. With ineffective credit management processes in place 38% on a book of R5.6bn had to be written off.

Unifers directors are being investigated for insider trading. Some directors ceased buying Unifer shares when disclosure became compulsory in 2000. They instead sold off in total, R7.2m in Unifer shares, an indication of their confidence in the shares of a company they were in charge of.

The demise of Unifer was precipitated when government suspended deductions of loan repayments from its employees. A regulatory council was established to protect the interest of borrowers, many of them illiterate. The council established a national loan register to enhance lender's capacity to access its client's ability to repay loan. Micro-lenders were further granted a grace period to consolidate their debtor books. It was during this period of consolidation and the establishment of a regulatory framework for the industry that governance breaches, fraudulent and downing illegal and reckless activities within the industry were unearthed. These developments as it turned out were to affect many players active in the sector such as Saambou, African Bank Limited, (ABIL), to name but a few.

2.4.1.2. SAAMBOU BANK (THUTHUKANI)

Saambou Bank Ltd (Saambou) was the seventh largest bank in South Africa with assets of R16bn. The bank, through a wholly owned subsidiary, Thuthukani, was also adversely affected by the negative publicity operators within the sector were receiving, the resultant intervention by regulators and government's ban on loan repayment deductions. Top officials with in the bank were accused of mismanagement and illegal activities, including money laundering and insider trading. These activities are manifestations of corporate misgovernance.

Negative media reports, to the effect that the bank was short of cash, resulted in nervous investors withdrawing more than a billion rand between the 7th and 8th of February 2002. Unable to honour its obligations in the short term due to resultant cash-flow problems, the bank was placed under curatorship on February 2002 (Naidoo, 2002). The bank was eventually divided in sections and sold off. Its home loan book was acquired by FNB whilst its electronic business (20twenty) was sold to Standard Chartered.

Subsequent investigations revealed that two directors disposed of their shareholding several months before the bank releasing a profit warning, which led to the bank's share price falling almost 50% in value. This formed the basis of subsequent insider trading investigations.

Money-laundering allegations stem from illegal transactions facilitated by the managing directors of a Saambou Bank Ltd subsidiary, Fourth Dimension. It is alleged that the director attempted to illegally transfer proceeds of illegal activities in Cote d ' Ivoire.

Although the money ($25m) was never remitted from the Ivory Coast, the director authorised the payment of R1.3m in Saambou Bank Ltd and Fourth Dimension's money to persons in the Ivory Coast, as part of the transaction, allegedly infringing exchange control regulations.

These allegations bear testimony to both corporate governance breaches and blatant acts of mismanagement. The recent collapse of Saambou is estimated to have cost taxpayers over R12billion.

2.4.1.3. REGAL TREASURY PRIVATE BANK (Ltd)

Regal Treasury Private Bank Ltd (Regal Bank) was granted a banking license in 1996. The Banks' intended target market was the wealthy, requiring professional and high quality personal financial advice and service. The board of the bank was dominated by one, Jeff Levenstein, the incumbent Chief Executive Officer (CEO). Levenstein loathed being challenged, contradicted or opposed. He wanted and was able to run the bank as a one-man show. Below some of the practices that were contrary to good corporate governance. It was the prominence and prevalence of these practices that led to negative market sentiments and ultimately the demise of the bank.

Contrary to good corporate governance practices, Levenstein had, against the advices of the Reserve Bank for a period of 19 months enjoyed a dual role as chief executive officer and chairman of the bank. He personally chaired five of the banks' eight board committees that included both the non all-important nominations and remuneration committees. The board, though comprised of a majority of outside directors, was dominated by a grouping with close ties to Levenstein, with issues at times agreed to without proper debate or by a board that was not properly constituted. Board proceedings were improper allowing Jeff Levenstein to commit acts that were illegal and fraudulent or with the intent to defraud. Proceedings were seldom recorded properly.

Directors' fees were not set at levels that could attract, retain and motivate the best the market could offer. The primary form of compensation to directors was participation in the company's share incentive scheme. It was subsequently proven that such schemes were used to create the impression that the bank was in a healthier financial state than was actually the case. The bank also provided funding for the purchase of its own shares, a contravention of both the Banks Act and the Companies Act 61 of 1973,as amended.

The preceding paragraph sets out as only a few acts or instances of misgovernance at board level within Regal Bank. The demise of Regal Bank was precipitated by Ernest & Young, the bank's statutory auditing firm when they announced that it was impossible to sign off the bank's 2001 year-end results. Instead, they decided to re-audit the bank's 2001 results after uncovering several breaches of corporate governance.

This fueled widespread speculation, with the bank later placed under curatorship. This signaled the demise of the bank, as it never recovered from its precarious position. Market forces are unforgiving to those that pay scant attention to good corporate governance.

2.4.1.4. NEDBANK

The board of Nedbank, South Africa's fourth largest bank has also found itself having to explain itself to shareholders in what was viewed as an act of self-enrichment. Certain Nedcor executives were to be rewarded for the performance of the bank's investment in Dimension Data, a company separate to Nedbank. The scheme was withdrawn when the ever-vigilant press started questioning the purpose and wisdom of such a scheme of arrangement.

The acquisition by the bank of a law firm in 1999 for R400m, a price believed to be unrealistic and highly inflated using shareholders funds is another instance where the board acted improperly. The firm was later sold back to its original owners for R50m, in a deal that truly destroyed shareholder value. When questioned in this regard, the former CE, the chairman and other directors and executive committee members chose not to talk. This veil of secrecy remains, with the investors non-the wiser.

The negative publicity that followed led to a steady drop in the company's share price in excess of 50% over a period of five years. When the allegations were made, the company's shares were trading at R152.00. The share has recovered slightly from its lowest level of R65 to its present price of R75.00.

2.5 THE KING REPORT ON CORPORATE GOVERNANCE FOR SOUTH AFRICA 2002

The King Report 2002 was developed as an initiative of the Institute of Directors in Southern Africa. It represents a revision and update to the initial King Report first published in 1994, in an attempt to keep standards of governance applicable in South Africa current with changing circumstances, both internationally and at the national level. It has been acclaimed as the most progressive and most comprehensive document on corporate governance. Its publication is a reflection of the South African business community and public sector's desire to ensure that local governance standards keep pace with the rest of the world. It serves as a contribution to the country's ongoing development.

The King Report 2002 emphasises the importance of striking a balance between "performance" (i.e. decisions and actions designed to ensure the creation and protection of value) and "conformance" (i.e. the demonstrable adherence to due process in coming to such decisions and taking such actions). In a corporate context, this means that the exercise of management's skill, expertise and flair in running business operations and creating shareholder value should be encouraged, but must be subject to appropriate checks and balances that allow the board to ensure that management is at all times acting in the interest of the organisation and its shareowners.

The King Report 2002 identifies the following as the seven primary characteristics of good governance:

- discipline - commitment by the organization's senior management to widely accepted standards of correct and proper behaviour;
- transparency - the ease with which an outsider can meaningfully analyse the organisation's actions and performance;
- independence - the extent to which conflicts of interest are avoided, so that the organisation's best interests prevail at all times;
- accountability - addressing shareowners' rights to receive, and if necessary query, information relating to the stewardship of the organization's assets and its performance;
- responsibility - acceptance of all consequences of the organisation's behaviour and actions, including a commitment to improvement where required;
- fairness - acknowledgement of, respect for, and balance between the rights and interests of organisation's various stakeholders; and
- social responsibility - the organisation's demonstrable commitment to ethical standards and its appreciation of the social, environmental and economic impact of its activities on the communities in which it operates.

These primary characteristics infuse the guiding principles set out in the Code of Corporate Practices and Conduct. The key aspect of governance derived from these characteristics can be grouped under the following headings:

- the constitution and operation of the board and its committees;
- performance evaluation and reward;
- risk management and internal control;
- internal audit;
- sustainability;
- business ethics and organizational integrity;
- accounting and auditing; and
- disclosure practices.

The King Report 2002 is primarily targeted at listed companies, financial services companies and public sector entities. The guidelines and principles it contains are, however, as applicable to other, non-designated entities that seek to take governance seriously, as they provide a sound basis for the successful running of any organisation. Organisations were expected to apply the principles contained within the King Code 2002 with effect from the financial year commencing on or after March 2002. The report advocates a proactive approach to governance that promotes focus on creating future value. Organisations that want to succeed should therefore follow the guidance offered by the King Report 2002 – and the King Code 2002 that it contains – not so much because they are obliged to comply, but rather because they see the benefit to, and value for, the organisation in doing so.

2.6 COMPARISON OF THE KING REPORT 2002 AND THE SARBANES-OXLEY ACT OF 2002

The United States witnessed, in the form of the Sarbanes-Oxley Act 2002, the most significant reform to securities legislation since they were enacted there in the early 1930s. The Act results from highly publicised scandals, such as the collapse of Enron and Worldcom, as well as the demise of Arthur Andersen LLP. These corporate scandals severely undermined public confidence in the American system of corporate governance and reporting. Consequently, the purpose of the Act was to build and restore confidence in the capital markets.

The act brought and will continue to bring about significance change in corporate governance, accounting and, ultimately, the financial markets, both in the United States and internationally. The act fundamentally changes how audit committees, management and external auditors carry out their respective responsibilities and interact with each other. The act builds on existing United States Securities and Exchange Commission ("SEC") and U.S. stock exchange (i.e. the NYSE, AMEX and Nasdaq) requirements by tightening restrictions, expanding disclosures and imposing more severe penalties.

The most telling change may be that the act represents a new era of public regulation in the capital market sector. Unlike in South Africa, the United States Congress has concluded that public confidence can best be restored through greater government involvement. This involvement led to specific requirements for affected parties with regard to corporate responsibilities, auditor regulation and independence, and financial reporting, as well as enhanced and, in some cases new, civil and criminal penalties for corporate fraud.

Below the researcher presents a synopsis on the similarities and differences of the King Code 2002 and the Act, including various proposals and rules promulgated under the Act.

2.6.1 BOARD OF DIRESTORS AND AUDIT COMMITTEE

2.6.1.1 The Board of Directors

The King Code 2002, as compared to the Sarbanes-Oxley Act 2002, covers a broader scope, ranging from corporate governance to corporate citizenship. As a result, the King Code 2002 places the roles and responsibilities of the Board of Director's at the heart of its discussion. The Sarbanes-Oxley Act, with its narrower focus on restoring public investor confidence in capital markets, limits its discussion of the Board of Directors to the composition and responsibilities of the Audit Committee, while simultaneously relying on existing SEC rules and U.S. stock exchange requirements and proposals to address board responsibility, composition, and liability.

Composition - Under the King Code 2002, the board should be of a sufficient size to meet the organisation's requirements. Its membership should reflect the balance of skills experience and demographic diversity necessary to provide effective leadership and control, in terms of approving the organisation's strategy and ensuring control over its operational implementation.

The King Code 2002 states that the board should comprise a balance of executive and non-executive directors (the latter preferably forming the majority) and include a "sufficient" number of independent non-executive directors. The chairperson of the board should preferably be an independent non-executive director. The process of appointing directors should be transparent. New directors should be subject to a background check to ascertain their suitability for the role. They should receive formal training and orientation to ensure they understand their new role and responsibilities.

General Responsibility - The King Code2002 establishes the board as the focal point of the corporate governance system, with ultimate accountability and responsibility for the performance and affairs of the company. Although board committees with formally determined terms of reference, roles and functions constitute an important element of the process, the delegation of authority to any committee does not in any way mitigate or dissipate the discharge by the board of directors of their duties and responsibilities. Every board should also adopt a formal charter describing its roles and responsibilities, which should be disclosed in the annual report.

The King Code 2002 identifies the following as board's main areas of responsibility:

- determining the company's purpose and values;
- determining the strategy to achieve the company's purpose and to implement its values;

- exercising leadership, enterprise, integrity and judgment in directing the company, so as to achieve continuing prosperity for the company;
- ensuring that procedures and practices are in place that protects the company's assets and reputation;
- monitoring and evaluating the implementation of strategies, policies, management performance criteria and business plans;
- ensuring that the company complies with all relevant laws, regulations and codes of best business practice;
- ensuring that technology and systems used in the company are adequate for running the business properly and for it to compete through the efficient used of assets, processes and human resources;
- identifying key risk areas and key performance indicators of the company in order for it to generate economic profit, so as to enhance shareholder value in the long-term
- regularly assessing its performance and effectiveness as a whole, and that of individual directors, including the chief executive officer; and
- ensuring that the company has developed a succession plan for executive directors and senior management.

The board should appoint the Chief Executive Officer and there should be a clear distinction between the oversight role of the directors and the operational role of executive management. Another recommendation that the King Code 2002 puts to the board of directors is that they should consider the need for a confidential reporting process ("whistle blowing"), covering fraud and other risks, in addition to the company's other compliance and enforcement activities.

The Sarbanes-Oxley Act of 2002 incorporates a similar requirement as part of the Audit Committee's oversight responsibility.

2.6.1.2 AUDIT COMMITTEE TO THE BOARD OF DIRECTORS

The board of directors should appoint an audit committee, providing it with a means to monitor and reinforce an effective internal control system. The King Code 2002 requires that the audit committee consist of a majority of independent non-executive directors, whereas the act will require independence of all members.

The King Code 2002 also requires that the majority of members of the Audit Committee be financially literate. The act, on the other hand, requires disclosure of whether the Audit Committee has at least one financial expert, as specifically defined based on a range of significant experience and understanding, and the name of the individual. If a company does not have a financial expert, the act requires disclosure of the reasons for not having one.

The King Code 2002 recommends that the audit committee be empowered by the board to engage advisors and have the financial means to do so. However, because the King Code 2002 is not codified law, it cannot, similar to the provisions of Sarbanes-Oxley Act, mandate this requirement.

The King Code 2002 identifies the following as the audit committee's main areas of responsibility:

- recommending the appointment of an external auditor;
- promoting co-ordination between internal and external auditors;
- Establishing principles for recommending the use of an external auditor for provision of non-audit services;
- reviewing the reliability and accuracy of financial statements;
- considering the need for an independent review of interim results;
- reviewing effectiveness of the internal control system;
- directing and monitoring internal audit activities; and
- concurring with the appointment / removal of head of internal audit function.

The act, similarly, requires the audit committee to be responsible for the:

- appointment, compensation and oversight of the external auditors;

- resolution of disagreements between management and auditors;
- pre-approval of audit and non-audit services and disclosure of the audit committee's policies and procedures for pre-approval of services; and
- procedures for handling complaints regarding accounting practices.

The King Code 2002 also establishes disclosure requirements associated with the audit committee's terms of reference and membership, which are already addressed in other laws promulgated in the United States.

CHAPTER 3

RESULTS AND INTERPRETATION

All respondents completed the same questionnaire. There was however, in certain instances, a marked difference in the responses received from the company secretary and director of each institution when compared with those of the managers and staff members of the same institution. Such anomalies were more prevalent in connection with matters pertaining the King Report 2002.

On further investigation and discussion with the company secretaries and directors of all the banks, the anomalies identified were ascribed to the circumstances discussed below.

Banks are compliant with all the corporate governance requirements as prescribed by the Banks Act 94 of 1990. This is due to the fact that these have been prescribed by the regulatory authorities and therefore must be implemented. When the banks commenced implementing the recommendation contained in King II, they proceeded with the process at board and executive management level. This process has until now not cascaded down into the management and operational levels of these organisations. Some of the reasons are noted below.

- Members of the board and executive management have been the only recipients of any training regarding corporate governance issues in all organizations researched.
- Staff have not been exposed to, or trained in, corporate governance matters. Banks have been standardising and eliciting appropriate behaviour by way of rules, regulations, policies, values, financial incentives and codes of ethics.
- One banking institution, Nedbank, had a dedicated Corporate Governance unit that dealt with corporate governance matters. This was a task performed by company secretaries within the other banks.

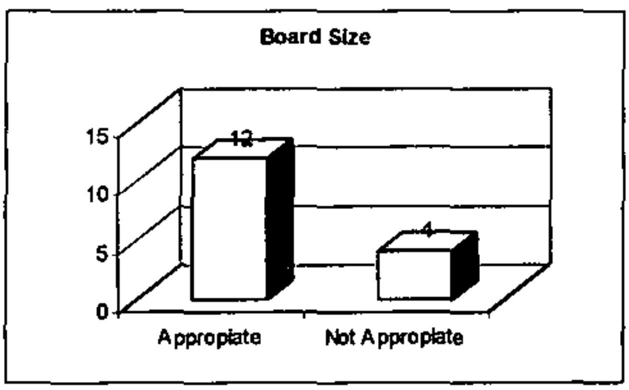
Another observation that is worth mentioning at this juncture is the fact that ABSA appears to be the most progressive in terms of implementing the recommendations contained in the Myburgh report and King II. This remark is based on the completeness of the responses received on the questions raised in the questionnaire.

3.1 ANALYSIS OF THE RESULTS

The anomalies raised in the preceding paragraph led to the decision that only the responses of the company secretaries and the directors would provide a balanced and accurate view of the current position regarding the state of implementation and adherence of banking institutions to the form and substance of corporate governance. These are the individuals who have until now been part of, and responsible for ensuring, that the recommendations are implemented within their respective organisations. They have firsthand experience in corporate governance matters, within their respective organisations.

3.1.1 BOARD SIZE,COMPOSITION AND ROLE

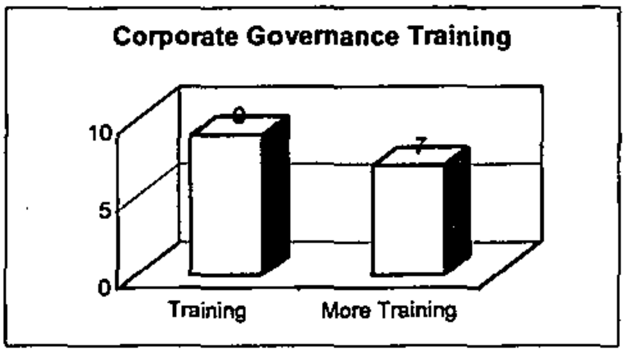
DO YOU BELIEVE THAT YOUR BOAD IS THE APPROPIATE SIZE TO FUNCTION OPTIMALLY?



Of the four banks, ABSA, First National Bank (FNB) and Standard Bank (STD) are of the opinion that their boards are the appropriate size. The boards consisted of twenty-one, fourteen and eighteen members respectively, whilst that of Nedbank constituted 19 members. ABSA contends that they are comfortable with a board that size due to the complexity of the financial services industry and the number of committees and sub-committees required to adhere to corporate governance requirements.

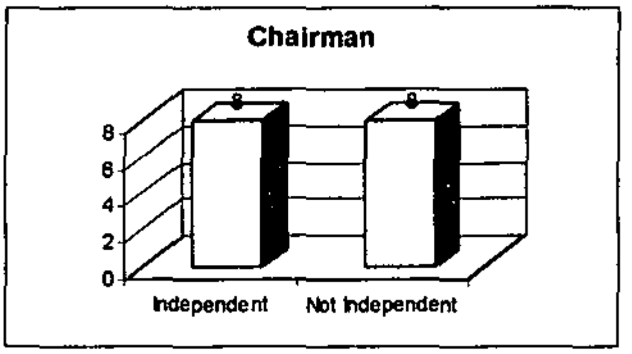
Most of the banks, with the exception of FNB, are therefore not in line with the recommendations contained in the Myburgh Report, which limits the number of members of a bank's board to 16, with no more than four executive directors. All the banks however conform to the latter requirement.

DO DIRECTORS RECEIVE PROPER TRAINING IN CORPORATE GOVERNANCE MATTERS?



All the banks provide training on corporate governance issues to their board members and executive management teams. With the increased responsibilities and accountability which accompany corporate governance and new legislation, more and continuous training is needed. It was the company secretaries and directors of two banking groups, FNB and STD who mostly pecialize the need for more training on corporate governance matters. Director training, they believe, is currently weighted towards pure risk management at the expense of corporate governance.

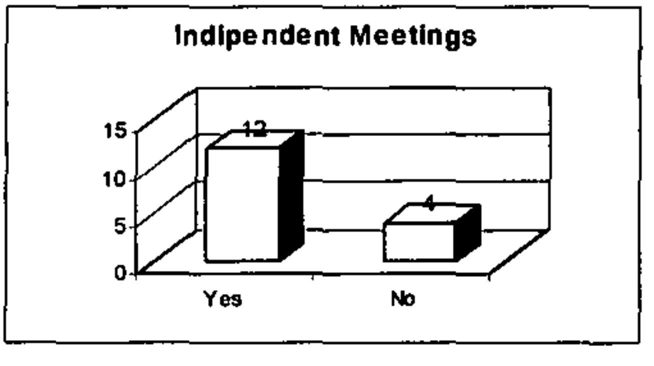
IS THE CHAIRPERSON AN INDEPENDENT NON - EXECUTIVE DIRECTOR?



The responses received from ABSA and Standard Bank confirmed that their chairpersons were independent non-executive directors. However those of FNB, and Nedbank were not.In the case of FNB, the chairman was not considered independent. The reason put forward was the fact that he had been on the board of the bank for more than 18 years. This matter has been debated by the board on a number of occasions and they have concluded that there is sufficient independence vested in the independent non-executive directors to ensure an appropriate balance of power within the board of the bank.

The chairman of Nedbank is not viewed as strictly independent. He also sits on the board of the bank's majority shareholder, Old Mutual Ltd.

DO OUTSIDE DIRECTORS MEET WITHOUT EXECUTIVE DIRECTORS?



Non-executive directors should meet on their own in order to confirm their independence, increase their effectiveness and to promote open discussion amongst themselves. Three of the institutions researched confirmed that this is normal practice within, whilst this is achieved to a degree at Nedbank. This stems from the fact that the bank's chairman is not perceived as an independent non-executive director.

WHICH BOARD COMMITTEES HAVE BEEN ESTABLISHED?

In addition to the prescribed, audit and remuneration committees, other board committees have been established at all the institutions. This is to provide for specialist knowledge to be applied where it is most appropriate and most effective. The breakdown is represented in Table 3.2.1, below.

TABLE 3.2.1
BOARD COMMITTEES

Board Committee	**ABSA**	**First National**	**Nedbank**	**Standard**
Audit	1	1	1	1
Remuneration	1	1	1	1
Nominations	√	√	√	√
Directors' Affairs	1	1	1	1
Finance	-	√	1	-
Safety & Health	-	√	√	-
Special purpose/Credit/Large Exposure	1	1	1	1
Governance	√	√	√	√
Strategic	√	-	√	√
Risk	1	1	1	1

1 Committee has been established. - Committee has not been established √ Committee forms part of another committee

The institutions have structured board committees in such a way that they can □peciali the available skills, experience and independence of the non-executive directors. As a result, there is no uniformity amongst the banks with regard to the committees established or their structures, since each bank has its unique business model and strategic imperatives.

The South African banking sector has become globally competitive and each bank strives to benefit from innovative business models, geared to take full advantage of the current economic conditions.

ABSA has established separate Audit, Remuneration, Director's Affairs, Credit/Large Exposure and Risk Committees. The Nominations, Governance and Strategic Committees are sub-committees of the Directors' Affairs Committee. The Group's Risk Committee and the Board Lending/Large Exposure Committee have specialized functions, which focused exclusively on risk. The large exposure committee was established in 2004, pursuant to recommendations by the South African Reserve Bank (SARB).

At FNB, Audit, Remuneration Directors Affairs, Large Exposure and Risk Committees have been established, with some performing dual roles or acting as sub- committees of other committees.

The nominations and governance committees are sub-committees of the Director's Affairs Committee. The Risk Committee deals with safety and Health issues, whilst strategic matters are dealt with by the banks' executive committee. No Strategic Board Committee was established. The Finance Committee is a sub-committee of the Audit Committee.

Nedbank has been able to establish most of the committees listed in Table 3.2.1. In addition, it established separate Transformation and Sustainability Committees. The Sustainability Committees deals with Black Economic Empowerment (BEE), safety and health, environmental and social issues. The bank's Director Affairs Committee deals with issues pertaining to the nomination of directors, corporate governance and strategy.

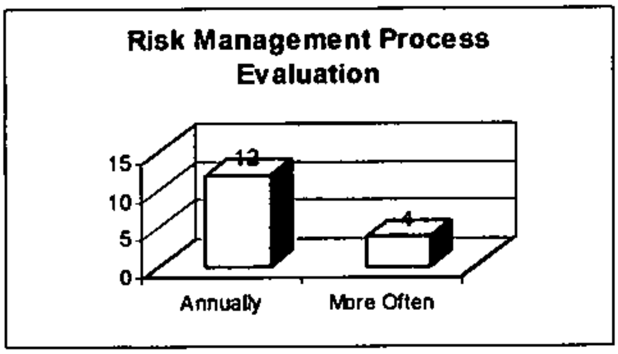
The bank's Risk Committee is however chaired by a director (M.M. Katz) who is not viewed as an independent non-executive director. He was part of Edward Nathan Katz, a law firm with very close ties with Nedbank. It was once owned by Nedbank, but was sold back to its original partners in 2004.

Standard Bank has established Risk, Remuneration, Audit, Credit and Directors Affairs Committees. The Strategic, Corporate Governance and Nominations Committees are sub-committees of the Directors' Affairs Committee. The bank has in addition also established a Transformation Committee and a Black Ownership Initiative Committee. The Risk Committee deals with safety and health issues whilst finance issues are dealt with by the Audit Committee.

The Credit and Directors' Affairs Committees are chaired by D.E.Cooper, who is also Standard Bank's chairman. He is not regarded as being an independent non-executive director. Mr Cooper has been on the board for 12 years and is in danger of being perceived as being so close to management that his capacity to act in an independent manner may be impaired or seen to be impaired. The respondents however believed that the current situation would in no way affect Mr Cooper's independence. The board shares this stance.

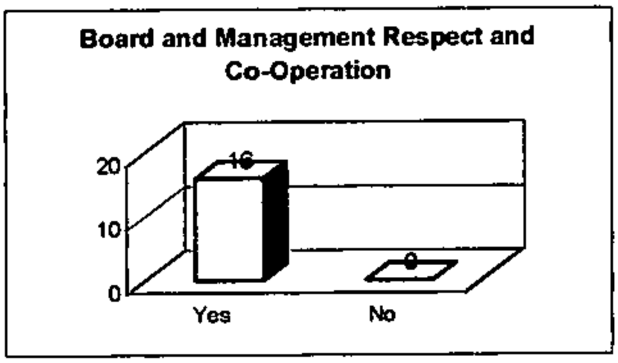
3.1.2 RISK MANAGEMENT AND INTERNAL AUDIT

HOW OFTEN DOES THIS BOARD EVALUATE THE EFFECTIVENESS OF THE RISK MANAGEMENT PROCESS?



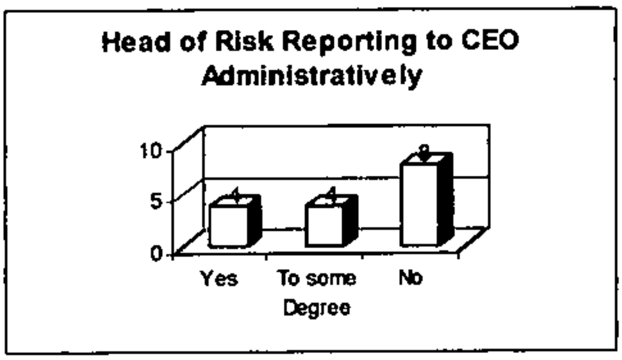
The evaluating of the effectiveness of the risk management processes by the board is undertaken annually within ABSA, FNB and Standard Bank. The process is, however performed, on an ongoing basis at Nedbank. Nedbanks' annual evaluation focuses particularly on the compliance with Regulation 38(5) and 39(4), which deals with the state of governance and internal controls respectively. At ABSA and FNB the evaluation, process is undertaken by the Risk Committee and reported to the Board.

DOES THE INTERNAL AUDIT FUNCTION ENJOY THE RESPECT AND COOPERATION OF THE BOARD AND MANAGEMENT?



Risk Management is a major contributing factor to the continued existence of any bank. Banks by their nature are in the business of risk. Internal Audit, as a functionary of Risk Management receives the co-operation and respect it requires in order to be effective in its task and responsibilities. This fact is confirmed by the responses received which reflect that the internal audit function at all banks receives the respect and co-operation of the Boards and management.

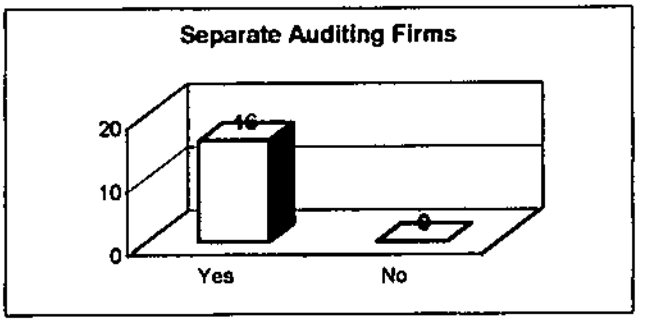
DOES THE HEAD OF THE INTERNAL AUDIT FUNCTION REPORT ADMINISTRATIVELY TO THE CEO?



At ABSA, the head of the internal audit function reports to the Chief Executive Officer (CEO) and has ready access to the chairperson of the board. At Nedbank the head of the internal audit function reports to the Chief Risk Officer, but has an exclusive monthly meeting with the CEO, separate from the risk officer.

At FNB, the Head of Internal Audit reports administratively to the Head of Risk, who in turn reports to the Chief Financial Officer (CFO). The head of Internal Audit has unfettered access to the CEO, the Chairman of the Board and the Board. At Standard Bank, the Head of Internal Audit reports administratively to the Head of Risk but has direct access to the CEO.

ARE THE INTERNAL AND EXTERNAL AUDIT FUNCTIONS CARRIED OUT BY SEPARATE ACCOUNTING FIRMS?

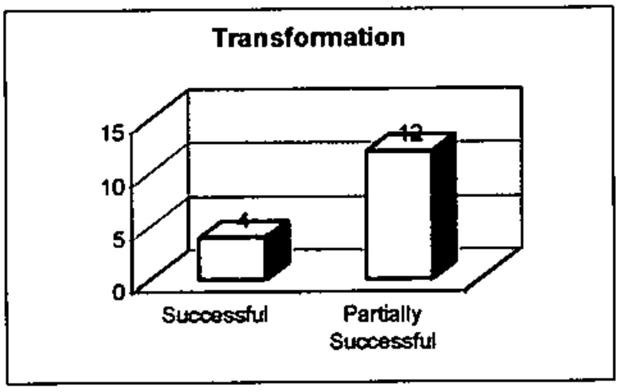


Separate institutions carry out the internal and external audit functions within the banks. Functionaries within each organisation perform the internal audit functions, whilst the external audit functions in each bank are performed simultaneously by two of the big auditing firms, namely KPMG Inc, PriceWaterhouseCoopers Inc. and Deloitte & Touche. KPMG Inc. and PriceWaterhouseCoopers Inc. perform the external auditing functions for Standard Bank. Those of Nedbank are performed by KPMG Inc. and Deloitte & Touche. FNB utilises the services of PriceWaterhouseCoopers Inc. and Deloitte & Touche, whilst ABSA utilises the services of KPMG Inc. and PriceWaterhouseCoopers Inc.

Different audit partners within each auditing firm are responsible for the auditing process where the same firms are responsible for the auditing of different banks.

3.1.3 INTERGRATED SUSTAINABILITY REPORTING

HAS THE COMPANY BEEN SUCCESSFUL IN ITS TRANSFORMATION PROCESS?

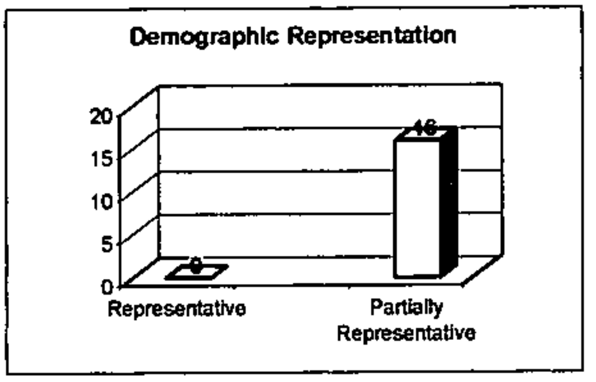


Most of the banks, with the exception of ABSA, believe that they have only been partially successful in transforming their respective organisations in terms of race, gender, age and other demographic criteria.

Representatives of ABSA, on the other hand, believe that they have achieved and in some instances exceeded their own targets and those as set out in the Financial Sector Charter. This they also argue should be viewed in the light of the organization's demographic composition ten years ago. The organisation had few staff of colour and virtually none in management positions.

All respondents agreed, however, that there is still scope for improvement for all the players in the industry. It is still dominated by white males. Most however believe that the Financial Sector Charter provides adequately for progressive transformation over a reasonable period of time, within the industry. This is an ideal to which all genuinely aspire to.

IS THE EXECUTIVE MANAGEMENT TEAM DEMOGRAPHICALLY REPRESENTATIVE?



All the banks have in some way tried to increase the headcount of blacks in executive management positions. Initially capable staff from within were elevated into executive management positions, but it became clear that the legacies of the past have not provided adequately for people of colour to progress this far in banking organisations. Most institutions then resorted to recruiting from government sponsored entities, which have been very progressive in advancing people of colour, both male and female.

All the respondents in this research were coincidentally white and male. They would like to see this demographic feature change much quicker. In their view, there is not enough people of colour that have been properly groomed to take up executive positions in banks in South Africa.

Table 3.1.3

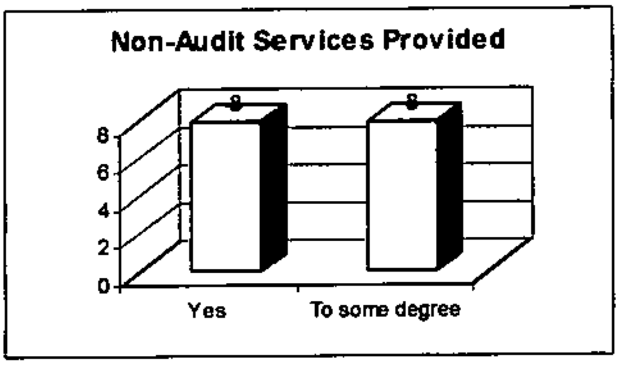
Composition of the Boards

Bank	Holding Company					Bank			
	E/Directors		Non Ind NEDS	Ind NEDS	TOTAL	E/Directors	Non Ind NEDS	Ind NEDS	TOTAL
	10		19	43	72	14	18	44	76
Male	70	92%							
Female	6	8%							
Black	21	27%							
White	55	73%							

Table 3.1.3 represents a combined breakdown of the boards of the four banking institutions observed. There are 44 independent non-executive directors, 18 non-

executive directors who were deemed independent and 14 executive directors throughout these banks. Amongst the 76 directors, 70 are male, whilst six are female. White males continue to dominate the boards, with 55 on the boards of the banks. There are 21 directors of colour within the boards of the banks. This number is overstated, as some of the black directors sit on the boards of different banking institutions.

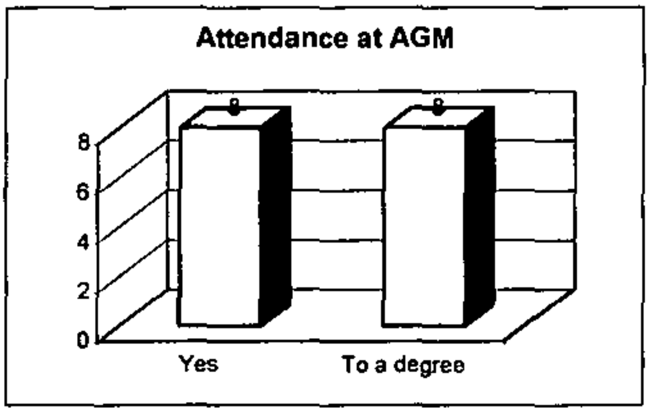
DOES YOUR STATUTORY AUDIT FIRM PROVIDE NON-AUDIT SERVICES?



The statutory audit firms for FNB and ABSA provide non-audit services to these banks. Those of Standard and Nedbank also do likewise, but to a lesser extent than the former two banks. All the banks confirmed that the fees derived from such services were in all instances less than the audit fees paid to the respective statutory audit firms, a feature that is in line with the recommendations contained in the King Report 2002.

They also confirmed that their respective audit committees have established principles for recommending the use of external auditors for non-audit services. This provides adequately for the requisite checks and balances that are paramount to good governance.

3.1.4 COMMUNICATION AND RELATIONSHIP WITH SHAREHOLDERS



Chairpersons of board committees attend annual general meetings (AGM) in order to answer questions raised by shareholders and other constituents. This is to provide for greater transparency and accountability. At FNB and Nedbank, the chairpersons of the Audit and Remuneration Committees are obliged to attend the bank's annual general meetings. It is optional for the chairperson of the other board committees to attend.

At ABSA and Standard Bank, the chairpersons of all the board committees as a matter of course and tradition attend the annual general meetings of their respective organisations.

All the banks indicated that they continue to encourage their shareholders to attend annual general meetings. They confirmed that they have been successful in increasing attendance due to the increase in the methods and media available to communicate with shareholders.

The advantage of such initiatives has been an increase in shareholders' interest and shareholder activism in the sector. This bodes well for corporate governance within the banking sector.

CHAPTER 4

CONCLUSION AND RECOMMENDATIONS

4.1 Conclusion

The four banks scrutinised in this research represent the South African banking sector by whatever criteria and as such set the tone for the industry. Other banks are mere followers. The position of the major banks, therefore requires that they take the lead in ensuring that they subscribe to and embrace all the tenets of good corporate governance. This is expected and required of them by authorities, depositors, creditors and a host of other stakeholders who would suffer financially and economically should these institutions fail.

In their approach to governance, representatives of the banking institutions confirmed that compliance with the form of corporate governance is important and has to a greater degree been accomplished in all the institutions. Greater emphasis is now being placed on ensuring compliance with the substance of corporate governance. This involves ensuring that good governance 'flows from the top of their organisations to the lower level structures and staff' and that everybody is sensitised to the notion of good corporate governance, a feature that is currently lacking in all the institutions. Good corporate governance is set to be an integral part of all operations and organisational activities.

The study undertaken found that banks generally comply with the external corporate governance framework. It is only when one decides to investigate and scrutinise the progress made closely that one finds certain areas of non-compliance or partial compliance, some technical and others overt. It was heartening to note that executive management was frank about such shortcomings and showed a commitment to closing such gaps. The Financial Sector Charter is an inclusive undertaking by the financial sector, including banks that sets definitive guidelines and targets to fulfilling some of the shortcomings within predetermined timelines.

There is consensus that the industry is highly regulated, but not over-regulated in terms of world standards. Most contend that the regulations are necessary to protect the country's financial system and are in line with international norms and standards. All however agree that the costs thereof comprise an unrealistic portion of the overall costs that banks have to incur in their operations.

The independence of the chairperson of the boards has been found to be where most banks fail to comply. Out of the four institutions analysed, three were found wanting in this regard. Moreover, some board committees were not chaired by independent non-executive directors. This in all instances was ascribed to the shortage of capable candidates to take up such positions.

Asked to rate their individual organisations in terms of infusing the recommendations contained in the Code in the day-to-day operations and activities, responses were in the range of 90% to 95%. Similar responses were received when reference was made to both the form, and later the substance, of corporate governance. The ratings reflecting compliance to the substance of corporate governance were generally the lowest. This anomaly is indicative of the fact that corporate governance matters dominate board proceedings, whilst little is passed on down the hierarchical structures of these organisations.

ABSA is marginally more advanced than the other banks in its corporate governance programmes. This must have been one of the factors that motivated to Barclays Bank to acquiring a controlling stake in the bank

4.2 Recommendations

It makes business sense to subscribe to the tenets of good governance and pursue the King II Code of Corporate Practice and Conduct and other statutes. It is also vitally important to internalise and craft such initiatives to form part of every employee's day-to-day activities and thinking. Such action will ensure that good corporate governance practices become second nature to everyone within the organisations.

To overcome the shortcomings identified, the points noted below are recommended.

- Corporate Governance is a strategic imperative. It requires the introduction of a corporate governance division within each bank, tasked with all the facets of infusing good corporate governance practices and policies throughout each organisation. This is indicative of the importance of good corporate governance within the sector. Such a strategic decision will make corporate governance and the principles it espouses accessible to all within each organisation, thereby motivating and eliciting increased adherence and conformance. This will also ensure that the stature of such a operational unit is elevated, reflecting its importance within the organisation.
- It is deemed necessary for corporate governance matters, principles and processes to cascade down and practised in all the tiers of banking organisations. They should be debated and practised at board level and likewise at operational and individual employee levels. This does not mean the Board of Directors abdicates on its ultimate responsibility to be the custodian, catalyst, highest authority and guardian of good corporate and business governance practices. Corporate governance issues are currently encapsulated in rules, policies and regulations within most organisations. This only serves to elicit mere conformance rather than absolute compliance. This strategy also negates the true spirit and intent of King II – that the Code should. not be 'legislated', a view vigorously propagated and defended by Judge Mervin King (Barrier, 2003)
- The different business units within the banks' governance structures need to work much more closely in order to benefit from the synergies that could flow from such a co-operation. These include, Internal Audit, Compliance, Operational Risk and Corporate Governance. It is only at Nedbank, where a dedicated corporate governance unit was established that there is greater co-operation between these units. The Compliance and Corporate Governance units have recently been merged under the leadership of Advocate Selby Baqwa, a well-respected scholar and practitioner on corporate governance.

- Overall, awareness of corporate governance at the lower levels in all the organisation is poor. The implementation thereof, by deduction has been poor. Cascading the notion of good corporate governance down to the lower levels of the organisations will go a long way in sensitising all employees towards the subject. The challenge of cascading the tenets of good governance should be seen as an opportunity to impart new knowledge to staff. Training and the upgrading of employees on the job has become more relevant than ever, now that South Africa has become part of a global village. The rapid advancement of technology also dictates likewise.
- Though difficult to achieve in large organisations, a culture of free, open and transparent rapport between the executive committee and everyone else should be created.
- The board and executive management, as the initial recipients of all the necessary training on corporate governance matters should set the tone in their respective organisations. They should, on an individual basis and collectively, visibly, by deed and their actions, subscribe to good governance and ethical behaviour. This is an obvious statement, but seldom practised in real life. It requires a special person with exceptional integrity and foresight.

CHAPTER 5

5.1 Limitations, learning and reflection.

This was a new and interesting topic for me. It has opened a new perspective and a new way of thinking. Academic literature on the South African perspective was not readily available. However, the King II report provided a solid base and point of departure for proceeding with the research.

The advantages, competitive and otherwise inherent in good governance are well understood at corporate level within banks and as such, it was initially difficult to obtain the desired co-operation and collaboration from the banking institutions. The bigger banks were, however, the most co-operative and willing to share information. It was difficult to obtain information from staff at the lower levels of the organisation, whilst executive management and board members were more co-operative, once approached through the company secretaries. The opposite applied to accessibility.

The interviews conducted have enriched my listening skills and the ability to deal with people at different levels in different organisations. The time spent with the Company Secretaries and the Directors was worth the time and effort. Disheartening, however, was the fact that enquiries at lower-levels staff within the organisations did not yield credible or complete data or information, that could be used constructively in this report. Few knew what corporate governance was or what it was all about. Lower-level employees were not aware or knew anything of the 'Code' or King I or II. This led to a marked difference in the responses received from company secretaries and directors when compared with responses received from staff at lower levels of the organisations.
Scheduling and obtaining time to speak to the executives was at times very frustrating. This, understandably was caused by the heavy schedules which dominate the lives of these individuals.

Corporate governance has been researched and reported on extensively in South Africa, but no specific research other than the Myburgh Report exists on the South African

Banking Sector. The King Report 2002, however, provided a good foundation for this research.

There are currently 38 banks operating in South Africa. Not all the banks could have been assessed during the period covered by the research. The sector is however dominated by the four banks, with the rest targeting specific niches within the South African market. The topic is itself complex and extensive and requires more research time by a single individual.

5.2 Improvements and recommended further study

This research deals with four banks in an industry comprised of 38 banks. The banks researched were selected on the bases that they are the dominant institutions within the industry and therefore set the tone and industry benchmarks. It would be interesting to discover what the outcomes would be should a larger number, including of smaller banks be investigated.

Risk management and ethics/values are important, if not vital, management components within a bank management framework. The sector is also highly profoundly dependent on good reputation. A run on any bank leads to numerous complications, economic, financial and otherwise, to the sector, the economy and a country. It would therefore add to the body of knowledge, if these areas were to be included in further research on corporate governance within the sector.

This research is the effort of a single person, with limited resources, undertaken over a period of nine months. The topic and the importance of the industry accessed dictate otherwise. A more in-depth, extensive, intensive and comprehensive investigation would increase and confirm the validity, accuracy and reliability of any further governance research into the banking sector. Ideally, the researcher believes a research spanning 24 months' is likely to be more holistic and provide more conclusive evidence.

Due to time and human capital constraints, not all banks could be investigated, only ABSA, First National Bank, Standard Bank and Nedbank were accessed.

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APPENDIX A

ASSESSING YOUR BANK IN TERMS OF CORPORATE GOVERNANCE:

The King Report in defining the scope of Corporate Governance contains a comprehensive and erudite questionnaire for evaluating affected companies, including banks. Due to their unique position, banks are obliged to pursue the recommendations contained in the King Report on Corporate Governance for South Africa (King II). Banks are also required to comply with the form and **substance** of corporate governance required by the Banks Act 94 of 1990.

The condensation below is a snapshot view designed to give a picture of the status of implementation and adherence of banking institutions to the form and substance of corporate governance within the financial sector. Its purpose is to identify both the apparently weakest and strongest areas of the sample, as a springboard for further, focused comprehensive studies. The results will form the foundation of a research being prepared by a UNISA Master of Business Leadership student, under the guidance of Professor V. Makin.

We do not presume to replace the King Questionnaire with this questionnaire, as we believe that each institution should undergo the thorough evaluation designed by the King II team.

		Yes 1	To a degree 2,3,4			No 5
	BOARD SIZE, COMPOSITION AND ROLE					
1	Has the board defined its role and responsibilities?					
	e.g. – Identified, prioritised and scheduled issues?					
	Have these been written down in the form of a charter?					
	Do you believe that your board is the appropriate size **to function optimally?**					
	Do you have a unitary board?					
	Does the Board periodically consider the diversity of the directors?					
	Do directors receive proper training in corporate governance matters?					
	Is there a procedure for directors to seek independent professional advice?					
	Does the board work well with the CEO and other directors / managers e.g. in the form of an open culture and frank discussion?					
	Notes:					
2	Is the Chairperson an independent non-executive director?					
	Are the roles of the Chairperson and the CEO separate?					
	Are the board's deliberations free from the dominance of any individual or group?					
	Do your directors routinely speak to senior managers who are not represented on the					

	board?					
	Do outside directors meet without management on a regular basis?					
	Notes:					
3	Which board committees have been established?					
	Audit					
	Remuneration					
	Nominations					
	Directors' Affairs Committee					
	Finance					
	Safety & Health					
	Special purpose					
	Governance					
	Strategic					
	Risk					
	Does an independent non-executive director chair each board committee?					
	Do Board Committees formally and fully report on its activities to the board?					
	Notes:					
4						
4.1	Is there a process to regularly review and assess:					
	The CEO?					
	The board?					
	The committees - especially the Audit Committee?					
	The individual directors?					
	Notes:					
4.2	Does the Company Secretary provide a central source of guidance and advice on business ethics and good governance?					
	Notes:					

	RISK MANAGEMENT AND INTERNAL AUDITING					
5	Has the board taken full responsibility for the process of risk management in the organisation?					
	Has the board implemented mechanisms designed to identify areas of potential problems in performance before crisis occurs?					
	Notes:					
6	How often does the board evaluate the effectiveness of the risk management process in the organisation?					
7	Does the board determine criteria for acceptable degrees of risk the organisation may run in pursuit of its objectives?					
	Does the board receive and review reports on the risk management process in the organisation?					
	Does the board identify key risk areas for the organisation?					
	Notes:					
8	Does the internal audit function enjoy the respect and co-operation of the board and management?					
	Notes:					
9	Does the head of the internal audit function report administratively to the CEO?					
	Does the head of the internal audit function have ready access to the chairperson of the board and the chairperson of the audit committee?					
	Notes:					

10	Is the appointment/dismissal of the head of internal audit undertaken with the concurrence of the audit committee?					
	Notes:					
11	Are the internal and external audit functions carried out by separate accounting firms?					
	Notes:					
12	How effectively does the internal audit function co-ordinate with other internal and external providers of assurance?					
	Notes:					
	INTERGRATED SUSTAINABILITY REPORTING					
13	Has the Board established guidelines on what is relevant for disclosure by the organisation?					
	Notes:					
12	How would you rate the information that is publicly disclosed in terms of:					
	Reliability?					
	Relevance?					
	Clarity?					
	Comparability?					
	Timeliness?					
	Verifiability?					
	Notes:					
13	Has the company been successful in its transformation process?					
	(Request breakdown in term of race, gender, age etc)					
	Notes:					

14	Is the executive management team demographically representative?					
	Notes:					
15	Do the procurement policies of the organisation support black economic empowerment?					
	Notes:					
16	**ACCOUNTING AND AUDITING**					
	Does your statutory audit firm also provide non-audit services?					
	If so, is the income derived from providing such services less than the audit fees?					
	Has the audit committee established principles for recommending the use of external auditors for non-audit services?					
	Notes:					
17	Does the co-ordination between the external auditors and the internal auditors include:					
	Periodic meetings to discuss matters of mutual interest?					
	The exchange of working papers, management letters and reports?					
	A common understanding of audit techniques, methods and terminology?					
	Notes:					
18	Does the audit committee have written terms of reference dealing with its members, authority and duties?					
	Are the majority of the members of the audit committee financially literate?					
	Notes:					

	COMMUNICATION AND RELATIONSHIP WITH SHAREHOLDERS					
19	Are shareholders encouraged to attend annual general meetings?					
	Do the chairpersons of the board committees attend annual general meetings to answer questions?					
	Does the organization's reporting provide a full, fair and honest account of its performance?					
	Does the organisation base its disclosure on the principles of **openness and substance** over form?					
	Notes:					

Composition of the Board

Bank	Holding Company				Bank			
	E/Directors	Non Ind NEDS	Ind NEDS	TOTAL	E/Directors	Non Ind NEDS	Ind NEDS	TOTAL
Male								
Female								
Black								
White								

The industry is perceived to be over-regulated: your views?

It is three years since the publication of King II. How far has the organisation progressed in infusing the recommendations into its **day-to-day operations/activities**?

On a scale of 1 – 10, rate how the organisation complies with the following:

1 The form of Corporate Governance.
Comments

2 The substance of Corporate Governance
Comments

In which areas has the/your organisation exceeded the recommendations/requirements as contained in:

1 The King II Report

2 The Banks Act 94 of 1990

Which recommendations contained in King II **require further attention/action** within your organisation?

Which recommendations **require modification** in order to render them more effective, practical or more cost effective?

In your opinion, to what extent (%) has your institution complied with the recommendations of King II and the Code of Corporate Practice and Conduct?

APPENDIX B

Composition and demographic make-up of the Boards – (combined)

Bank	Holding Company					Bank			
	E/Directors		Non Ind NEDS	Ind NEDS	TOTAL	E/Directors	Non Ind NEDS	Ind NEDS	TOTAL
	10		19	43	72	14	18	44	76
Male	70	92%							
Female	6	8%							
Black	21	27%							
White	55	73%							

APPENDIX C

Background on Corporate the Governance Division in Nedbank

During 2003 a dedicated Corporate Governance Division, headed by Selby Baqwa was established to coordinate corporate governance and sustainability considerations for the Nedbank Group. This new team has been working closely with the Company Secretary and various risk management functions in promoting a culture of good governance in the group. To this end, the Corporate Governance Function has been charged with the responsibility to:

- define a comprehensive sustainability strategy for the group;
- collate information about the impact of the bank's operation on economic, social and environmental matters;
- increase dialogue with stakeholders;
- build awareness about sustainability among employees and suppliers;
- assist business units to assess and address environmental and social risks;
- compile, communicate and distribute full sustainability reporting;
- extend relationships with the Nedbank-aligned Green Trust and with the World Wide Fund For Nature South Africa (WWF-SA).

The Function reports directly to the bank's Group Social and Environment board sub-committee, which formulates non-financial policy guidelines that are ratified by the board. The sub-committee also helps ensure that the value and implications of a strong social conscience are cascaded throughout the group.

At management level, a Corporate Citizenship Committee has been mandated to integrate sustainability strategies into many of the Group Activities – including black economic empowerment, human resource development, procurement, environmental impact and corporate social investment – all within the framework of the Financial Sector Charter. Nedcor fully endorse the citizenship imperative outlined in the aforementioned Charter.

Nedbank is further committed to complying with regulations, legislations and supervisory codes of conduct not only on a local level but internationally, in respect of its relationship with Old Mutual and other international bodies like UNEP and GRI. The four primary pillars of fairness, accountability, responsibility and transparency are fundamental to all these international guidelines of corporate governance and we will strive to adhere to them in our internal governance processes.

Why was there a need for a Corporate Governance Function?

Refining certain processes, such as succession planning, as well as cascading best-practice governance principles throughout the organisation to ensure that every employee recognizes that these principles are relevant to his or her daily activities.

The division was established to coordinate corporate governance and the sustainability considerations for the Nedbank Group. Closely working with the Company Secretary and various risk management functions in promoting a culture of good governance within the group.

Corporate Governance Awareness Strategy formulated by the corporate governance unit

Targeted Audience: Board, Board Committees, Executive Committee (EXCO), management and non-management including all subsidiaries, joint ventures etc.
Tools of communication:
Recommendations to board and board committees
Web site (still under development)
Recommendations to EXCO via CEO
Consultation and communication with company secretaries of subsidiaries
Close working relationship with Risk (SBU)
Use of internal publications, electronic and print
Adhoc presentations including the viewing of videos at the relevant levels

Other publications through internal existing channels such as magazines

Reporting: Annual Report

Sustainability Report

Frequency: Set by Marketing, No defined communication calendar

Who is responsible for corporate governance within Nedbank?

In allocating responsibilities concerning corporate governance, one cannot take a one-dimensional view on the five-point recovery plan. We need to look at the role of business units in corporate governance and the role of business units in corporate strategy.

Responsibility towards corporate governance

All business units, including the Corporate Governance Unit have a responsibility toward corporate governance which include:

- creating a culture around being a good corporate citizen;
- transparency;
- implementing governance structure within business units;
- conforming to legislative issues.

It is the responsibility of all employees to assist in creating a sustainable business and this requires a definition of true corporate values and a commitment by all employees to conduct themselves so as to remain true to such values.