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**A GOVERNANCE FRAMEWORK FOR UMGENI WATER'S
BOARD WITH SPECIFIC REFERENCE TO THE KING III AND
KING IV REPORTS**

by

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ABSTRACT

Umgeni Water is not an SOE but a National Government Business Enterprise (See Schedule 3 (Part B) of the PFMA. SOE's are also not funded by the National Revenue Fund. Government provides guarantees-such as in the case of SAA, ESKOM, etc. SOE's are supposed to function on a profit base. SOE's do not appear in the national budget.

Improving the governance performance of SOEs is very important, as is the transformation of board practices in South Africa in line with the adopted King III and King IV Reports and the Companies Act (No. 71 of 2008), Sections 30 and 66 to 78; the Public Finance Management Act (PFMA) (No. 1 of 1999), Section 77; and Treasury Regulation 27.1.1.

Governance framework transformation for SOEs in order to achieve their objectives or their mandate is highly imperative as set out by the central government through its legal framework.

In terms of the Constitution of the Republic of South Africa (Act No. 108 of 1996), and as guided by the Water Services Act (No. 108 of 1997), the water utility provides water to the citizens of the country. The South African government is the sole shareholder, having 100% ownership, managed by a Board (Umgeni Water Board) who is also the accounting authority in terms of Section 49 of the PFMA.

This research also focuses on the role of the government in relation to the oversight role through parliament committees' portfolio committees, such as the Standing Committee on Public Accounts (SCOPA) and the Portfolio Committee on Water and Sanitation.

Government ownership means that the state is responsible for ensuring that SOEs' governance framework and best practices, according to the King III and King IV Reports, are in place and that the board functions effectively and efficiently and is supported financially in order to execute the government mandate.

Hendrikse and Hefer-Hendrikse (2014:104) state that corporate governance is a partnership of shareholders, directors, and management to provide wealth creation and economic wellbeing to the wider community of stakeholders.

Hendrikse and Hefer-Hendrikse (2014:104) further state that good corporate governance should be thought of as a basic business common sense framework in which companies can systematically pursue superior performance and enhance shareholder value.

The aim of this study is to explore the governance framework with specific reference to the King III and King IV Reports with the aim of improving on, if any, the governance framework. The King III Report also differentiate between national government business enterprises and national public entities. See also Section 52 of the PFMA for differentiation between public entity and government business enterprises.

Umgeni Water was selected among the two water utilities in KwaZulu-Natal managed by a Board in terms of Section 49 of the PFMA.

Keywords: State-owned enterprise (SOE), compliance, stakeholders, risk management, corporate governance.

DECLARATION

I, Jabulani Makhaye, hereby declare that this mini-dissertation for the Programme in Governance and Political Transformation at the University of the Free State (Bloemfontein) is my own original work and has not been submitted by me or any other individual at this or any other university for any other degree or qualification. I also declare that all references used for this study have been properly acknowledged.

Mr J. Makhaye

Date

Student number: 2004055303

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LIST OF ABBREVIATIONS

ANC	African National Congress
APP	Annual Performance Plan
B-BBEE	Broad-based Black Economic Empowerment
BRICS	Brazil, Russia, India, China, and South Africa
CEO	Chief executive officer
CFO	Chief financial officer
CIPC	Companies and Intellectual Property Commission
COB	Chair of the board
CRO	Chief risk officer
CS	Company secretary
DWS	Department of Water and Sanitation
EE	Employment equity
EEA	Employment Equity Act
EU	European Union
HR	Human resources
ICGN	International Corporate Governance Network
IFC	International Finance Corporation
IFR	International Financial Report
IoDSA	Institute of Directors in Southern Africa
JSE	Johannesburg Stock Exchange
KPI	Key performance indicator
MOI	Memorandum of Incorporation
NPO	Non-profit organisation
OECD	Organisation for Economic Co-operation and Development

PDG	Président-directeur général
PFMA	Public Finance Management Act
SAA	South African Airways
SANRAL	South African National Roads Agency Limited
SCOPA	Standing Committee on Public Accounts
SME	Small and medium enterprise
SOE	State-owned enterprise
UK	United Kingdom
USA	United States of America

CHAPTER 1:

RESEARCH BACKGROUND AND MOTIVATION

1.1 INTRODUCTION

Umgeni Water is a Schedule 3 (Part B) National Government Business Enterprise founded under the provisions of the Water Services Act, (No. 108 of 1997) of South Africa, guided by the Constitution of the Republic of South Africa (Act No. 108 of 1996). Section 27(1) (b) of the Constitution states that “[e]veryone has the right to have access to sufficient food and water” and that “[t]he state must take reasonable legislative and other measures, within its available resources, to achieve the progressive realisation of each of these rights”.

Umgeni Water possesses the infrastructure and operates an interbasin transfer scheme, a major water treatment plant, and an offshore waste water disposal pipeline, and manages water treatment and sewage plants on an agency basis for the industry and municipalities.

Corporate governance embodies processes and systems by which SOEs are directed, controlled, and held to account. In addition, the legislative requirements enabling legislation and corporate governance with regard to SOEs are applied through the precepts of the Public Finance Management Act (PFMA) (Act No. 1 of 1999) and to run in tandem with the Protocol on Corporate Governance, which encapsulates the principles contained in the King III Report on Corporate Governance.

Umgeni Water is listed in Schedule 3 (Part B) as a National Government Business Enterprise of the national government SOEs in terms of the PFMA. The Minister of Water and Sanitation, in terms of Section 28 (1)(a) of the Water Services Act, 1997, is empowered to appoint the board of the water utility.

The board reports to the Minister through an annually approved Shareholder Compact, which sets out the strategic objectives of the organisation (Umgeni Water 2016:27).

1.2 PROBLEM STATEMENT

The African National Congress (ANC) initiated a comprehensive review of SOEs in 2007. To take the process forward, the president appointed and established a Presidential Review Commission (PRC) in 2010. The report of the PRC was accepted by Cabinet on 30 April 2013. Among the commission's responsibilities is to make policy proposals on the means by which SOEs in South Africa can be strategically positioned in line with the ANC's economic transformation policies.

The Economic Transformation policy document of the ANC is a very important document that seeks to transform SOEs' reforms into real economic drivers and, in turn, for these institutions to become key agents of economic development; thus not merely being confined to the economic growth domain.

SOEs were established to support strategies for economic development and to promote public interests; however, over the years, the definition of and reference to these institutions have gradually evolved and, as such, some inherent tension between the interests of the public and those of the enterprises have developed.

South Africa is a member of the Brazil, Russia, India, China, and South Africa (BRICS) association, which is both an opportunity and a challenge for South Africa. It is a challenge because membership alone will not necessarily translate into automatic positive growth and development and it necessitates the urgent reorganisation of the state and its capacity; therefore the government of South Africa will need to transform the governance framework for all SOEs to align with the international best practices around the corporate governance principles (Gumede 2012:13).

Secondly, it is an opportunity because as a country we need to transform SOEs into real economic drivers and, in turn, these institutions must become key agents of economic development.

In the period between 1910 and 1994, the first SOE in South Africa was the South African Railways and Harbours Administration it support economic development and service delivery imperatives.

In 1994, the Government of National Unity identified a need for the privatisation of some SOEs. It was decided that a few smaller SOEs like Aventura and Arivia would

be completely privatised and others like Telkom and South African Airways (SAA) would sell a portion of their ownership share to private investors (Gumede 2012:13).

The National Treasury, in its analysis of the 2016 budget, discovered that SOEs in South Africa are struggling because of poor corporate governance. The boards of these entities are failing to apply proper corporate governance procedures and best practices and are making *ultra vires* decisions by not applying the Companies Act, 2008 (Act No. 71 of 2008) and the PFMA, 1999 (Act No. 1 of 1999) correctly.

This has resulted in the government of South Africa prioritising the improvement of SOEs' transformation of the governance framework and the independence and composition of the boards. The National Treasury has increased government guarantees to SOEs to R477.7 billion in the current financial year; up from R469.9 billion (National Treasury 2005).

The research focuses on the corporate governance aspect of conflicts of interests that exist between different stakeholder groups and it also examines the role of the government as one of the shareholders as it has a percentage ownership (National Treasury 2005).

In addition to the above, the research emphasises that the amount mentioned above by the National Treasury is equivalent to a quarter of the government's total national debt, allowing major public entities such as Eskom and SABC to access cheaper funding to continue their operations (National Treasury Budget Review 2015).

The abovementioned major public entities, as well as Umgeni Water, need to improve both their operational management and the governance of their boards to be efficient and effective in running their board activities without compromising service delivery, as it is mandated by the Constitution that every citizen of this country has the right to access to water.

The country relies on government departments and municipalities to execute its service delivery programmes. Many of them are going through operational and management turmoil, largely as a result of political interference by government ministers and officials, which negatively affects their capacity to execute the mandate of the state.

SOEs in South Africa are struggling to comply with the corporate governance principles with specific reference to the King III and King IV Reports.

1.3 RESEARCH QUESTIONS

The research addresses the following questions that are most critical for the transformation of the board of Umgeni Water's governance framework with specific reference to the King III and King IV Reports:

- Is the recommendation or nomination and appointment processes of the board members codified and legislated?
- Is there a legislative directive that regulates the appointment of the independent and non-executive directors?
- Is there general compliance with the legislative dictates on board appointments?
- What is the process of recruiting and appointing board members in SOEs?
- What is the role that the Minister play in the appointment of board members?
- Are the board's terms of office of SOEs codified and, if so, in which legislative dictate? How many terms can each board member serve? Is it legislated or is it in the King III and King IV Reports?
- Is the board composition of SOEs aligned to their mandate?
- How many board members sit on the boards of SOEs?

1.4 RESEARCH MOTIVATION

The focus on transforming the governance framework in both developed and developing countries has recently been on clarifying, simplifying, and streamlining the roles of the state as the owner, SOE ownership, boards, and management (Organisation for Economic Co-operation and Development (OECD) 2011:1).

A number of countries have recently moved to reform SOEs to improve performance and effectiveness, and to raise the quality of public services, in the context of decreasing government financial support (OECD 2011:1). These reforms focused on recognising the ownership function of the shareholder. Some countries have established specific shareholder ownership units (Gumede 2012:13).

Building effective SOE executive management and boards is one of the major challenges that the government of South Africa is facing.

A number of countries have established special purpose vehicles or centralised holding companies for their SOEs, for example China, Singapore, Thailand, Vietnam, Malaysia, and Finland (Gumede 2012:13). Examples of these include that of Singapore, where the holding entity, Temasek, is the ownership entity for all SOEs. Temasek is fully owned by the Ministry of Finance. In Norway, the government is the owner, policymaker, and regulator. In the case of Norway's Statoil, where the state owns the oil resources, the Ministry of Petroleum and Energy performs the owner's function by setting resources policy and monitoring that the oil company follows such policies in its operations. The Norwegian state is the largest shareholder, with 67% shares (Gumede 2012:13).

In Sweden, the Ministry of Industry, Employment and Communications serves the ownership role for its large SOEs. Within the Ministry there is a specialist unit – the SOE division that administers the shareholding function (Gumede 2012:13).

Swedish SOEs follow the country's Companies Act, like any other company. This means that the board is empowered to provide oversight and the strategy of the SOE (Gumede 2012:13).

1.5 AIM AND OBJECTIVES OF THE RESEARCH

1.5.1 Aim

The main purpose of the research is to investigate poor corporate governance in a National Government Business Enterprise that falls under the Department of Water and Sanitation (DWS), namely Umgeni Water.

The researcher seeks to address the study's objectives through the following areas of transformation, which are important in the governance of SOEs.

1.5.2 Research objectives

1.5.2.1 Separation of the state as the shareholder and regulatory functions of the state-owned enterprises (SOEs)

Good practice comprises establishing a proprietorship entity accountable for developing the government's proprietorship policy, representing the state as proprietor, and reporting to the public on SOE performance (OECD 2014d:14).

This encourages government accountability for SOE performance and can help avoid lax oversight by the state. An ownership entity can also help shield SOEs from political interference by ensuring that the state's prospects as a proprietor are communicated in a structured, transparent, and regular manner to SOE boards.

The formation of a proprietorship entity can also be beneficial in separating the exercise of the state proprietorship function from other government functions that stipulate SOEs' circumstances, such as market parameters or safety and consumer protection regulation.

Separation of roles is imperative to evade circumstances in which a distinct part of the state is tasked with implementing potentially conflicting objectives, such as ensuring the commercial success of an SOE, while encouraging fair competition with its private players.

1.5.2.2 Role of the Minister, Cabinet, and Parliament as shareholders

The government exercises the proprietorship of SOEs in the interest of the general public. It prudently appraises and discloses the objectives that justify state ownership and subjects these to repeated evaluation (OECD 2015:118).

The definitive determination of state ownership of enterprises should be to ensure value for money, through a well-organised apportionment of funds (OECD 2015:18).

The government should advance a proprietorship strategy. The strategy should, *inter alia*, outline the overall rationale for state ownership, the state's role in the governance of SOEs, how the state will implement its ownership policy, and the respective roles and responsibilities of those government offices involved in its implementation.

The proprietorship strategy should be subject to apposite procedures of political responsibility and be divulged to the broad public. The government should review at regular intervals its proprietorship strategy. The state should explain the reasons for owning separate SOEs and subject these to recurring review.

Any public strategy objectives that individual SOEs, or groups of SOEs, are required to realise should be mandated and disclosed by the relevant authorities.

1.5.2.3 The role of the state as shareholder of an SOE

The presence of the government must be seen as the government acting as a cognisant and active shareholder, instead of being dictatorial and interfering, and ensuring that the governance of SOEs is carried out in a transparent and responsible manner, with a high degree of efficiency and effectiveness.

The state should streamline the best practices and legislation under which SOEs should operate. The operational practices should include constant monitoring so that mistakes don't happen and effective corporate models be established.

The independence of SOEs is very important. The government should also allow SOEs to have full operational self-governance to achieve their defined objectives and refrain from intervening in SOE administration.

The government as a main shareholder must redefine the SOEs' proper governance framework. The presence of the state in SOEs must allow the independence of the SOEs to exercise their duties (OECD 2015:17).

1.6 THE ROLE OF SOEs IN THE ECONOMY

Consistent with the justification for state ownership, the legal and regulatory framework for SOEs should ensure a level playing ground and impartial competition in the marketplace when SOEs undertake economic activities (OECD 2014d:14).

There should be a flawless separation between the government's proprietorship function and other government functions that may influence the environments for SOEs, predominantly with regard to market parameters.

Shareholders and other concerned parties, including creditors and challengers, should have access to efficient redress through unprejudiced legal or arbitration processes when they suspect that their rights have been violated.

Where government entities combine economic activities and public policy objectives, high morals of transparency and disclosure regarding their cost and revenue structures must be sustained, allowing for an acknowledgment of main activity areas.

Expenditure associated with public policy objectives should be financed by the state and disclosed in the financial statements of the entity in accordance with the International Financial Report (IFR) (Hendrikse & Hefer-Hendrikse 2014:43).

1.7 RESEARCH METHODOLOGY

This section defines the research background. The research is mainly pragmatic in that it seeks to draw conclusions based on the data that will be collected from interviews.

The methodological approach that will be employed by this research is the qualitative approach.

Du Plooy-Cilliers (2016:290) states that qualitative researchers collect artefacts, stories, phrases, words, images, and all kinds of symbols that will assist in creating a deeper understanding of a phenomenon. The researcher opted to utilise questionnaires and interviews for the collection of data.

Qualitative research is based on flexible and explorative methods that enable the researcher to change the type of data being collected progressively so that a deeper understanding of what is being investigated can be achieved.

1.8 RESEARCH DESIGN

Bless, Higson-Smith and Sithole (1995:130-131) state that a project has a definite beginning and ending date. A research project also takes place over a period of time and, as a result, requires a clear plan or design to ensure high internal validity.

Babbie and Mouton (2001:104-105) state that a research design is a structured framework of the study for how the research will be executed.

Mouton (1996:169) states that in qualitative research researchers work with a wealth of rich, descriptive data collected through methods such as observation, interviews, and analysis of organisational documentation. However, in qualitative research, like the present study, one must not deny the value of quantitative research. This study is qualitative in nature, and at its core are careful considerations and descriptions.

According to Mouton (2001:55), the research design is a plan or blueprint of how one intends to conduct the research.

Bogdan and Biklen (2007:49) further explain that the research method is the researcher's plan of how to proceed with the research.

A number of qualitative research designs are recognised today. From a qualitative research perspective, these are often regarded as strategies of inquiry.

Denzin and Lincoln (2000) describe such strategies as comprising the skills, assumptions, enactments, and material practices one uses when moving from a paradigm and a research design to collecting and analysing data about the research subject.

This research targets the chief executive officer (CEO), the chief financial officer (CFO), the chair of the board (COB), and the company secretary (CS). The CS is the record keeper of the board and thus provides independent advice. The CS is also the right hand of the board and forms part of this research because he/she ensures that correct information is provided to stakeholders.

1.9 ETHICAL CONSIDERATIONS

The ethical behaviour of a researcher is very important when he/she embarks on a research project. According to Welman and Mitchell (2005:180), ethical behaviour is important in research, as in any other field of human activity.

The researcher considered the vital importance of ethical issues that are procedural and that promote good ethics in research. The competence of the researcher is very

important. Welman and Mitchell (2005:182) explain that a researcher would not embark on research involving the use of skills in which they have not been adequately trained. They state that to do so may risk causing harm to subjects, abusing a subject's goodwill, damaging the reputation of the research organisation, and may involve wasting time and other resources.

Welman and Mitchell (2005:182) state that any research should be produced by a thorough review of the literature to ensure, as a far as possible, that the proposed research has not already been conducted elsewhere.

Plagiarism is seen as the use of other scholars' information, data, and any ideas without due acknowledgement and permission granted where appropriate, which in the academic world is viewed as unethical, and should be avoided at all times.

1.10 ORGANISATIONAL STRUCTURE OF THE DISSERTATION

This dissertation is structured as follows:

Chapter 1: Research Background and Motivation

This chapter provides the actuality and motivation of the research, the problem statement, the aim of the study, the methodology, and the structure of the research.

Chapter 2: Conceptualisation of the Legal Environment

Chapter 2 contains the investigation of the legal background and environment, for example, the Companies Act, the PFMA, and the King III and IV Reports.

Chapter 3: Existing Policies and Procedures

In this chapter, the focus is on the existing policies and procedures. The concepts of compliance and risk form an integral part of governance and are also explained in detail. Various types of committees and their functions are also discussed.

Chapter 4: Methodology, Procedures, and Execution of the Empirical Study

Chapter 4 describes the methodology and procedures employed in the study, the research type, and the execution of the empirical study.

Chapter 5: Findings of the Empirical Study

Chapter 5 summarises the findings of the empirical research conducted for this study.

Chapter 6: Summary, Recommendations and Conclusions

In this chapter, the Summary, Recommendations and Conclusions is presented.

CHAPTER 2:

CONCEPTUALISATION OF THE LEGAL ENVIRONMENT

2.1 INTRODUCTION

The first part of this chapter deals with the development of corporate governance and the key concepts of the corporate environment. The second part deals with the legal environment with specific reference to the Companies Act and the PFMA. The difference between King III and King IV will also receive attention. The contributions of the board of directors, the CS, the COB, and the CEO towards the achievement of the objectives of organisations are important and will also be analysed.

The focus will be on the most fundamental corporate governance practices, principles, and governance.

2.2 CORPORATE GOVERNANCE DEVELOPMENT

The King Committee on Corporate Governance was established in 1992, under the auspices of the Institute of Directors in Southern Africa (IoDSA). The IoDSA is the centre of corporate governance and pursues the promotion of good corporate governance in the context of South Africa (Kneale 2012:224). The many business failures all over the world increased the interest in effective corporate governance.

The purpose of the King I Report of 1994 was, and remains, to promote the highest standards of corporate governance in South Africa (Kneale 2012:226). The King I Report went further than the financial and regulatory aspects of corporate governance in advocating an integrated approach to good corporate governance in the interests of a wide range of stakeholders. These aspects contribute to good financial, social, ethical, and environmental business practices.

The King Committee of 1994 formalised the need for companies to recognise that they are no longer able to act independently from the public and the environment in which they operate. On 1 April 2016, the King Committee recognised the need for the introduction of King IV, reducing the King III principles from 75 to 17, and the need to make it more relevant and easier to apply (Kneale 2012:226).

King IV (2016) promotes good corporate governance and can be viewed as an important integral aid of management in successfully running a business. Like King III, King IV was introduced to ensure accountability and transparency and to ensure that the board of SOEs and public companies comply with specific standards and run organisations effectively and efficiently (Kneale 2012:225).

Both the King III and King IV reports prescribe important principles with regard to fairness and the responsibilities of board members (Kneale 2012:228).

2.3 KEY CONCEPTS OF THE CORPORATE GOVERNANCE ENVIRONMENT

The key concepts of corporate governance are as follows (Jackson & Stent 2014:4-7):

- **Transparency of the board:** Transparency refers to the ease with which an outsider is able to understand the information available about a company. This includes both financial and non-financial information, as well as the strategic objectives of the company.
- **Independence of the board:** Independence of the board is paramount and refers to the extent to which procedures and structures are in place to minimise potential conflict of interest.
- **Accountability of the board:** Acceptance of accountability of board members is very important for the credibility of the board.
- **Responsibility of the board:** The board members have a responsibility to ensure that they act responsibly when making decisions, even when such decisions are *ultra vires* or *intra vires*.
- **Fairness of the board:** Stakeholders should receive equal consideration when the company deals with them indirectly or directly.
- **Social responsibility of the board:** Social responsibility is very important for a company to contribute to the community and the citizens it serves.
- **Environment of the board:** Scanning and preserving the micro-environment are very important for the board of directors. The company should look after the environment and the interests of all the stakeholders. The relationship and trust of the stakeholders are important. This means that the ideal of sustainability

can only be achieved when a company succeeds in gaining and retaining the support of its various stakeholders.

2.4 MORAL DUTIES OF THE BOARD OF DIRECTORS

It is expected from all corporate directors to apply sound ethical practices. Each director should exercise the following moral duties (Jackson & Stent 2014:4-8):

- **Conscience of the board:** The directors of the company should act with an intellectual mind in the best interest of the company. Directors should avoid conflicts of interest at all times and remain independent in mind and action.
- **Competence of the board:** It is vital that directors are competent and possess the required skills in order for the organisation to grow and be able to compete with other organisations in the same micro or macro market environment.
- **Commitment of the board:** The board members should be committed at all times and be available at all times to ensure that the organisation is successful in its efforts to make a profit.
- **The courage of the board:** The courage of management is the essential foundation for building a successful company. Without courage and taking risks, the expected objectives cannot be achieved. The directors should manage all possible risks that can be associated with directing and managing the organisation.

2.5 FUNDAMENTAL DIFFERENCES BETWEEN KING III AND KING IV

The introduction of King II and III brought huge changes in the corporate governance environment and promoted the culture of good ethics in SOEs as well as in the private sector.

This reduction in principles has been realised through the refining of concepts of the King III Report; nevertheless, most of the fundamental principles of King III have been reserved in the King IV Report (2016:3). It can be assumed that the purpose of the reduction in principles is to facilitate an easier interpretation and application of King IV.

2.5.1 King IV introduces sector additions or supplements

Part 6 of King IV contains sector supplements applicable to municipalities, non-profit organisations (NPOs), retirement funds, small and medium enterprises (SMEs), and SOEs.

These supplements provide specific guidance to the aforementioned categories of organisations in their interpretation and implementation of King IV. These sector supplements are directed at making it easier for companies to achieve good corporate governance through the application of King IV.

2.6 THE INDEPENDENCE OF DIRECTORS UNDER KING IV

The independence of directors is very important, especially where a shareholder is the state and where political influence might affect the functioning of the board.

The King IV Report has moved away from the situation in King III where it contained a list of indicators which the body should, holistically and on a substance over form basis, consider when evaluating the independence of the board of directors for purposes of categorisation.

King III required that a corporate governance framework be agreed on between the group members and its subsidiary boards.

2.7 THE LEGAL ENVIRONMENT

According to King III, the financial regulations of SOEs fall under the PFMA (Act No. 1 of 1999). The PFMA applies to SOEs and government departments and was revised and promulgated in late 2002 as an updated Protocol on Corporate Governance for SOEs (DPE (2009:13)).

SOEs are completely governed and the legislation collectively includes the Companies Act, The PFMA, the King Reports I-IV, and the Protocol on Corporate Governance for SOEs.

Some SOEs are funded through the PFMA and through the National Revenue Fund, but others for example SAA and TELKOM not. These SOEs need to ensure

compliance in terms of financial reporting and follow proper procedures in appointing suitable and competent board members as per the public sector corporate governance protocol.

2.7.1 The Companies Act (No. 71 of 2008)

The Companies Act of 2008 came into effect on 1 May 2011. The Companies Act determines the fundamental issues of the appointment of committee members of a board. Section 72 of the Act specifies the qualities of the directors who may serve as board members.

Regulation 43 of the Companies Act also determines the importance of the social and ethics committee. This rule states that the committee must not include less than three directors or prescribed officers of the company; at least one of whom must be a director who is not involved in the day-to-day activities of the company.

The Companies Act instructs on good corporate governance principles and compliance.

Although King IV is not legally binding it does not mean that there are no legal consequences arising from non-compliance.

In this instance a court will consider the King IV Report (2016) when evaluating what is regarded as good practice at that particular moment of the court case for the adjudicating presiding officer, especially where governance duties are involved. The King III (2009) code operates on a recommended application or explanation basis (Kneale 2012:104).

2.7.2 Consumer Protection Act (No. 68 of 2008)

The Consumer Protection Act was officially introduced in South Africa on 1 April 2011. The Consumer Protection Act introduces general principles of consumer protection and serves as an overarching governing statement on consumer protection matters to ensure that consumers are protected. Its aim is also to prevent consumer harm and to enhance the economic welfare of consumers in South Africa.

Other important functions of the Consumer Protection Act is to create and promote an economic environment that supports and strengthens a culture of consumer rights in South Africa, to emphasise the responsibilities of consumers in South Africa, and to promote fair, efficient, and transparent marketing practices for consumers and businesses.

2.8 BOARD OF DIRECTORS

2.8.1 Role of the board

The King III Report (2009:21) states that the board should act as the focal point for and custodian of corporate governance.

The King IV Report (2016:39) further determines that the governing body should serve as the focal point and custodian of corporate governance in an organisation. The board should ensure that the company is and is seen to be a responsible corporate citizen. The board should also provide effective leadership based on an ethical foundation guided by the corporate governance principles to ensure compliance with reference to the King III and King IV codes.

2.8.2 Board composition and independence

The King IV Report (2016:40) states that the governing body should ensure that it comprises a balance of the skills, experience, diversity, independence, and knowledge needed to charge its role and responsibilities.

Regarding board composition, the King III Report (2009:11) recommends that there should ideally be a majority of non-executive, independent directors, because this reduces the possibility of conflicts of interest (Hendrikse & Hefer-Hendrikse 2014:201).

2.8.2.1 Board size

The size of the board is vital for the success of the board; the smaller the board, the more effective it will be in implementing decisions.

The International Finance Corporation's (IFC) *A Guide to Corporate Governance Practices in the European Union* (2015) discusses board diversity and structures.

Board structures are important to corporate governance as they affect the nature and extent of directors' powers, influence, and responsibilities, and may also affect the ability of a board to hold managers accountable for running the company.

The IFC further discusses that board structures in the European Union (EU) cannot easily be classified. Classification typically divides companies into dual systems of unitary (one-tier) and two-tier structures, or into three categories: one-tier, two-tier, and Nordic structures (IFC 2015:37).

2.8.2.2 Board composition

The IFC (2015:39) discusses the composition of boards and that they should include the types of directors, roles, and those who participate in different capacities on the board. The IFC (2015:39) discusses European boards, which range widely in all of the abovementioned categories. The table below indicates the types of boards in the EU.

Table 2.1: Board types in Europe

Country	Board type
Austria	Mandatory two-tier board structure.
Belgium	One-tier board or mixed structure.
Bulgaria	Choice between one-tier and two-tier board structure. One-tier boards predominate.
Croatia	Choice between one-tier and two-tier board structure. Two-tier boards predominate.
Cyprus	One-tier board structure (although company law does not contain mandatory rules to a company's board structure).
Czech Republic	Mandatory two-tier board structure.
Denmark	There is a legal choice between the Nordic model and the German two-tier board structure; however, no listed company uses the two-tier version.
Finland	There is a legal choice between the Nordic model and the German two-tier board structure.
France	Choice between one-tier and two-tier board structure. In addition, within the one-tier structure, the company may choose the président-directeur général (PDG) model, which combines the offices of the CEO and the COB. One-tier boards predominate.
Germany	Mandatory two-tier board structure.
Greece	One-tier board structure.
Hungary	One-tier boards predominate.

Country	Board type
Ireland	There is a legal choice between the Nordic model and the German two-tier board structure.
Italy	Only five listed companies use the two-tier version, and this number is decreasing (and the Finnish code advises against the use thereof). The choice of three different structures: traditional" a model with a board of directors and a board of statutory auditors, as well as a typical two-tier and a typical one tier system.
Latvia	Mandatory two-tier board structure.
Lithuania	Both supervisory board and/or board of directors are optional under Lithuanian law. One-tier boards predominate.
Luxembourg	Choice between one-tier and two-tier board structure. One-tier boards predominate.
Malta	One-tier board structure.
Netherlands	Choice between one-tier and two-tier board structure.
Poland	Mandatory two-tier board structure.
Portugal	Choice of three different board structures (a board of directors and an audit board, as well as typical two-tier and a typical one-tier system).
Romania	Choice between one-tier and two-tier board structure. Two-tier boards predominate.
Slovak Republic	Mandatory two-tier board structure.
Slovenia	Choice between one-tier and two-tier board structure. Two-tier boards predominate.
Spain	One-tier board structure.
Sweden	Nordic model.
United Kingdom (UK)	One-tier board structure (although UK company law does not contain mandatory rules as to a company's board structure).

Source: Adapted from the IFC (2015:40)

2.8.3 Board size of SOEs

Section 66(2) of the Companies Act sets the minimum number of directors required on a board, depending on the type of company and whether it is a public or a non-profit company or a private company or an SOE.

According to the IFC (2015:41), two-tier boards, by definition, will have 100% non-executive directors on their supervisory boards.

Heidrick & Struggles International Inc. (2014:41) identifies in a survey that Poland has the lowest proportion of non-executives on the listed boards in the EU, namely 59%. Table 2.2 indicates board sizes from a survey that was conducted in 2013.

Table 2.2: Board size

Country	Average no. of directors	Country	Average no. of directors
2013 EU average	12.3	Austria	11.8
Germany	17.0	Sweden	11.6
Spain	14.3	Switzerland	10.3
Portugal	14.1	Denmark	10.0
France	14.0	Netherlands	8.6
Italy	14.0	Norway	8.5
Belgium	12.5	Poland	8.3
UK	12.4	Finland	7.5

Source: Adapted from Hedrick & Struggles International Inc. (2014) and IFC (2015:41)

The survey revealed that the proportion of independent directors is a concept that cannot be precisely defined. The European Commission recommends criteria for determining independence but these are just guidelines. It is a matter for the board to determine whether a director is independent in character and judgement and whether there are any relationships or circumstances that could affect a director's judgement.

The validity of the criteria must be reviewed annually, and in practice the evaluation of the independent attitude should be more important than compliance with the detailed criteria.

The European Commission (2005:41,42) recommends the following criteria for an independent director:

- Cannot be an executive or managing director of a company or an associated company, or have been in such a position within the previous five years.
- Cannot be an employee of the company or an associated company, or have been in such a position within the previous three years, unless elected to the supervisory board as a worker director/representative.

- Cannot receive or have received significant additional remuneration from the company or an associated company apart from a fee received as a non-executive. Such additional remuneration covers in particular any participation in a share option or any other performance-related pay scheme; it does not cover the receipt of fixed amounts of compensation under a retirement plan (including deferred compensation) for prior service with the company (provided that such compensation is not contingent in any way on continued service).
- Cannot be a or represent the controlling shareholder(s).
- Cannot have or have had within the last year a significant business relationship with the company or an associated company, either directly or as a partner, shareholder, director, or senior employee of a body having such a relationship. Business relationships include the situation of a significant supplier of goods or services (including financial, legal, advisory, or consulting services), of a significant customer, and of organisations that receive significant contributions from the company or its group.
- Cannot be or have been within the last three years a partner or employee of the present or former external auditor of the company or an associated company.
- Cannot be an executive or managing director in another company in which an executive or managing director of the company is a non-executive or supervisory director, and not to have other significant links with executive directors of the company through involvement in other companies or bodies.
- Cannot have served on the board as a non-executive or supervisory director for more than three terms (or, alternatively, more than 12 years where national law provides for normal terms of a very small length).
- Cannot be a close family member of an executive or managing director of the company.

There may be differences depending on the country. Most of the boards of large European companies typically include a sufficient number of non-executive and independent directors to ensure the effectiveness of the board committees. For instance, the audit committee in other countries requires the majority of its members to be independent (IFC 2015:41). The boards of companies and SOEs take care to ensure that non-executive or independent appointees have sufficient time available to devote to the position (IFC 2015:41). The survey conducted for *A Guide to Corporate*

Governance Practices in the European Union (IFC 2015:41) argues that complying with the guide is important for chairing committees in terms of best practice.

When companies appoint directors, the letter of appointment should set out the expected time commitment (IFC 2015:41).

According to the IFC (2015:41), the non-executive or independent directors should be sure that they will have sufficient time to do what is expected of them. It further states that the board should disclose other significant commitments before the appointment; if there are any changes, the board should also be informed.

Board directors who service too many boards can interfere with the performance of board members (IFC 2015:41). SOEs and public companies must consider whether multiple board memberships by the same person are compatible with effective board performance (European Confederation of Directors' Association (ecoDa) 2010).

The IFC (2015:41) further explains the importance for the COB to facilitate the effectiveness of non-executive contribution and independent directors to ensure constructive relations between all the directors of the board.

Non-executive directors and independent directors should offer a constructive attitude that will help to develop proposals on strategy. Non-executive directors and independent directors should scrutinise the performance of management in meetings. They should agree on goals for the board and the board's objective should be to monitor the reporting of performance of the board committees and the board (IFC 2015:41).

It is advantageous for a board to include independent and non-executive directors. The following are some ways that can contribute to the board and its structures:

- Bringing an outsider perspective on the strategy and the control function.
- Adding new skills and knowledge to the board and to the committees of the board that may not be available within the company, whether it is an SOE or public company.
- Bringing an independent and objective view that shareholders may not have.

- Hiring and promoting decisions that are independent of family ties (IFC 2015:41).

The board should act as a balancing element between the different shareholders and in some cases serve as objective judges of disagreements among the family members or managers of the company.

According to a survey, the number of independent directors on boards increased from 29% in 2000 to 34% in 2010 (Ferreira & Kirchmaier 2013 cited in IFC 2015:42). The survey results show that both the sizes and performance of companies are positively related to board independence in European countries (IFC 2015:42).

A Guide to Corporate Governance Practices in the European Union discusses the proportion of boards where the CEO's and the COB's roles are combined. According to the IFC (2015:42), the proportion of boards with a combined CEO and COB varies among member states.

Heidrick & Struggles International Inc. (2014) reports that the Netherlands has the highest proportion of independent directors at 68%, while the UK, Germany, Sweden, and Poland have the lowest, with 0% (see Table 2.3). The survey found that 93% of directors of EU-listed companies think that it is important for the leadership of the board to encourage excellent team dynamics.

Table 2.3: Proportion of companies with combined CEO and COB

Country	% companies with combined CEO/COB	Country	% companies with combined CEO/COB
2013 European average	20	Belgium	10
Netherlands	68	Switzerland	5
Austria	65	Norway	5
France	65	Denmark	5
Spain	31	UK	0
Italy	18	Germany	0
Finland	15	Sweden	0
Portugal	13	Poland	0

Source: Adapted from Heidrick & Struggles International Inc. (2014) and IFC (2015)

Ferreira and Kirchmaier (2013 cited in IFC 2015) further discuss the important issue of employee participation on EU boards. Regarding their survey, Ferreira and

Kirchmaier state that the systems of employee participation varied widely in EU companies. In the German system, for example, employee representatives form 50% of the supervisory board in the companies. At the other end of the spectrum is the Dutch system of nomination and opposition rights, where employees are in effect restricted to make recommendations. The table below indicates board-level employee representation in Europe.

Table 2.4: Board-level employee representation in Europe

Country	Board-level representation	Country	Board-level representation
Austria	Yes	Italy	No
Belgium	No	Latvia	No
Cyprus	No	Lithuania	No
Czech Republic	Yes	Luxembourg	Yes
Denmark	Yes	Malta	Yes (public companies)
Estonia	No	Netherlands	Yes
Finland	Yes	Poland	Yes (public companies)
France	Yes	Portugal	Yes
Germany	Yes	Slovenia	Yes
Greece	Yes (public companies)	Spain	Yes(public companies)
Hungary	Yes	Sweden	Yes
Ireland	Yes (public companies)	UK	No

*At the time of the survey, Croatia was not a member of the EU.

Source: Adapted from Carly, Baradel & Welz (2011 in IFC 2015)

2.8.4 Board diversity of SOEs

Heidrick & Struggles International Inc. (2014) survey confirmed that board directors value diversity (cited in IFC 2015:44).

The survey results showed that 97% of directors of EU-listed companies believe that it is important for a board to have the right balance of skills, knowledge, and experience necessary to constructively challenge senior management (Heidrick & Struggles International Inc. 2014 cited in IFC 2015:44).

In 2010, a list of principles was published by ecoDa to help boards to achieve a balanced board composition. These principles are as follows:

- The board should not be so large as to be unwieldy. The balance of skills and experience should be appropriate for the requirements of the business. Changes to the board's composition should be manageable without undue disruption.
- There should be an explicit procedure for the appointment of new directors to the board.
- Appointments to the board should be made after careful examination against objective criteria.
- The board should satisfy itself that plans are in place for orderly succession for appointments to the board and to senior management. The aim is to maintain an appropriate balance of skills and experience within the company and on the board.
- The period of appointment of directors should be carefully considered. The board should balance the flexibility of open-ended appointments against the need to ensure planned and progressive refreshing of the board (ecoDa 2010 cited in IFC 2015:44).

Recent years have seen a growing focus on increasing board diversity. In South Africa it has also been on the government's agenda to increase board diversity in all SOEs ANC (2012:58).

According to the IFC (2015:44), the greater diversity of directors' backgrounds, skills, and experiences may enhance EU board effectiveness, bringing a wider range of perspectives and knowledge to deal with issues of the company's performance, strategy, and risk.

The IFC (2015:44) further argues that for far too long boards have been composed of male, frail (elderly), pale (white), and stale (not up-to-date) members, and that increasing diversity should be a major imperative for EU companies. In addition, the IFC argues for improving diversity of thought among board members and the avoidance of "group think" where views go unchallenged.

In South Africa, the first item on the agenda of the ANC is women empowerment and advancing women to higher levels of echelons; either in politics or in the government. The IFC (2015) indicated that there is a growing body of research that has shown that

gender diversity is positively associated with financial performance and shareholder value.

The IFC (2015:44) discusses the growing number of studies that show a link between more women in senior positions and companies' financial performance. McKinsey & Company (2010) reports that gender-balanced companies have 56% higher operating profit than male-only companies (IFC 2015:44).

Ernst and Young (2011 cited in IFC 2015:44) studied the 290 largest publicly listed companies and found that the earnings of companies with at least one woman on the board were significantly higher than those companies that had no female board members. It can be concluded that getting more women into the labour market is an important factor in improving economic competitiveness (IFC 2015:44).

Catalyst (2011) concurs with the argument that companies that have achieved diversity and managed it well attain better final results, on average, than other companies. Catalyst (2011) recommends using three measures – return on sales, return on invested capital, and return on equity – to examine financial performance. Catalyst (2011) found that on return on sales criteria, companies with the most female board directors outperformed those with the least by 16%. On return on invested capital criteria, Catalyst (2011) found that companies with the most female board directors outperformed those with the least by 26%.

Regarding companies with sustained high female representation, which Catalyst (2011) defined as those with three or more female board directors in at least four of five years, significantly outperformed those with sustained low female representation, by 84% on return on sales criteria, and 46% on return on equity criteria.

Research conducted by Ahern and Dittmar (2011) on the effects of the 40% female quota legislation introduced in Norway indicated that the effect of the female quota caused a drop in the stock market price at the announcement of the law and a decline in asset value over the following years. In addition, they discovered that the quota led to less-experienced boards and a deterioration in operating performance consistent with less-capable boards.

A study conducted by the Credit Suisse Research Institute in 2013 found that a sample of companies with women on their boards outperformed peers that lacked female directors by 26% over a period of six years (cited in International Corporate Governance Network (ICGN) 2013).

Adams and Ferreira (2008) found that firm profitability (as measured by return on assets) is positively related to the proportion of women on the boards of EU firms.

Board gender diversity improves firm performance; however, an equally plausible hypothesis is that more profitable and well-governed firms select more women to serve on their boards (IFC 2015:44).

According to Adams and Ferreira (2008), female directors have better attendance at board meetings, and male directors have better attendance when boards are more gender diverse. Other researchers noted that greater diversity is associated with more complex group dynamics in reaching consensus, and that there are higher expectations on the COB to organise an effective discussion (IFC 2015:45).

Adams and Funk (2009 cited in IFC 2015:45) reveal that female and male directors differ in their core values and risk attitudes. They found that female directors were more “benevolent” and “universally concerned” but less power orientated than men (IFC 2015:45).

Female directors were also found to be less traditional and less security orientated than their male counterparts and were slightly more open to taking risks than male directors. The research indicated that having women on the board did not necessarily lead to more risk-averse decision making (IFC 2015:45).

The research revealed that public demand strongly support better gender balance in EU boards. In a recent European opinion poll, 88% of respondents said that, given the same qualifications and skills, women should be equally represented in top business jobs, and 75% said they were in favour of legislative measures to enforce better gender balance (European Commission 2012 cited in IFC 2015:46).

Research conducted in 2012 indicated that only 15.8% of board members and 16.8% of non-executive board members of the largest companies were listed on stock

exchanges in the 27 member states of the EU. The research revealed that the European Commission proposed a directive that sets a minimum objective of 40% women in non-executive board member positions in listed companies in the EU by 2020, and by 2018 for listed public undertakings (European Commission 2012 cited in IFC 2015:46). The research also revealed that the directive is under scrutiny by the Council of the EU.

Table 2.5: Percentage of men and women leading large companies in the EU

Gender	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Men	98.4	97.4	96.9	96.3	97.1	97.0	97.0	96.6	97.3	96.8
Women	1.6	2.6	3.1	3.7	2.9	2.8	3.0	3.4	2.7	3.2

Source: European Commission (2012 cited in IFC 2015:46)

2.8.5 Appointment of directors

The first directors of a company are the incorporators of the company, and serve until such time as other sufficient directors who are not disqualified in terms of the Act are elected by the shareholders as per Section 67(1) of the Companies Act.

2.8.6 Removal from the office by resolution of shareholders

Section 71 of the Companies Act states that removal of a director shall be effected by an ordinary resolution of the shareholders and a director can be removed notwithstanding any provision that contradicts the company's Memorandum of Incorporation (MOI) or rules, or any contract that may exist between the company and that director, or between that director and any shareholders.

2.8.7 Memorandum of Incorporation (MOI)

The MOI is the constitution of the company that guides the directors on how the company should be operated and managed in the accordance with the Companies Act.

According to Davis and Mongalo (2014:41), the MOI is an important document that enables significant flexibility as to the relationship between a company and its

stakeholders. The MOI can therefore determine the rights, powers, and duties of all stakeholders, as well as the nature of the company (Davis & Mongalo 2014:41).

2.8.8 The state-owned “company” or enterprise

According to Section 1 of the Companies Act a “state-owned company” means an enterprise that is registered in terms of the Companies Act as a company, and either-

- (a) Falls within the meaning of “state-owned enterprise” in terms of the Public Finance Management Act, 1999 (Act No. 1 of 1999); or
- (b) Is owned by a municipality, as contemplated in the Local Government: Municipal Systems Act, 2000 (Act No. of 2000), and is otherwise similar to an enterprise referred to in paragraph (a).

A state-owned “company” (or enterprise, whose name ends with “SOC Limited”) is a profit-orientated organisation that is listed as a public entity according to either Schedule 2 or 3 of the PFMA (Davis & Mongalo 2014:35). Both schedules are, however, divided in different parts for specific reasons. National public entities receive funds from treasury via the budget as they are no-profit driven as opposed to business enterprises.

2.8.9 The public company

A “public company” means a profit company that is not a state-owned company, a private company or a personal liability company (Section 1 of the Companies Act). A public company can be listed (on a stock exchange) or unlisted (Davis & Mongalo 2014:35).

2.8.10 The private company

Section 1 of the Companies Act determines that a “private company” means a profit company that-

- (a) Is not a company or a personal liability state-owned company; and
- (b) Satisfies the criteria set out in section 8(2) (b) of the Companies Act.

2.8.11 The election of the Chair of the Board (COB)

The Companies Act refers to a COB in certain sections (such as Section 73 (5)(e), which deals with tied votes). The Companies Act does not specifically address the election of a COB. In case of a SOE the governing body should elect an independent non-executive member as chair to provide leadership to the board (King Report IV 2016:43).

The King III Report (2009:16) explains that the board should elect a COB who is an independent, non-executive director. It further states that the CEO of the company must not also fulfil the role of the COB.

The Companies Act does not address the appointment of a retired CEO becoming the COB; however, the King III Report states that a retired CEO should not become the COB until three years have passed since the end of the CEO's tenure as an executive director. After this period, the retired CEO may be considered for appointment as a non-executive director chairperson after an assessment of his/her independence.

2.8.12 The COB's role and functions

The Companies Act (2008:30) does not address the roles of the COB. The King III Report (2009:40.17) states that the role of the COB should be formalised to avoid conflict of interest and to ensure that the board remains the governance structure rather than being a technical board.

2.8.13 The board and director's independence

The total independence of an individual director is important. Board independence is essential for the board to act in the best interests of the shareholders. Directors must act independently regardless of the views or decisions of those who appointed them.

2.8.14 The tenure of board members

The Companies Act does not address the tenure of the board but the King III Report (2009:84) states that board balance should be sought between continuity in board membership that is subject to performance and eligibility for re-election, as well as

considerations of independence and the sourcing of new ideas through the induction of new board members.

2.8.15 Board of directors' rotation of non-executive directors

The rotation of directors should be structured so as to retain valuable skills in the company, to maintain and ensure continuity of knowledge and experience, and to introduce people with new ideas and expertise.

2.9 TYPES OF DIRECTORS FOR SOEs AND UMGENI WATER

In the case of SOEs, government could any time and in its own discretion remove and appoints directors. The Companies Act of 2008 recognises various types of directors. They are described in Table 2.6.

Table 2.6: Types of directors

Type of director	Characteristics
<i>Ex officio</i> director	An <i>ex officio</i> director is a person who holds another office.
MOI-appointed director	This director does not have to be appointed by shareholders.
Alternate director	Elected or appointed to serve, as per occasion.
Elected director	Fifty percent of directors must be elected by shareholders.
Temporary director	The memorandum provides for the appointment of a temporary director.

Source: Davis & Mongalo (2014:111-112)

2.9.1 Directors' ineligibility and disqualification

A director who has been prohibited in a court of law from becoming a director may not be appointed as the director of the company. Such a person has been declared to be delinquent by a court of law in terms of Section 162 of the Companies Act and in terms of Section 47 of the Close Corporations Act (No. 69 of 1984).

The following people are considered to be ineligible: a juristic person, an emancipated minor or person under a similar legal disability, or any person who does not satisfy the requirements in the MOI to serve as a director of the board (Davis & Mongalo 2014:131).

2.9.2 Board of directors' disqualification exemption to serve as a director of the company

The Companies Act, in Section 69(11), gives the court discretion to grant an exemption from being disqualified from appointment as a director. The following people can lodge an application to the court for such exemption to be considered: an un-rehabilitated insolvent, a person who was removed from the office of trust for dishonest misconduct, or a person who was convicted of a crime with an element of dishonesty (Davis & Mongalo 2014:133).

2.9.3 Director development

The challenge of developing and training directors of the board is of vital importance. It counters ineffective methods and procedures, and general ignorance of new techniques, aids, systems, management practices, and functions. It keeps the organisation ahead of market competitors. Training can also help the director to understand the political dynamics that might affect the company and also the relationship with other companies in the same market (King III Report 2009:42).

2.9.4 Board performance assessment

The assessment of board members to ensure that the board functions effectively and efficiently is of vital importance. Unsuitable directors should be removed or transferred.

It is recommended that directors of a company be assessed once a year. Appraisals must take place to ensure that hard work and good ethics are rewarded (King III Report 2009:44).

2.9.5 Remuneration of directors and senior executives

The remuneration of directors and senior executives in the company is very important. Money is not the only motivating factor; other motivational factors should also be considered. These might be found in Maslow's hierarchy of needs. High productivity levels are important and in times of low economic growth might protect the company from financial disaster (King III Report 2009:48).

2.9.6 Chairperson (COB)

The King II Report of 2002 refers to “chairperson”, while the King III Report of 2009 refers to “chairman” (Kneale 2012:104).

This is the non-executive director responsible for running the board of directors and the management and control of the performance of individual directors (Kneale 2012:104).

2.9.7 Chief executive officer (CEO)

The CEO of a company is the person responsible for the executive management of the company’s operations. As the title suggests, he/she is the senior executive in charge of the management team and to whom all other executive managers report (Kneale 2012:104).

This is an executive director who is responsible for the running and management of the company, the performance of the senior management of the company, and providing good individual top leadership (Kneale 2012:104).

2.10 COMPANY SECRETARY (CS)

The CS is the right hand of the board. He/she is the governance specialist and plays a vital role in providing advice individually and collectively to the board of directors. The CS is the secret safe of the board and guards confidential matters of the board.

The CS may or may not be an executive director of the company. The CS is also responsible for the smooth administration and functioning of the records of the board. Updating all legal and secretarial matters affecting the company is another duty of the CS (King III Report 2009:27).

The CS is appointed by the board to which he/she also reports. His/her role is to ensure that the board functions effectively. This entails providing the entire board and individual directors with detailed guidance as to the nature and extent of their duties and responsibilities and, more importantly, how such duties and responsibilities should be properly discharged in the best interests of the SOE and the shareholders (Department of Public Enterprises 2002:11).

The CS's role also entails the induction of new and inexperienced directors and, together with the chairperson of the board, developing mechanisms for providing continuous education and training for all board members in order to improve and maintain the effectiveness of the entire board (Department of Public Enterprises 2002:11).

According to Section 86 of the Companies Act, 2008 (Act No. 71 of 2008), a public company or SOE must appoint a CS irrespective of whether the appointment is compulsory in terms of the Act or voluntary in terms of a requirement in a company's MOI, as contemplated in sections 34(2) and 84(1)(c).

The CS is the right hand of the board. He/she is a governance specialist and plays a vital role in providing advice individually and collectively to the board of directors. The CS is the secret safe of the board and keeps confidential matters of the board (Cassim 2012:488).

Cassim (2012:489) explains that the CS is the gatekeeper of good governance, and that it is important for the CS to maintain an arm's-length relationship with the board of directors.

Cassim (2012:489) argues that the CS should not be a director of the company. The CS may or may not be an executive director of the company and is also responsible for the smooth administration and functioning of the records of the board. Updating all legal and secretarial matters affecting the company is another duty of the CS.

The responsibilities of the CS are to ensure that resolutions of the board are implemented and to guarantee that all decisions of the board are captured correctly. He/she keeps the documents of the company in a safe place that is limited in terms of access.

2.11 THE ROLE OF THE COB AND CEO

The executive authority should appoint one of the members of the board, who should preferably be an independent, non-executive director, as the chairperson of the board. The chairperson's responsibilities should, again, preferably be separate from those of the CEO. Where this, however, proves to be impracticable is when

the board must appoint an independent, non-executive director as a deputy chairperson to ensure that no one individual has unfettered decision-making powers.

The chairperson (COB) is the head of the board and his/her responsibilities include:

- ensuring that all the board members are fully involved and informed of any business issue on which a decision must be taken;
- ensuring that the executive directors play an effective management role and participate fully in the operation and governance of the SOE;
- ensuring that the non-executive directors monitor the business and contribute to the business decisions of the SOE;
- working closely with the CS in ensuring that at all times all the board members fully understand the nature and extent of their responsibilities as directors in order to ensure the effective governance of the SOE; and
- ensuring that the performance of the CEO is appraised on an annual or other more frequent basis as the SOE's circumstances may demand, either by the chairperson or a sub-committee appointed by the board (Department of Public Enterprises 2002:10).

2.11.1 The COB

The King II Report 2002:104) refers to a “chairperson” while King III Report refers to a “chairman”. In both these documents the terms refer to the same office, the COB.

The King III Report (2009) summarises the role of the COB as follows:

- The COB should be an independent non-executive director.
- The COB should preside at board meetings and manage conflicts of interest.
- The COB's role should be formalised in written form.

2.11.2 The CEO

The CEO of a company is the person responsible for the executive management of the company's day-to-day operations. He/she is the spokesperson of the company.

The CEO is also responsible for executive management, while the responsibilities of the COB relate primarily to managing the board of directors (Hendrikse & Hefer-Hendrikse 2014:335).

2.12 COMMITTEES OF THE BOARD

The committees indicated in paragraph 2.12.1 are considered the most important for SOEs. However, depending on the circumstances of each SOE, other committees of the board may be established as recommended in the King III Code of 2009 (Department of Public Enterprises 2002:15).

The Companies Act, in Section 72, provides that except to the extent that the MOI provides otherwise, the board of directors may appoint any number of board committees, and it may delegate any of the authority of the board to a committee (Davis & Mongalo 2014:142).

According to Davis and Mongalo (2014:143), Regulations 4(1) and 92 of the Companies Act provide that every SOE and every listed company must appoint a social and ethics committee.

According to the King III Report (2009:24), board committees with appropriate terms of reference may be appointed.

The King III Report (2009) requires that board committees should only consist of directors. An independent, non-executive director is required to be the chairperson of the audit and remuneration committees.

The King IV Report (2016:08) states that the governing body should ensure that its arrangements for delegation within its own structures promote independent judgement, and assist with balance of power and the effective discharge of its duties.

The board can appoint non-directors to a committee as long as they are not disqualified or ineligible.

2.12.1 Most important committees of the board

The Minister, in accordance with Regulation 43, can prescribe that a listed public company, an SOC Limited enterprise, or any other company that has in any two of the previous five years scored above 500 points in terms of Regulation 26(2) or would have scored so if the Act had been in effect at that time, are obliged to have a social and ethics committee as per the King III Report.

2.12.1.1 Audit committees

The King III Report (2009:56) states that the board and management of any company should be fully committed to the goal of supporting and maintaining an effective audit committee. The King III Report (2009:3) further states that the board should ensure that the SOE has an effective and independent audit committee.

The provisions of the Companies Act conflict with those of the PFMA regarding the election of the audit committee members. Section 3(3) of the PFMA regulates that if any conflict exists between the PFMA and another Act, the PFMA prevails.

Regulation 42 of the Companies Act states that at least one-third of the members of the company's audit committee must have academic qualifications or experience in economics, law, corporate governance, finance, accounting, commerce, industry, public affairs, or human resource (HR) management.

2.12.1.2 Remuneration committee

Remuneration committees are fundamental in the private sector. They exist to assist an organisation to ensure that it follows proper labour relations and promotes HR development, specifically that of top management. Remuneration committees does not exist in the public sector.

The King III Report states that the chairperson of the remuneration committee should be an independent, non-executive director (principle 2.23). The majority of the remuneration committee members should be non-executive directors of which the majority should be independent (principle 2.23.7).

2.12.1.3 *Nomination committee*

The King III Report (2009) specifies that all companies should have an audit and HR and remuneration committee, with any other committees as necessary (Kneale 2012:107).

It is important to note that a nomination committee does not have the authority to make new appointments; it simply carries out the search and makes the recommendation. Appointing new directors is a matter for the board, and decisions should therefore be made by the whole board (Kneale 2012:107).

In order for the board to operate effectively and efficiently, it should sub-delegate without completely abdicating its responsibilities as a board to avoid conflicting with the management where a board becomes a technical board instead of being a governance structure. Therefore the importance of appointing some of the board members to the nomination committee is vital for the board to function effectively and efficiently.

It should be taken into consideration that the chairperson of the nomination committee should be an independent, non-executive director (King III principle 2.23). The majority of the nomination committee members should be non-executive directors of which the majority should be independent (principle 2.23.7).

2.12.1.4 *Risk committee*

The risk committee of the board is important because it assesses the risk and threats that surround the company so that the board can implement mitigating strategies.

The risk management function is not a function of the sub-committee, but it is a function of the board. It is sometimes sub-delegated to the sub-committee to develop recommendations for the board. The board approves policies relating to risk management and is responsible for developing a risk register to search for identified high-risk areas.

The King III Report (2009) stipulates that the chairperson of the risk committee should be an independent, non-executive director (principle 2.23). The membership of the risk committee should consist of executive and non-executive directors (principle 4.3.2.2).

2.12.1.5 Social and ethics committee

The Companies Act requires the following companies to appoint a social and ethics committee (section 72(4) read with Regulation 43): SOEs; listed public companies; and companies that obtained a public interest score above 500 points in any two of the previous five years.

Subsidiary companies are exempt from the social and ethics committee requirements if their holding company has a social and ethics committee and the holding company's social and ethics committee performs the functions required by the Companies Act and Regulation 43(2)(a) (Kneale 2012:310).

These committees of the board are very important for those companies prescribed by Regulation 43 of the Companies Act. The social and ethics committees should comprise not less than three directors or prescribed officers of the company.

2.12.2 Board meetings

Section 73 of the Companies Act states that any director of Umgeni Water may call a board meeting at any time. The meetings of the board of directors are very important for the board to evaluate its responsibilities and to kept abreast of a company's activities and development.

The majority of directors must be present in person in a meeting, unless the company's electoral processes allow electronic communication before a vote can be called at the meeting.

The 2008 Act makes it possible to conduct boards meetings via electronic communication.

According to Mahony (2015:242), section 63(2) of the Companies Act states that, unless prohibited by its MOI, a company may provide for a shareholders' meeting to be conducted entirely by electronic communication or for one or more shareholders, or proxies of shareholders, to participate by electronic communication in all or part of a shareholders' meeting that is being held in person, as long as the electronic communication employed enables all persons participating in that meeting to

communicate directly with one another without an intermediary, and to participate reasonably effectively in the meeting.

2.12.2.1 *Electronic communications*

Every shareholders' meeting of a public company must be reasonably accessible within the Republic for electronic participation by shareholders, irrespective of whether the meeting is held in the Republic or elsewhere. All members must be able to communicate reasonably effectively and concurrently with one another without an intermediary (Mahony 2015:168).

The Companies Act makes it possible for the board to conduct meetings electronically if facilities, like video conferencing, is available.

2.12.2.2 *Notice of board meetings*

According to Mahony (2015:242), it is essential to issue a notice convening a meeting in order to inform participants of the event, what it is about, when, where, and at what time.

In the common law it has been confirmed that the accidental coming together of two or more people who had no intention to meet would not constitute a valid meeting (Mahony 2015:243).

In the case of *Barron v Potter* [1914] 1 Ch 895, two gentlemen were in conflict and if one called a meeting, the other simply refused to go. Mahony (2015:243) further states that this carried on and no business could be transacted. Eventually, Potter happened to see Baron on a railway platform and declared this to be a meeting, and made a proposal which Baron ignored but Potter voted in favour of.

Potter declared the resolution "carried" but when Baron heard of this, he applied to have the resolution set aside since it had not been taken at a proper meeting (no notice had been issued so therefore there was no intention to meet). The resolution was set aside.

No board meeting can be called or be convened without notice to all the directors. If all of the directors are present at a meeting and acknowledge actual notice of the

meeting or waive the notice of the meeting, the meeting may proceed, even if the company failed to give notice or when the notice given was defective.

Stein and Everingham (2011:212) require all types of companies to give their shareholders at least 14 days' written notice of a general meeting, other than an annual general meeting or a general meeting to consider a special resolution, both of which require at least 21 days' written notice.

No board meeting can be called or convened without notice to all the directors. If all the directors are present at a meeting and acknowledge the actual notice of the meeting or waive the notice of the meeting, the meeting may proceed, even if the company failed to give notice or when the notice given was incorrect.

2.12.2.3 Quorum at board meetings

One of the most misunderstood requirements is that of a quorum. The purpose of a quorum is to enable the meeting to legitimately pass resolutions that are binding on the total membership of the body (Mahony 2015:243).

The required minimum number of directors present at the meeting before a vote may be cast is called a quorum.

2.12.2.4 Voting at board meetings

Members in a meeting have general voting rights. These are voting rights that can be exercised at a general meeting of a company. Every person present at a meeting is entitled to vote. However, members have discretion to vote or to abstain from voting (Haupt & Malange 2010:19).

There are four ways of voting at meetings: by voice or acclamation, by show of hands, by count or division, and by poll or ballot (Haupt & Malange 2010:174).

Each director has one vote. The number of votes cast on a resolution is sufficient to approve a resolution at a board meeting with a quorum. In the event of a tied vote, the chairperson of the board can cast a deciding vote if the chair did not initially cast a vote.

2.12.2.5 Board meeting minutes and resolutions of the board

Bouwman (2015:280) states that it is a statutory requirement that all companies record minutes of the proceedings at all annual general meetings and shareholders' meetings.

Bouwman (2015) further explains that the minutes must be signed by the chairperson; it is generally accepted that this signature is *prima facie* evidence that the meeting has been properly constituted and conducted. According to the Companies Act, minutes have to be written, typed, printed, or lithographed in one of the official languages of the country and kept in specially bound books with sequentially numbered pages (Mahony 2015:280).

According to Haupt and Malange (2010:175), a resolution is a formal decision taken at a meeting or motion that is adopted by a majority vote of the meeting. The only way in which members can express the will of the company on any matter is by means of a resolution passed at a general meeting.

The CS is responsible for ensuring that discussions are recorded and that the resolutions of the board are executed. These minutes must be kept by the company and it is the responsibility of the chairperson to sign the board's minutes and resolutions.

2.12.2.6 Board and director evaluation

Director evaluation is the board's responsibility. The terms of reference and key areas for evaluating the board and its secretariat must be aligned with the approved strategic plan of the board. The King III Report (2009:12) states that the evaluation of the board is of vital importance to ensure that the board meets its objectives as stipulated in the board's approved strategic and annual performance plan.

2.13 CONCLUSION

This chapter outlined corporate governance development and key concepts of the corporate governance environment in South Africa. It provided an indication of the impact that these policies and procedures have on corporate governance. The moral

duties of the board of directors and the difference between the King III and King IV reports were also discussed.

The independence of directors as well as the legal environment in which they operate and the roles of the CS, the COB, and the CEO were put into perspective. Lastly, the role of the board and some of the most important committees were discussed.

The next chapter introduces the risk management process and indicates the impact it has on governance.

CHAPTER 3: EXISTING POLICIES AND PROCEDURES ON RISK MANAGEMENT

3.1 INTRODUCTION

The focus of this chapter is on existing risk management policies and procedures of SOEs. It will investigate the impact these have on good governance.

Although various committees were discussed in Chapter 2, the audit and risk management committees will be explained in more detail in this chapter. In this chapter the focus will also be on related policies and procedures. The concepts of compliance and risk form an integral part of governance and will also be explained in more detail.

All organisations face risks. The nature and severity of these risks vary from one company to another.

3.2 DEFINITION OF RISK MANAGEMENT

- The risk management process is concerned with the threats that might affect an organisation and which will require mitigation strategies after identification of those potential risks. The boards of SOEs should ensure that these enterprises have and maintain effective, ongoing risk assessment processes Department of Public Enterprises (2016:33).

According to the King IV Report (2016:5), risk is about the uncertainty of events, including the likelihood of such events occurring and their effect, both positive and negative, on the achievement of an organisation's objectives.

The King IV Report (2016:05) states that risk includes uncertain events with a potential positive effect on the organisation (i.e. opportunities) not being captured or not materialising.

3.3 THE GOVERNANCE OF RISK FOR SOEs

The board of an SOE should exercise leadership to prevent risk management from becoming a series of activities that are detached from the realities of an SOE's business.

The board of an SOE is responsible for the organisation's governance of risk through a formal process, which includes the total system and process of risk management. The board should show leadership in guiding the efforts aimed at meeting risk management expectations and requirements.

The board of an SOE must be able to disclose how it has executed the risk management process during the past financial year. Deviations from existing policies and legislation should be investigated thoroughly and be reported to the board (King III Report 2009:73).

3.4 THE ROLE OF THE BOARD OF DIRECTORS

The responsibility of the board is to ensure the soundness of risk management and to determine the company's overall risk tolerance and risk policies (Jackson & Stent 2016:4-14).

3.4.1 Responsibilities of the board of directors

An SOE must have a unitary board structure. It should represent a strong and independent element of the board. Independent directors must make up at least one-third of the board (King III Report 2009:75).

3.4.2 Expertise of the board of directors of SOEs

The board should comprise members with diverse backgrounds and skills, who as a professional group will provide an appropriate balance and diversity of skills, experience, gender, and knowledge to the company.

The board should have expertise, knowledge, and understanding of the risk management process and should not rely too much on the internal audit function (King III Report 2009:75).

3.4.3 Risk management policies

Risk management policies should be in place. The adoption of a good enterprise risk management policy helps an organisation to ensure that its desired objectives are achieved (Kneale 2012:104).

3.4.4 Risk appetite and risk tolerance

Companies must develop procedures and practices that will determine their levels of risk tolerance and risk policies (Kneale 2012:104).

3.4.5 Culture and risk of the organisation

The culture of an organisation will often link to the risk management plan of the organisation.

3.5 CORPORATE GOVERNANCE LINK TO RISK MANAGEMENT OF THE BOARD

According to the King III Report of 2009, it is the responsibility of the board of directors to look after the assets of the company and to protect the value of their shareholders' investment. This includes the duty to take measures to prevent losses through error, omission, fraud, and dishonesty. Control measures should also include an effective and efficient internal control system (King III Report 2009:14).

3.6 DETERMINATION OF BOARDS' LEVELS OF RISK TOLERANCE

The board and management should implement specific limits or tolerance levels that are aligned with the overall limits set by the board at business operational or functional units. The board as the centre of governance should continually monitor significant risks taken by management, and should satisfy itself that management decisions balance performance with the defined tolerance limits.

The board of an SOE must ensure that it understands the implications of risks taken by the management of the organisation in pursuit of returns, as well as the potential impact of risk taking on shareholders and relevant stakeholders (Jackson & Stent 2016:5-7).

3.7 ROLE OF THE RISK AND AUDIT COMMITTEES IN THE MANAGEMENT OF RISKS

The role of the risk and audit committees in the management of risks is determined by section 51(a)(i) and 51(a)(ii) of the PFMA. The establishment of the risk and the audit committees is also one of the most important responsibilities of the board as the centre of governance. The risk committee should identify risks early and continuously. One of the responsibilities of the risk committee is to assist the board in executing its responsibilities in regard with risk management.

The board, as the centre of governance, should establish the subcommittees and appoint members of the board to form the committee to review the risk management progress. The effectiveness of risk management activities, the most important risks facing the company, and the responses to address the most important risks should be monitored closely and consistently.

It is the responsibility of the board to assign this function to the audit committee and this must be done with careful consideration of the resources available to the audit committee to adequately deal with risk governance. The audit committee is supported by the internal audit function.

The composition of the risk committee should comprise a minimum of three members chosen from the board members of the company (Hendrikse & Hefer-Hendrikse 2014:14).

In terms of its functionality, the risk committee should convene at least twice per year and individuals reporting to the committee should provide it with sufficient information to effectively discharge its responsibilities (Hendrikse & Hefer-Hendrikse 2014:14).

3.8 RESPONSIBILITY FOR THE MANAGEMENT OF RISK

It is the responsibility of the board to delegate to management the responsibility to design, implement, and monitor the risk management plan of the company.

The management of the company is accountable to the board for all aspects relating to designing, implementing, and monitoring the process of managing risk and integrating it into the day-to-day activities of the company.

Multinational companies can appoint a chief risk officer (CRO) to assist in managing risk. The appointed personnel should have access to the board and make sure that there is regular interaction with the board on its strategic matters.

According to Von Wielligh, Prinsloo and Penning (2014:122), the board of the company should review the company's risk management plan at least annually against actual performance and it should be updated when necessary.

3.9 THE COMPONENTS OF INTERNAL CONTROL

The internal control system of the organisation consists of control methods and control procedures. The internal control function of the company is devised and enforced to ensure accountability as far as it is practical and given the circumstances (Jackson & Stent 2014:5)

3.9.1 Risk assessment function of SOEs

The risk assessment process involves assessing the likelihood and frequency of risks identified and estimating the potential impact if the risk were to occur (King III Report 2009:76).

3.9.2 Risk response function for SOEs

The board of an SOE should ensure that management considers and implements appropriate risk response policies (King III Report 2009:78).

3.9.3 Risk monitoring function for SOEs

The board of an SOE should ensure continuous risk monitoring by managers and should also provide oversight over the secretariat of the company to ensure that risk management is implemented. The board of an SOE should also adopt a risk monitoring strategy for the company (King III Report 2009:79).

3.9.4 Risk assurance function for SOEs

The board should receive assurance regarding the effectiveness of the risk management process. The management of the company should provide assurance to

the board that the risk management plan is integrated into the daily activities of the company (King III Report 2009:79).

The internal audit unit of the company should provide the board with a written assessment of the effectiveness of internal control and risk management. It should also not perform any of the functions or processes of risk management but should assist the board of the company in monitoring the risk management process in the company (King III Report 2009:79).

To ensure that the company's internal audit unit is independent of risk management, the two departments should report to each other and should preferably not report to the same executives (Von Wielligh *et al.* 2014:122).

3.9.5 The board's risk disclosure function for SOEs

The boards of SOEs should ensure that there are processes in place that enable complete, timely, relevant, accurate, and accessible risk disclosure to stakeholders. The board must disclose any current, imminent, or envisaged risks that may threaten the company's long-term sustainability. It must also disclose its views on the effectiveness of the company's risk management processes in the integrated annual report.

The board's statement in the integrated report must disclose for the period under review any undue, unexpected, or unusual risks it has taken in the pursuit of rewards, as well as any material losses and the causes of these losses (King III Report 2009:80).

3.9.6 Internal control objectives in the risk assessment process

The internal control objectives of the organisation should be defined so that the risk of failing to achieve the objectives can be properly identified, assessed, and responded to.

Objectives must be set for all departments and functions of an SOE, and the risks that threaten the achievement of the objectives can thus be identified, assessed, and responded to.

3.10 FINANCIAL REPORTING ON RISKS

The components of the internal control function in the risk assessment process are illustrated in Figure 3.1. Accurate information systems can support effective risk management.

Control activities can improve the control environment and the achievement of objectives. It can also improve the accounting system that is supposed to record and process only transactions and events that have occurred, that have been authorised, and that are recorded and processed accurately and completely (King III Report 2009:64).



Figure 3.1: Components of the internal control function in the risk assessment process

Source: Von Wielligh *et al.* (2014:122)

3.10.1 Adoption of the risk management plan for SOEs

The board of directors, as the centre of accountability and good governance and as the highest decision-making structure in the organisation, should adopt a risk management plan. The risk management plan of the organisation must be reviewed annually for the proper running of the organisation and to ensure effectiveness (King III Report 2009:36).

3.10.2 Risk disclosure for SOEs

The board of an SOE should ensure that there are processes and procedures in the organisation that will enable complete disclosure to the stakeholders of the organisation. It is the responsibility of the board to disclose and inform the stakeholders about current or imminent threats that might affect the running of the company. It is also the responsibility of the company to disclose its views on the effectiveness of the company's risk management processes in the integrated report of the company (King III Report 2009:39).

3.10.3 Risk assurance of SOEs

The senior management of the organisation or the executives of the company are accountable to provide the board, as the centre of governance, with assurance that it has implemented and monitored the risk management plan and that it is integrated in the day-to-day operations of the company.

The reports of the senior management of the board of directors must provide a balanced assessment of the key risks facing the company and the effectiveness of internal control for ensuring risk responses and interventions.

The board of the company must satisfy itself of management's appropriate application of risk management processes and the compliance of risk management policies and procedures in general.

The senior management or the executives of the company are also responsible to disclose the processes in place to improve the risk management maturity of the company.

The internal audit function of the company should provide independent assurance of low risks in relation to scarce financial and other resources. The internal audit function does not necessarily assume that the functions, systems, and processes of risk management are in place but provides an important element of independence assurance to the board on the integrity and robustness of the risk management processes of the company (King III Report 2009:38).

3.10.4 Risk-monitoring strategy of SOEs

It is the responsibility of the board to ensure continual risk monitoring by the management of the company. The board of the company should ensure that management monitors the risk management plan effectively and continually (King III Report 2009:38).

3.10.5 Risk response for SOEs

The board of the company should ensure that the senior management of the company considers and implements appropriate risk responses (King III Report 2009:38).

3.11 CONCLUSION

The governing body should manage risks and threats in such a way that it supports the organisation in achieving strategic objectives. Risk management policies should be in place, including an internal audit function that ensures that risks and threats are kept as low as possible. Compliance with an effective risk management policy and constant monitoring by top management can contribute to protecting scarce financial resources.

The next chapter will discuss the research methodology, procedures, and planning of this empirical study. The chapter will also include the methods employed throughout the research, the methods used for the collection of data, the data analyses, the paradigm the researcher has chosen to describe the governance framework phenomenon, as well as the ethical considerations of the research. The chapter will further discuss the types of interviews the researcher employed throughout the research process.

CHAPTER 4: METHODOLOGY, PROCEDURES, AND PLANNING OF THE EMPIRICAL STUDY

4.1 INTRODUCTION

The previous chapter explained the existing risk management policies and procedures of SOEs. It also investigated the impact these have on good governance with reference to the King III and King IV codes.

It further discussed how the governing body should manage risks and threats in such a way that it supports the organisation in achieving strategic objectives. Risk management policies should be in place, including an internal audit function that ensures that risks and threats are kept as low as possible. Compliance with an effective risk management policy and constant monitoring by top management can contribute to protecting scarce financial resources.

This chapter focuses on the research methodology, the procedures, and planning of the empirical study employed in this research. It further explains the research phases, the methods used to gather information or data, and the procedures followed in the administration and coordination of the research instrument.

4.2 THE RESEARCH METHODOLOGY AND RESEARCH DESIGN

The researcher opted to utilise questionnaires and interviews for the collection of data.

Qualitative research can, theoretically speaking, be described as an approach rather than a particular design or set of techniques. Van Maanen (1979:520) further defines qualitative research as an “umbrella phrase covering an array of interpretive techniques which seek to describe, decode, translate, and otherwise come to terms with the meaning of naturally occurring phenomena in the social world”.

Therefore, the qualitative approach is also fundamentally a descriptive form of research.

Qualitative research is based on flexible and explorative methods because it enables the researcher to change the type of data being collected progressively so that a deeper understanding of what is being investigated can be achieved.

This research is mainly pragmatic in that it will seek to draw conclusions based on the data that will be collected from the interviews.

The researcher opted to use the ethnographic methods applied by cultural and social anthropologists in their field studies of social groups and communities. These approaches have been adopted and adapted by sociologists, psychologists, and educationists, among others, and are often referred to as qualitative research approaches (Welman & Mitchell 2005:193).

The ethnography approach can be described as an essentially descriptive design which is used in investigations among individuals or groups within a given community. The community in this study refers to the corporate governance community.

4.2.1 Questionnaires

The field of questionnaire design is vast. According to Cohen, Manion and Morrison (2013:317), questionnaires will always be an intrusion into the life of the respondent, be it in terms of time taken to complete the instrument, the threat levels or sensitivity of the questions, or the possible invasion of privacy.

According to Cohen *et al.* (2013:320), there are several kinds of question-and-response modes in questionnaires; including, for example, dichotomous questions, multiple-choice questions, rating scales, constant sum questions, ratio data, and open-ended questions.

Cohen *et al.* (2013:320) emphasise that if a site-specific case study is required, then qualitative, less structured, word-based, and open-ended questionnaires are more appropriate as they capture the specificity of a particular situation. Open-ended questions are useful if the possible answers are unknown or the questionnaire is exploratory (Bailey 1994:120), or if there are so many possible responses that a closed-ended question would contain an extremely long list of options.

The advantages of questionnaires enable respondents to answer as much as they wish, and are particularly suitable for investigating complex issues to which simple answers cannot be provided.

The researcher chose to employ questionnaires as one of the instruments for data collection. Questionnaires were emailed to the board of directors and senior management of Umgeni Water.

4.2.2 Interviews

Interviews are an important factor in the collection of data. According to Cohen *et al.* (2013:348), interviews are a flexible tool for data collection, which enable multi-sensory channels to be used; namely verbal, non-verbal, spoken, and heard.

Cohen *et al.* (2013:348) further emphasise that the order of the interview may be controlled while still giving space for spontaneity, and the interviewer can press not only for complete answers but also for responses about complex and deep issues. In short, the interview is a powerful instrument for researchers.

On the other hand, researchers using interviews must be aware that they are time consuming, they are open to interviewer bias, and they may be inconvenient for respondents (Cohen *et al.* 2013:348).

Dyer (1995:56-58) states that an interview is not an ordinary, everyday conversation. For example, in contrast to an everyday conversation, it has a specific purpose. It is often question based, with the questions being asked by the interviewer; the interviewer alone may express ignorance (and not the interviewee), and the responses must be as explicit and often as detailed as possible.

The interview is a constructed rather than naturally occurring situation, and this renders it different from an everyday conversation; therefore the researcher has an obligation to set up and abide by the different rules of the game in an interview (Cohen *et al.* 2013:348).

Interviews have important functions or purposes in the wider context of life. These functions or purposes vary; for example:

- to evaluate or to assess a person in some respect;
- to select or to promote an employee;
- to effect therapeutic change, as in a psychiatric interview;
- to test or to develop hypotheses;
- to gather data, as in surveys or experimental situations; and
- to sample respondents' opinions, as in doorstep interviews (Cohen *et al.* 2013:350).

In this study, telephonic interviews were conducted with an identified audience. The researcher recognised the value of the telephonic interview as the most important method of data collection, although it is common practice in a survey research.

One disadvantage of telephonic interviews is that they do not feel like interviews, as the parties involved are deprived of several channels of communication and establishment of a positive relationship. On the other hand, telephonic interviews are sometimes cheaper and quicker than face-to-face interviews. They also enable researchers to select respondents from a much more dispersed population than if they have to travel to meet the interviewees. Travel costs are also limited or omitted, and the response rate is higher than, for example, with postal questionnaires (Cohen *et al.* 2013:379).

4.2.2.1 Types of interviews

Le Compte, Milloy and Preissle (2009:352) discuss that the type of interview chosen is frequently a function of the sources utilised. They identify six types of interviews: standardised interviews, in-depth interviews, ethnographic interviews, elite interviews, life history interviews, and the focus group.

Bogdan and Biklen (2007) add semi-structured interviews and group interviews to this list; Lincoln and Guba (1996) add structured interviews; while Oppenheim (1992:65) adds exploratory interviews. Patton (1980:206) outlines four types of interviews; namely informal conversational interviews, interview guide approaches, standardised open-ended interviews, and closed quantitative interviews.

The researcher opted to employ standardised open-ended interviews because they have the exact same wording and the sequence of questions is determined in advance. All interviewees are asked the same basic questions in the same order. The strength of the open-ended interviews is that respondents answer the same questions, while their weakness is that they offer little flexibility in relating the interview to particular individuals and circumstances (Patton 1980:206).

4.3 QUALITATIVE DATA ANALYSIS

Cohen *et al.* (2013:461) state that qualitative data analysis involves organising, accounting for, and explaining the data. In short, it makes sense of data in terms of a participant's definitions of the situation, and notes patterns, themes, categories, and regularities.

Cohen *et al.* (2013:341) further explain that qualitative data analysis is often heavily focused on the interpretation of the information; one must note that there are frequently multiple interpretations of qualitative data.

The researcher opted for analysing the data by employing grounded theory and content analysis, which involved a number of systematic series of analyses, including coding and categorisation, until theory emerged that explained the phenomena being studied or that could be utilised for predictive purposes.

Cohen *et al.* (2013:462) further explain that qualitative data analysis often focuses on smaller numbers of people than quantitative data, yet the data can be detailed and rich. The researcher organised data analysis by individual, the total responses of a single participant were presented, and then the analysis moved to the next individual.

4.4 VALIDITY IN QUALITATIVE RESEARCH

Validity is an important key to effective research; if a piece of research is invalid, then it is worthless (Cohen *et al.* 2013:132). Validity is thus a requirement for both quantitative and qualitative research. In qualitative data, validity might be addressed through the honesty, depth, richness, and scope of the collected data, the participants approached, the extent of triangulation, and the disinterestedness or objectivity of the researcher (Cohen *et al.* 2013:132).

In qualitative data the subjectivity of respondents, their opinions, attitudes, and perspectives contribute to a degree of bias. Validity should then be seen as a matter of degree rather than as an absolute state (Cohen *et al.* 2013:132).

The researcher explored descriptive validity (the factual accuracy of the account that is not made up, selective, or distorted) during the validation of data; in this respect the researcher sees that validity subsumes reliability of what happened in that particular situation (actual factor).

4.5 RELIABILITY IN QUALITATIVE RESEARCH

Qualitative research reliability can be regarded as a fit between what researchers record as data and what actually occurs in the natural setting that is being researched. Cohen *et al.* (2013:148) state that inter-rater reliability is conducted where the researcher and another observer with the same theoretical framework and observing the same phenomena would have interpreted it in the same way.

4.6 RELIABILITY AND VALIDITY OF QUESTIONNAIRES

The validity of questionnaires can be seen from two viewpoints: whether respondents who have completed questionnaires did so accurately, honestly, and correctly; and whether those who failed to return their questionnaires would have given the same distribution of answers as returnees who did (Cohen *et al.* 2013:156).

The question of accuracy can be determined by means of the intensive interview method, a technique consisting of 12 principal tactics that include familiarisation, temporal reconstruction, probing, and challenging (Cohen *et al.* 2013:156).

4.7 VALIDITY AND RELIABILITY OF INTERVIEWS

Silverman (1993:12) suggests that it is important for each interviewee to understand the question in the same way. He suggests that the reliability of interviews can be enhanced by careful piloting interview schedules, training interviewers, inter-rater reliability in the coding of responses, and the extended use of closed-ended questions.

Silverman (1993:142) further emphasises the importance of the open-ended interview, as it enables respondents to demonstrate their unique way of looking at the world –

their definition of the situation. It recognises that what is a suitable sequence of questions for one respondent might be less suitable for another, and open-ended questions enable important but unanticipated issues to be raised.

To ensure the reliability of the data, the researcher considered the causes of biased interviewing, biased sampling (sometimes created by a researcher not adhering to sampling instructions), poor rapport between interviewer and interviewee, changes to the wording of questions (questions were not changed to avoid bias), and poor handling of difficult questions (Cohen *et al.* 2013:150).

4.8 DATA TRIANGULATION

Triangulation can be defined as the use of two or more methods of data collection in a study of some aspect of human behaviour (Cohen *et al.* 2013:140).

The use of a multi-methods approach, as it is sometimes called, contrasts with the ubiquitous but generally more vulnerable single-method approach that characterises so much of research in the social sciences (Cohen *et al.* 2013:141).

In its original and literal sense, triangulation is a technique of physical measurement: maritime navigators, military strategists, and surveyors, for example, use (or used to use) several locational markers in their endeavours to pinpoint a single spot or objective. By analogy, triangular techniques in the social sciences attempt to map out, or explain more fully, the richness and complexity of human behaviour by studying it from more than one standpoint and, in so doing, making use of both quantitative and qualitative data (Cohen *et al.* 2013:141).

The use of triangular techniques, it is argued, will help to overcome the problem of “method-boundedness” (Cohen *et al.* 2013:142).

Gorard and Taylor (2004) demonstrate the value of combining qualitative and quantitative methods but the researcher in this case opted for single-method qualitative research.

In this study, the researcher chose investigator triangulation to achieve valid results. This type of triangulation engages more than one observer, therefore data are discovered independently by more than one observer.

The researcher opted to use data triangulation to ensure validity of the results. Campbell and Fikse (1959:56) define triangulation as a powerful way of demonstrating concurrent validity, particularly in qualitative research.

4.9 ETHICAL CONSIDERATIONS

There are numerous ethical issues that should be considered while conducting this research. Saunders, Lewis and Thornhill (2012:231) explain that in order to be ethical, the rights of respective parties should be considered and respected and the data gathered must remain confidential.

Saunders *et al.* (2012:232) further state that it is necessary to provide the necessary acknowledgement when information is used from other authors. The use of sources in this research has been clearly referenced where applicable in order to provide the necessary acknowledgement.

Saunders *et al.* (2012:245) state that the privacy of individuals can be protected by withholding their names or any unnecessary data that could lead to the identification of the person.

The participants were informed of the purpose and nature of the study before the interviews and consent was granted by the participants to take part in the interviews. There were no promises of compensation regarding participation in the interviews.

The participants were informed that any information shared would be kept confidential between the interviewer and interviewees.

The participants were assured of their right of their privacy, and that they would be protected from harm, whether physical or emotional.

The researcher was well aware that he should guard against manipulating respondents or treating them as objects or numbers rather than individual human beings.

The researcher took into consideration that he should not use unethical tactics and techniques of interviewing.

4.10 CONCLUSION

In this chapter the methodology, procedures, and planning of the empirical study were discussed, as well as the methods employed throughout the research, the methods used for the collection of data, and the data analysis. It further discussed the paradigm the researcher chose to describe the governance framework phenomenon. It also discussed the ethical considerations that the researcher had to consider when conducting the research. The chapter further discussed the types of interviews the researcher employed throughout the research process.

The next chapter will summarise the findings and results of the empirical study. The study will summarise the findings on the key elements of the corporate governance framework and the board of directors, the composition of the board and risk committee, and the appointment and performance evaluation of the CEO.

The chapter will further discuss the findings on the board appointment process and terms of the board, and the committees of the board, namely the audit, remuneration, and social ethics committees.

CHAPTER 5: SUMMARY OF THE EMPIRICAL FINDINGS

5.1 INTRODUCTION

There is no economy that can be successful and productive without adequate water for human consumption, therefore water is critical for the economy of the country and for sustainable socio-economic development and the eradication of poverty in communities. Water also contributes towards mining, agriculture and irrigation.

In order for the economy to support a transforming governance framework for SOEs, especially those entities that currently fall under the national DWS, the SOE needs to strengthen its governance structures.

It is essential for the boards of these entities to function properly to fulfil the mandate of the DWS as per the Water Services Act and the Constitution.

Corporate governance becomes a very important tool for measuring the performance and compliance of the water utility's board. Transforming the corporate governance of SOEs requires total, collective commitment of the board to achieve the stated goals as per the approved strategic and annual performance plan for the board.

Corporate governance does not only deal with the compliance issues, but also good corporate governance principles and characteristics, such as transparency, commitment, accountability, fairness, and the openness of the board. At all times it will be required of the board to subscribe to good principles to deliver high-quality corporate governance to the organisation.

The legislative mandate ensures that the country's water resources are protected by the Water Act of South Africa. The transformation of the corporate governance framework plays a significant role in the provision of water and sanitation services by the board. If it is dysfunctional, it will not be able to fulfil the mandate of the DWS.

One of the functions of a water board is to provide water services to other water services institutions in municipalities in the areas in which they operate. There are currently 15 water boards in South Africa. In terms of capacity and strength, some of these

water boards perform other activities within the ambit of the Water Services Act of 1997. These water boards require strong corporate governance structures and functional structures.

5.2 SUMMARY OF EMPIRICAL FINDINGS

5.2.1 Chapter 1 review: Research background and motivation

Chapter 1 provided the actuality and motivation of the research, the problem statement, the aim of the study, the methodology, and the layout of the research.

The chapter firstly discussed the state as the shareholder and regulatory functions of the SOEs. Secondly, the role of the Minister, the Cabinet, and Parliament as shareholders was highlighted. Thirdly, the role of the state as the shareholder of SOEs was emphasised.

The study found that the state should streamline the best practices and legislation under which SOEs should operate. The study also found that the independence of SOEs is very important and that the government should also allow SOEs to have full operational self-governance in order to achieve their defined objectives.

The objective of the research was to explore and investigate the governance framework with specific reference to the King III and King IV codes. The research answered questions raised in Chapter 1 regarding the role of the state in SOEs with the aim of improving the governance framework of Umgeni Water.

5.2.2 Chapter 2 review: Conceptualisation of the legal environment

The first part of Chapter 2 dealt with the development of corporate governance and the key concepts of the corporate environment. The second part dealt with the legal environment with specific reference to the Companies Act and the PFMA. The difference between King III and King IV also received attention in par.2.5. The contributions of the board of directors, the CS, the COB, and the CEO towards the achievement of the objectives of organisations are important and were analysed. The focus was on the most fundamental corporate governance practices and principles.

The research discussed corporate governance development, and concepts of the corporate governance environment for SOEs in the public sector. The study found that the moral duties of the board of directors are important. The study further attempted to answer important questions relating to the appointment and removal of directors, the election of the COB, the COB's role and functions, the tenure of board members, and the board's performance assessment framework. The study discovered the importance of appointing the CS as a specialised governance professional in the board.

This chapter concluded that board committees are important arms for a board to function effectively. The chapter outlined corporate governance development and key concepts of the corporate governance environment in South Africa.

The aim and objectives of the research were to explore and investigate the governance framework for the SOEs with specific reference to the King III and King IV codes.

5.2.3 Chapter 3 review: Existing policies and procedures on risk management

The focus of this chapter was on existing risk management policies and procedures of SOEs, and the impact these have on good governance. Although various committees were discussed in Chapter 2, the audit committee and risk management committee were explained more fully. In this chapter, the focus was also on related existing policies and procedures. The concepts of compliance and risk form an integral part of governance and were also explained in more detail.

All organisations face risks. The nature and severity of these risks vary from one company to another. The role of the board in the management of risks, the risk committee, and the responsibilities of the board in managing the risks were discussed. The research discovered that the responsibilities were applied correctly.

The chapter concluded by finding that the governing body should manage risks and threats in such a way that it supports the organisation in achieving its strategic objectives. The research also found that risk management policies should be in place, including an internal audit function to ensure that risks and threats are kept as low as possible.

5.2.4 Chapter 4 review: Methodology, procedures, and planning of the empirical study

Chapter 4 focused on the research methodology, the procedures, and planning of the empirical study employed in this research. This chapter further explained the necessary research phases, the data-collection technique used to gather information or data, and the procedures followed in the administration and coordination of the research instrument. This chapter also attempted to answer the questions set out in Chapter 1 of the research.

The main objective of the research was to explore and to investigate the governance framework of Umgeni Water. The research methodology comprised a qualitative description, explanation, and investigation of governance framework structures, and different procedures and processes of qualitative data collection that were employed to collect data for the empirical research.

5.2.5 Chapter 5 review: Findings of the empirical study

Chapter 5 summarises the findings and results of the empirical study. The study summarised findings on the key elements of corporate governance framework, boards of directors, the composition of the board, the risk committee, and the appointment and performance evaluation of the CEO.

The chapter further discusses the findings on the board appointment process and terms of the board, and the committees of the board, namely the audit committee, risk committee, HR and remuneration committee, and social and ethics committee.

The research aimed to answer the research questions as presented in Chapter 1. The process of appointing the CEO, the outcomes from the respondents regarding the audit committee composition, the terms of reference of the audit committee, HR and remuneration committee, and the social and ethics committee's composition are also discussed with the aim of improving governance structures.

During the research process, the study revealed gender parity; namely that females are well represented on the board. The research also revealed that inequality exists among board members in terms of race. The research revealed that companies

represented on the board by female members performed very well in terms of financial performance compared to those represented by male board members.

5.2.6 Chapter 6 review: Summary, recommendations, and conclusions

This chapter provides the summary, recommendations, and conclusion of the research conducted. This chapter also discusses the recommended corporate governance elements required to strengthen corporate governance of the SOEs. These elements are specified in the King III and King IV corporate governance codes, the PFMA, and the Companies Act. These elements, the board and directors, the appointment of directors, the term of office for the directors, the composition of the board, the role of the board, the board committees, and the performance and appointment of the CEO are discussed.

5.3 THE RESEARCH'S POSSIBLE LIMITATIONS

There are many possible limitations when a researcher conducts research. Sometimes these limitations have negative and/or positive impacts. It depends on the circumstances that influence the environment.

One of the limitations the researcher identified was that questionnaires were ignored and some of the questionnaires were submitted incomplete. This had an impact on the findings of the research.

The researcher attempted to reduce the possible limitations to an acceptable level and gave the participants an extension to the time framework for the return of the questionnaires. It was sometimes time consuming for the researcher to collect the data from the respondents.

The researcher extended the timeframe for the interviews with the selected participants due to the participants' commitment to other activities. He also extended the timeframe to include the CFO of the board.

5.4 MAJOR FINDINGS OF THE RESEARCH

5.4.1 Composition of the board

The boards of companies have different types of board models and types of board sizes and compositions. The number of independent and non-executive directors also differs in terms of the skills and competencies that contribute to the effectiveness of the board in making decisions. Companies are required in terms of the prevailing legislative requirements to adhere to the legislative requirements.

Umgeni Water considered a mixture of the skills and competencies of non-executive directors and directors when building a competent board of directors. During the assessment process, the results from the interviews conducted with the board secretariat revealed that directors must complement one another and must come from different disciplines, either from legal, accounting, HR, or relevant specialisations. It depends on the company's area of operation; in this case water and sanitation practitioners.

Umgeni Water appointed 13 board members to support the activities of the board and to fulfil its mandate to provide water and sanitation services. Umgeni Water adopted a unitary board structure. The board consists of the executive and 12 non-executive directors.

The research process revealed that the unitary board structure is responsible for all aspects of the corporate activities, and all the directors have responsibilities to ensure the success of the institution. The shareholders elected the directors at the annual general meeting.

Umgeni Water reports to the Minister of Water and Sanitation, as guided by the Water Services Act.

The study revealed that in terms of the Water Services Act, the SOEs that fall under Water and Sanitation are mandated to include in their boards a CEO but not a CFO. The Companies Act and King III and King IV codes state that SOEs appoint a CFO and a CEO.

Figure 5.1 reflects that Umgeni Water’s board is composed of 42% of non-executive directors and 58% executive directors.

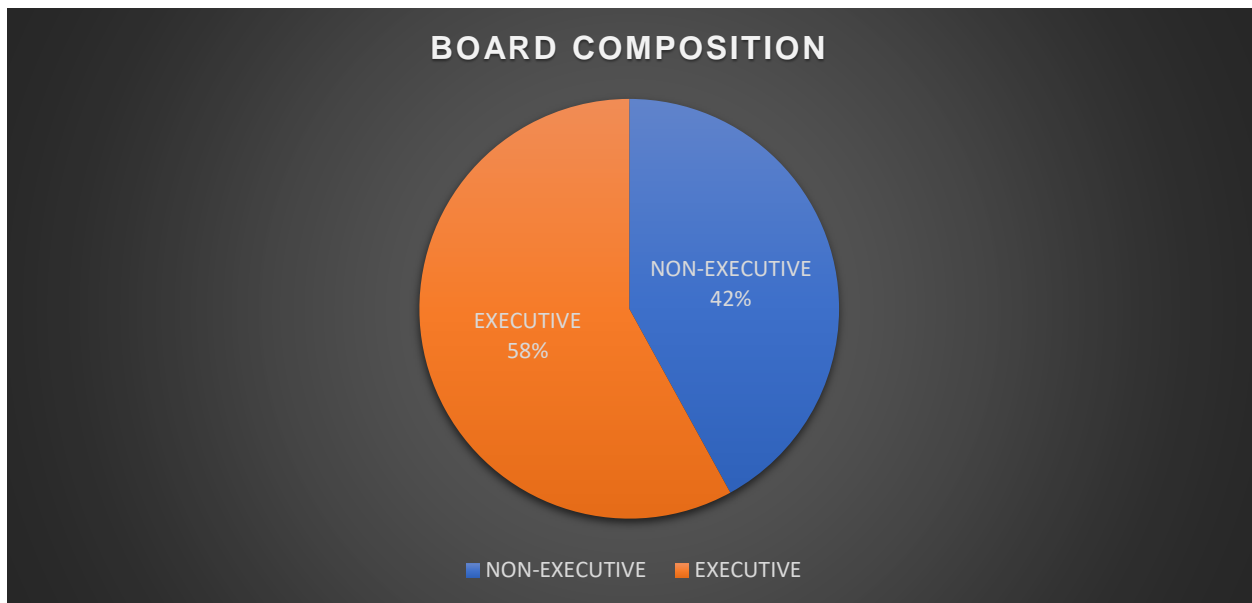


Figure 5.1: Umgeni Water board composition

Source: Umgeni Water 2016:39

Figure 5.2 represents the board’s gender profiling. The 2015/2016 annual report for the board reflects that the board has the following inclusions in terms of addressing gender parity with the aim of improving governance framework: 38% (5) of the females presented on the board following 62% (8) of male representation in the board.

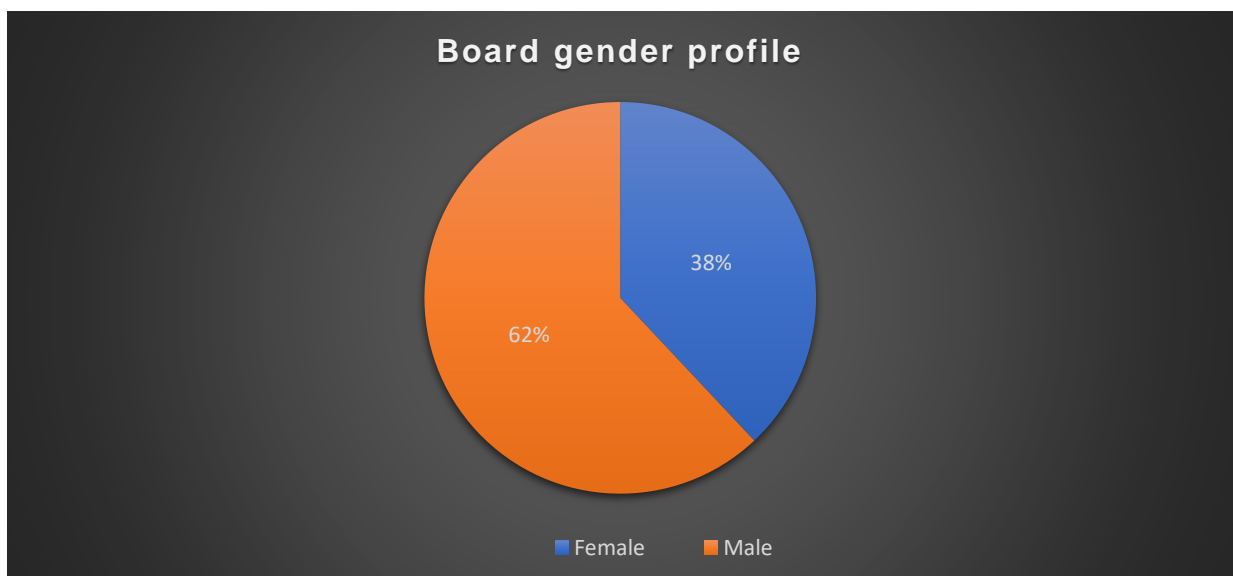


Figure 5.2: Umgeni Water board gender profile

Source: Umgeni Water 2016:39

5.4.2 Appointment of the CEO

The questionnaire that was forwarded via email to the board's secretariat and the interviews conducted both confirmed that although Umgeni Water is responsible for the appointment of the CEO, the board of directors delegated this responsibility to the HR and remuneration committee. This committee also deals with all board recruitments and is chaired by an independent, non-executive director. It has terms of reference and it makes recommendations to the board.

The nomination and appointment of board members is the Minister's responsibility. The nomination and appointment of board members are also important responsibilities in the organisation to strengthen the corporate governance framework. Umgeni Water has a process of appointing a CEO; however, there is no legislative framework for the appointment of a CEO.

The CEO is an executive board member. He/she reports to the board and sits at the board meetings in terms of the King III and King IV codes in order to liaise between the board and the senior management of the institution.

Figure 5.3 reflects the process adopted by Umgeni Water in terms of the appointment of a CEO.



Figure 5.3: CEO appointment process

Source: Umgeni Water 2016:39

After the assessment of Umgeni Water’s recruitment policies and procedures, the HR and remuneration committee reviews the organisational structure. The committee receives applications for the CEO position and matches them with the company’s requirements. It follows with a screening process of all applications, verification and conducting background checks, and the committee makes final recommendations to the board for approval to conduct interviews with the shortlisted candidates.

The corporate HR department makes an offer to the candidate who scored the highest marks during the interview. The corporate HR department structures the remuneration package as per the directive of the HR and remuneration committee’s approved policies.

5.4.3 Performance evaluation of the CEO

Board evaluations are a major challenge for the board members. The process of evaluating board members can be very easy if the company appoints facilitators to avoid conflicts and victimisation.

The CEO assessment process should be based on a number of leading international practice principles. The CEO performance assessment should be in line with the strategic objectives of the organisation.

The performance evaluation of the CEO and other senior members of the company is very important for the company to measure its performance in terms of the skills that it possesses. Key result areas should be covered in the evaluation process.

In the assessment of HR, the study found that policies are in place that deal with HR matters that cut across the organisation. There is no policy or legal framework for the performance evaluation of the CEO, therefore Umgeni Water has not complied with the King III and King IV codes' principles.

5.4.4 The term of the board

The following results were revealed from the assessment of the board's documents and procedural manual, the Companies Act, the interviews conducted, and the questionnaires forwarded to the board and to the board's secretariat:

Umgeni Water follows the Companies Act and the recommendations of the King III and King IV codes, as indicated in Chapter 6 of this mini-dissertation. The term of the board expires when the members of the board cease to be members.

The study also revealed that the board expires when it is dissolved by the Minister of Water and Sanitation. The Water Services Act empowers the Minister to appoint and dissolve the board.

The term of the board expires when board members resign or become incapacitated and unable to discharge fiduciary responsibilities as the board requires. There is no legislative framework in place that provides for the term of the board, and the annual report only addresses the disqualification and ineligibility of directors to serve on the board. Umgeni Water has a process in place for the term of the board, therefore, in this case, Umgeni Water complies with the legislative requirements.

5.4.5 Board committees

The establishment of board committees according to Section 72 of the Companies Act is important for the board. This enables the board to function effectively and being able to implement board decisions. Personal interviews were conducted with participants and questionnaires were forwarded via email, which covered, among others, one of the most important corporate governance elements, namely board committees.

The findings from the data collected through the data-collection instruments revealed that Umgeni Water has established five committees of the board to strengthen the board and to delegate, according to Section 72(1)(b) of the Companies Act, some functions to (but not the responsibilities) the committees. One of those functions is the adoption of policies. Umgeni Water has done so to implement the process of appointing board committees.

The results of the study on the governance framework for Umgeni Water revealed that the board also established other committees of the board, such as the governance committee, which comprises chairs of committees. The assessment and investigation revealed that the governance committee is responsible for the monitoring and evaluation of the activities of the committees and board targets are achieved as per the approved Strategic Plan and approved Annual Performance Plan (APP) of the board.

Budget allocation and monitoring expenditure are also functions of the committee to ensure that the board utilises money according to its allocation to avoid overspending and underspending on programmes. It is the objective of the board to avoid irregular and unauthorised expenditure.

The assessment of the documentation revealed that Umgeni Water committees have terms of references, methods of reporting for all committees, stated purpose of the committees, and stated tenure of the board committee members, which exist because of the membership to the board.

Figure 5.4 represents the governance structures for Umgeni Water that were adopted to ensure the proper functioning of the board and to create synergy in the board.

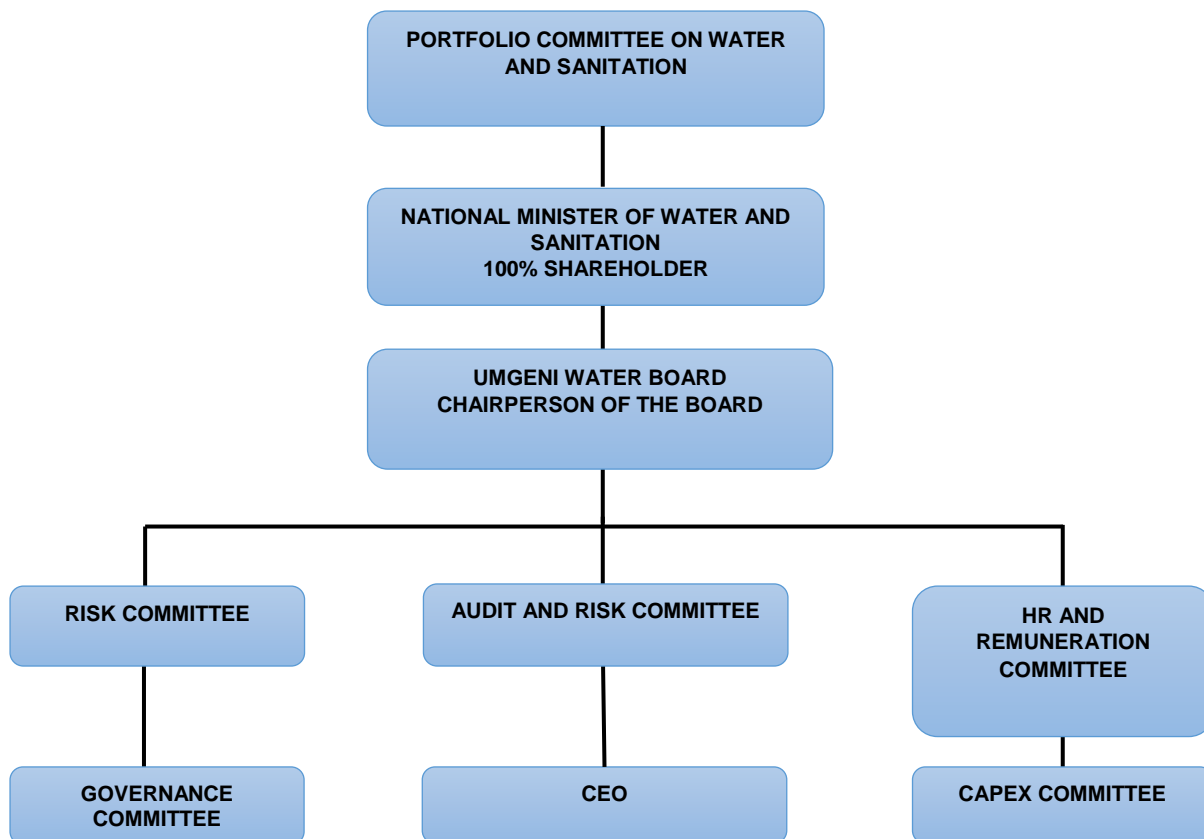


Figure 5.4: Governance structure for Umgeni Water

Source: Umgeni Water 2016:39

The assessment of the 2015/2016 annual report and the questionnaire that was forwarded to the board’s secretariat and executive committee of the board confirmed the above governance structure of the board.

5.4.6 Risk committee (This is a sub-committee)

The Annual Report for the year 2015/2016 reflects that Umgeni Water has appointed an audit committee (Page 36 of the Report). As required, the risk committee assists the audit committee in discharging its duties relating to the implementation of the integrated risk management policy Umngeni Water Board Annual Report (2016:28).

The committee membership includes a member of the audit committee, the CEO, the executive management, the CS, and the risk manager. The risk committee is essential for supporting the board in executing its responsibilities. The composition of this committee needs to be taken into consideration, as well as the mix of board members; this is the most important committee of the board. The assessment of Umgeni Water’s

documentation and annual reports revealed that Umgeni Water has established a risk committee.

The risk committee is an independent committee of the board and it therefore cannot report to an audit committee. Umgeni Water has not complied with the King III and King IV codes in this regard. This committee reports to the audit committee instead of reporting to the board as the highest structure of decision making. This structure appoints and provides oversight to all sub-committees of the board. This study revealed that sub-delegation of duties is not acceptable for the good governance of committees.

5.4.7 Human Resources and remuneration committee

The HR and remuneration committee is a statutory committee of the board and has been established in accordance with the provisions of the Companies Act that regulates SOEs and other corporations.

The 2015/2016 annual report of Umgeni Water indicates that an HR and remuneration committee has been appointed to deal with all issues that relate to HR policies and performance development policies.

The report indicates that it has six members; namely four non-executive directors, the CEO, and a non-executive director as the chairperson of the committee. The committee reviews and makes recommendations to the board with regard to all HR policies, organisational structures, and compliance with the provisions of the EEA and other labour relations legislation.

5.4.8 Ethics committee (This is a sub-committee)

Umgeni Water's annual report for the 2015/2016 financial year reflects that the board has appointed a social and ethics committee to comply with the corporate governance elements. The report further indicated the committee's composition and committee duties.

The study revealed that the social and ethics committee must deal with unethical behaviour of board members and must condemn fraud and corruption in the board when discharging their duties as board members.

The 2015/2016 annual report reflects that the committee is chaired by an independent chairperson. The annual report further disclosed the committee's operational terms and periods. In addition, the study also revealed that the committee meets at least four times per year to execute its roles and responsibilities as prescribed in the board committee's operational plan for Umgeni Water. It includes monitoring the corporate activities relating to social and economic development, including EE and Broad-Based Black Economic Empowerment (B-BBEE); and good corporate citizenship, including the promotion of equality, prevention of unfair discrimination, corporate social investment, and reduction of corruption. This committee also considers sponsorship, media, and advertising matters.

This committee's composition is not reflected or disclosed in the annual report. The following issues that affect the board are also not reflected: the number of committee members, the gender of committee members, and the race of the committee members, which are important in the transformation of governance framework structures with specific reference to the King III and King IV codes.

During the assessment of the annual report, the findings were that the board has not complied with the King III and King IV codes in terms of disclosure of information and other relevant information that affects SOEs and other multinational corporations listed on the Johannesburg Stock Exchange (JSE).

In terms of the study of sub-delegation, it is not acceptable to sub-delegates duties as a committee to another committee of the board. Only the board has the power to delegate duties to the committees of the board. Sub-committees of the board have no power to delegate functions and responsibilities in terms of good corporate governance, therefore Umgeni Water has not complied with the King III and King IV codes in this regard.

5.4.9 Audit committee

It is compulsory for an SOE to have an audit committee. This committee should deal with. The composition and tenure of the audit committee is determined by the PFMA. The terms of reference must be approved by the board of directors, and all board

members that sit in the audit committee must be guided by these terms of reference when taking decisions to avoid *ultra vires* decisions.

Umgeni Water appointed an audit committee in terms of the PFMA, and has therefore complied with the requirements of the Act. The audit committee reports to the board as the highest decision-making structure that is responsible for government policies and where all committees of the board account for effectiveness and efficiency.

5.4.10 Other subcommittees of the board

The 2015/2016 annual report, and the questionnaire that was forwarded to the board secretariat to be cascaded to all board members, reflected that the board has appointed other committees. These committees are discussed in the following sections.

5.4.10.1 Governance committee

The annual report and response from the board's secretariat confirmed that the board has appointed a governance committee. The governance committee comprises four members. Non-executive committee chairs are nominated from the chairs of the committees of the board to ensure the governance and accountability of all board committees.

This committee assists the board in monitoring and assessing the performance of the executive management and the CS to ensure that performance objectives and targets are met as per the approved strategic plan of the board.

The annual report reflects the performance results which are considered by the HR and remuneration committee in determining the remuneration of the CEO. Other executive management members of the company are also to be recommended to the board for approval. The governance committee is chaired by the COB.

5.4.10.2 Capital projects, fixed assets, and procurement committee

During the 2015/2016 financial year, the annual report of Umgeni Water established the capital projects, fixed assets, and procurement committee. This committee is

chaired by the non-executive director and comprises eight members, comprising seven non-executive directors and the CEO.

This committee of the board recommends supply chain management policies to the board for approval. This committee also assists the board with decisions related to the capital expenditure programme, including the approval of the release of capital expenditure above executive management's delegated authority and with the committee's delegation of authority.

5.5 THE INTERNAL AUDIT FUNCTION

During the assessment of the 2015/2016 annual report, and it was discovered that the internal audit function has been outsourced, which supports the board in terms of risk management and other financial functions related to the board.

5.6 CONCLUSION

Chapter 5 summarised the findings and results of the study. The study also summarised the findings on the key elements of the corporate governance framework, the board of directors, and the composition of the board and committees, and the appointment and performance evaluation of the CEO.

The chapter further discussed the findings of the annual report on the board appointment process and terms of the board, and the committees of the board; namely the audit, HR and remuneration, and social and ethics committees.

The following chapter discusses the summary, recommendations and conclusions on corporate governance and concludes the study.

CHAPTER 6: SUMMARY, RECOMMENDATIONS, AND CONCLUSIONS

6.1 INTRODUCTION

This chapter provides a summary, recommendations and final conclusions. This chapter discusses recommendations regarding the elements of the King III and King IV corporate governance reports; these elements are the board and its directors, the appointment of directors, the term of office for directors, the composition of the board, the role of the board, the board committees, and the appointment and performance of the CEO.

According to Cassim (2012:473), sound corporate governance is essential for the wellbeing of a company and is in the best interest of the growth of South Africa's economy, particularly in attracting new investments.

Good corporate governance increases the ability of properly governed companies to implement sustainable growth and to identify and manage their business in such a way that their potential ability is not limited (Cassim 2012:473).

The non-executive directors are often included on the board of directors for the purpose of improving the board's performance. This could also bring about new perspectives on the management and the board of the company. Furthermore, Cassim (2012:478) states that non-executive directors contribute to the development of management strategies and monitor the activities of the executive directors.

The researcher recommends that the principles of the King III and King IV codes, National Treasury Regulations, the PFMA, and the Companies Act be complied with.

6.2 RESEARCH RECOMMENDATIONS

6.2.1 Recommendations regarding the board of directors of SOEs

Boards of companies are important for policymaking and policy implementation for any organisation. An SOE must be controlled and directed by a competent board. The competence of the board will be seen through the decisions that the board makes. These decisions could be either *intra vires* or *ultra vires* decisions, not through the size of the board but in terms of principles prescribed by the Constitution.

6.2.2 Recommendations regarding the role of the board for SOEs

The two-tier board structure is the most suitable structure and is regarded as the most appropriate for SOEs. A two-tier board comprises both a management board and a supervisory board (see par.6.2.3 below). The boards are responsible for the performance of the SOEs. In this case, boards are accountable to the government as a major shareholder.

Companies should be headed by a board that directs, governs, and is in effective control of the company. Every board should have a charter that sets out its responsibilities and it should meet as often as is required to fulfil its duties; preferably at least four times a year (King III Report, 2009:28).

The board should approve the long-term and short-term strategies for the business of the company and monitor implementation by management (King IV Report, 2016:13).

6.2.3 Recommendations regarding the board composition for SOEs

The opinion of Naidoo (2009:106) is that board should be the heart of a company's system of corporate governance and should direct, govern, and be in effective control of the company. In the simplest terms, the board of directors is responsible for the company's strategic direction and is therefore ultimately responsible for ensuring the company's success. Management, on the other hand, is primarily responsible for giving effect to the strategy as defined by the board.

There are generally two types of board structures: unitary boards and two-tier boards (Cassim 2012:482). A two-tier board comprises both a management board and a

supervisory board. The task of management of the company is entrusted to the management board, and is composed of executive directors (appointed by the supervisory board) (Cassim 2012:482).

The supervisory board, which is composed of non-executive directors who are elected by the shareholders and in some cases by employees, monitors how the management board discharges its functions. Both employees and shareholders are represented on the supervisory board (Cassim 2012:482).

The two-tier board structure results in a more defined separation between management and the supervisory functions (Cassim 2012:482).

The unitary board, on the other hand, is composed of both executive and non-executive directors who interact directly with each other (Cassim 2012:482). Furthermore, Cassim (2012:482) states that the unitary board is the norm in Britain, the United States of America (USA), and the Commonwealth.

The unitary board structure with executive directors and non-executive directors interacting in a working group is more appropriate for South African companies (Cassim 2012:482).

The researcher supports and recommends the following:

- There should be a balance of power and authority in the board and that no one individual or block of individuals should have sufficient power to be able to dominate the board's decision making (Cassim 2012:482);
- Every board should have a minimum of two executive directors, being the CEO and the director responsible for the finance function (King III Report, 2009:25);
- The board should comprise a majority of non-executive directors. The majority of non-executive directors should also be independent as this reduces the possibility of conflicts of interest and promotes objectivity (King III Report, 2009:38, principle 2.18); and
- That the governing body should provide strategic direction for its composition to be balanced. The governing body should establish a succession plan for its own members, which should include the identification, membership, and development of future candidates (King IV Report, 2016:40, principle 3.2).

Section 73 of the Companies Act recommends the number of directors to be appointed to the board. It recommends two executive directors to be appointed to the board, namely the CEO and the director responsible for the finance function to ensure that there is more than one point of contact between the board and the management.

6.2.4 Recommendations on the board size of SOEs

The researcher recommends the following principles in regard with the board size of the company (King IV Report, 2016:40):

- The governing body should assume responsibility for its composition by setting the direction and approving the processes for it to attain the appropriate balance of knowledge, skills, experience, diversity, and independence to objectively and effectively discharge its governance role and responsibilities;
- The CEO and at least one other executive should be appointed to the governing body to ensure that it has more than one point of direct interaction with management. The executive members, other than the CEO, appointed to the governing body may be the CFO or another designated executive as is appropriate for the organisation; and
- When determining the requisite number of directors to be appointed on the board, a number of factors should be taken into consideration. These factors include the appropriate mix of knowledge, skills, and experience – including the business, commercial, and industry experience of the enterprises – needed to govern the organisation.

6.2.5 Recommendations regarding the appointment of the board of SOEs

The researcher supports and recommends the following principles in regard with the appointment of the board of SOEs:

- ✓ Directors should be appointed through a formal process and according to the King III Report (2009:40). The researcher also recommends that the board should ascertain whether potential candidates are sufficiently competent to be appointed as directors and can contribute to the business judgement calls made by the board;

- ✓ Prior to the appointment, the directors' backgrounds should be investigated, along with the lines of their approaches (King III Report 2009:40);
- ✓ The procedures and recommendations for appointment of the governing body should be formal and transparent. All appointments must be considered by the governing body as a whole, and assisted by the nomination committee's recommendations (King IV Report, 2016:41, principle 3.2);
- ✓ The nomination committee should assist with the process of identifying suitable members of the board. It further recommends that background checks and reference checking should be conducted before the nomination and appointment of directors (King III Report, 2009:39); and
- ✓ A full disclosure of each individual director should be made to enable shareholders to make their own assessment of the directors (King III Report, 2009:39).

6.2.6 Recommendations on the removal of directors of the board for SOEs

The researcher recommends that:

- A director of the company may be removed by shareholders, and in some circumstances by the board of directors (Davis & Mongalo 2013:140); and
- Section 70 of the Companies Act further instructs that in terms of section 71, paragraph (2), the notice of shareholders' meeting to remove a director, and the resolution, must be given to the director prior to considering the resolution to remove the director.

6.2.7 Recommendations regarding the removal of directors by shareholders of SOEs

Davis and Mongalo (2013:140) state that a director may be removed by an ordinary resolution adopted at a shareholders' meeting. The director must be allowed a reasonable opportunity to make a presentation. The researcher supports this approach.

6.2.8 The board's performance assessment: Recommendations for the board of SOEs

The researcher recommends:

- The evaluation of the board, its committees, and individual directors should be performed every year (King III Report, 2009:28, principle 2.22); and
- That the governing body should have clear direction on the evaluation of performance. The governing body should appoint an independent, non-executive member to lead the evaluation of the chair's performance (King IV Report, 2016:50, principle 3.5).

6.2.9 Recommendations regarding the board committees of SOEs

According to Hendrikse and Hefer-Hendrikse (2014:289), the role of the board is to govern and, in particular, to make decisions and to delegate decision-making authority. To do so, it needs to appoint board committees to provide detailed research, investigation, analysis, and recommendations on all or some of its main functional areas.

The board should delegate duties and authority to committees, but cannot delegate responsibility (Hendrikse & Hefer-Hendrikse 2014:289).

Naidoo (2009:141) recommends that board committees must be established with specific mandates. Authorities may either be standing committees appointed to perform a continuing function (such as the audit committee) or *ad hoc* committees constituted with a specific task.

The board as a centre of governance delegating its functions to a well-structured committee can do so without abdicating its own responsibilities (Cassim 2012:482).

The researcher supports and recommends the following principles:

- That formal terms of reference should be established and approved for each committee of the board. The King III Report (2009:23) further recommends that all public companies and SOEs must appoint an audit committee. The King III Report (2009:46) in principle 2.23 recommends that the board should delegate

certain functions to well-structured committees but without abdicating its own responsibilities (King III Report, 2009:23);

- The establishment of a risk committee to assist the board in carrying out its risk responsibilities and the establishment of a Human Resource and remuneration committee to assist the board of directors in setting and administering remuneration policies. The establishment of governance, information technology steering, and sustainability committees is also recommended (King III Report, 2009:23, 28 and 29);
- That the governing body should consider creating additional governing structures to assist with the balance of power and the effective discharge of authority, but without abdicating accountability (King IV Report, 2016:44, principle 3.3);
- The appointment of committees and to delegate to any committee the authority of the board. Committees of the board should be able to take independent advice without fear of being accused of professional misconduct (Section 72 of the Companies Act); and
- That external parties may be present at committee meetings by invitation, but may not interfere in committee matters (King III Report, 2009:23).

6.2.10 Recommendations regarding the audit committees of SOEs

According to Hendrikse and Hefer-Hendrikse (2014:291), the board is responsible for the preparation and presentation of the financial reporting aspects of the company's annual report. According to the PFMA there must be an audit committee. The audit committee should fulfil a two-fold role: to be in touch with the developments in financial reporting, risk management, and accounting standards; and to interact with both the internal and external auditors.

The purpose of the audit committee is to assist the board in discharging its duties in relation to financial reporting, asset management, risk management, internal control systems, processes and procedures, and to measure the quality of both the external and internal audit function (Hendrikse & Hefer-Hendrikse 2014:291).

The author supports and recommends the following principles:

- ❖ That the board of directors should ensure that the company has an effective and independent audit committee (Cassim 2012:489). The audit committee plays a central role in corporate governance and is vital to ensure the integrity of integrated reporting and internal financial controls and to identify and manage financial risks (Cassim 2012:482). The audit committee should comprise at least three members who are suitably skilled and experienced independent, non-executive directors (King III Report, 2009:31).
- ❖ The board of directors should not be the chairperson or a member of the audit committee. Cassim (2012:490) further recommends that the chairperson of the audit committee should be an independent, non-executive director (King III Report, 2009:31).
- ❖ The PFMA requires that the governing body of any organisation that issues audited financial statements should establish an audit committee. The King III Report, 2009:56, principle 3.1, states that the board should ensure that the company has an effective and independent audit committee, and further states that an independent audit committee should fulfil a vital role in corporate governance. The King III Report, 2009:56, principle 3.3, also states that the audit committee should be chaired by an independent, non-executive director.
- ❖ The audit committee should report to the board of directors and shareholders on how it has discharged its duties (Cassim 2012:490).
- ❖ The audit committee should meet with the internal auditors; such a meeting could include the CFO and financial and accounting managers (Hendrikse and Hefer-Hendrikse 2014:291).

6.2.11 Recommendations regarding the Human Resource and remuneration committee of SOEs

The researcher supports and recommends the following principles:

- ✚ The purpose of the Human Resource and remuneration committee is to ensure that directors are appropriately rewarded for their work in a manner that will ensure, as far as possible, the recruitment, retention, and appropriate motivation of people with the skills that the company needs (Wixley & Everingham 2010:75).

- ✚ Hendrikse and Hefer-Hendrikse (2014:293) state that the purpose of the HR and remuneration committee is to provide an independent and objective body that will recommend policy on the remuneration of the executive directors.
- ✚ Wixley and Everingham (2010:75) is of the opinion that the HR and remuneration committee should consist of non-executive directors of whom a majority, including the chairperson, should be independent. The King IV Report (2016:47), in principle 3.3, recommends that the governing body should consider establishing a committee for remuneration to devise and recommend a policy that results in fair, responsible, and transparent remuneration. The companies should remunerate directors and executives fairly and responsibly and companies should adopt remuneration policies and practices for executives that create value for the company (King III Report, 2009:48, principle 2.25).

Section 35 (6) of the Water Services Act determines that the non-executive board members will be remunerated at a level approved by the Minister. Salaries of executive board members (CEO in case of Umgeni) will be determined by committee.

- ✚ Companies should adopt remuneration policies aligned with the strategy of the company and these should be linked to individual performance. The HR and remuneration committee should assist the board in setting and administering remuneration policies (King III Report, 2009:48, principle 2.25.1 and 2.25.2).

6.2.12 Recommendations on the group boards of SOEs

The researcher supports and recommends the following principles:

- The governance framework should be agreed upon between a group and the board of its subsidiaries (King III Report, 2009). It also recommends that a holding company must be recognised and that it should respect the fiduciary duties of the directors of the subsidiary company. Its particular duty is to act in the best interest of the subsidiary company at all times (Cassim 2012:482);
- If it is acceptable for the COB or CEO, a subsidiary director can be appointed on the holding company's board, but emphasises that the fiduciary duties of the director are owed to the company to which the director is appointed (Cassim 2012:482) and (King III Report 2009);

- The implementation and adoption of holding company's policies, processes, or procedures in the operations of the subsidiary company should be considered and approved by the subsidiary company, if the subsidiary company should disclose this adoption and implementation in its integrated report (Cassim 2012:482); and
- A governance framework should be agreed upon between the group and its subsidiary boards (King III Report, 2009:46, principle 2.24).

6.2.13 Recommendations regarding the and ethics committee

The researcher supports and recommends the following principles:

- In terms of section 72(4) of the Companies Act the Minister may by regulation prescribe a category of companies that each must have a social and ethics committee, if it deems it in the public interest (Cassim 2012:482).
- Regulation 43(1) of the Companies Act requires an SOE and a listed public company to appoint a social and ethics committee (Cassim 2012:459). In terms of the public interest score, Umgeni Water has 500 points above the required points to appoint the social and ethics committee.

Furthermore, Cassim (2012:459) states that if a public company or SOE fails to appoint a social and ethics committee, sections 84(6) and 84(7) of the Companies Act would be applicable. Under section 84(6) of the Companies Act, the Companies and Intellectual property Commission may issue a notice to a company that fails to appoint a social and ethics committee to show why the Companies and Intellectual property Commission should not convene a shareholders' meeting for the purpose of making that appointment.

According to Cassim (2012:459), if a company fails to respond to such a notice, or in responding fails to satisfy the Companies and Intellectual property Commission that the board of directors will make the appointment, or convene a shareholders' meeting to make the appointment within an acceptable period, the Companies and Intellectual property Commission may give notice to the shareholders and convene a shareholders' meeting to make the appointment of the committee.

The King IV Report's (2016:47) principle 3.3 recommends that the social and ethics committee should consist of at least three members of the governing body or prescribed officers, at least one of whom should be a non-executive director.

6.2.14 Recommendations regarding the CS

The researcher supports and recommends the following principles:

- ❖ The King III Report (2009) recommends that the board should be assisted by a competent, suitably qualified, and experienced CS. Cassim (2012:489) recommends that the CS should also assist the nominations committee in the appointment of the directors of the company. Cassim (2012:489) states that the King III Report of 2009 recommends that companies should delegate or outsource the responsibilities of a CS to an appropriate person or organisation;
- ❖ The King IV Report (2016:49), in principle 3.3, recommends that the governing board should ensure that it has access to the services of a CS or corporate governance professional for guidance and direction on governance and on the legal duties of members of the governing and its structures, and to support and coordinate the functioning of the governing body and its committees; and
- ❖ The King III Report (2009:27), in principle 2.21, recommends that the board should be responsible for appointing and removing the CS. The CS is accountable to the board. According to section 86 of the Companies Act, the board has a mandatory obligation to appoint the CS for an SOE.

6.2.15 Recommendations regarding the CEO's evaluation

The researcher supports and recommends the following principles:

- ✓ According to Cassim (2012:486), the King III Report of 2009 recommends that the board, committees, and individual directors be evaluated on an annual basis. The evaluations should be performed by the chairperson or an independent director (King III Report 2009:28);
- ✓ According to Hendrikse and Hefer-Hendrikse (2014:252), the company must carefully consider whether performance appraisals should be conducted internally or by an independent service provider. Furthermore, they recommend

that the assessment of the board, the various board committees, and each individual director be conducted on an annual basis;

- ✓ The nomination for reappointment of a director at the annual general meeting is not an automatic process. It should occur after the proper evaluation of the performance and attendance of the director in question (King III Report 2009:28);
- ✓ The King III Report (2009:28) recommends that the appraisal process, its results, and action plans are required to be disclosed in the integrated report. There are key areas for the performance evaluation of the CEO to ensure that the company functions effectively (Hendrikse & Hefer-Hendrikse 2014);
- ✓ The chairperson or a committee appointed by the board should evaluate the performance of the CEO and other executive directors at least once a year. It further recommends that the evaluation should assess the performance of the CEO and other executive directors, both as directors and as executives (King III Report, 2009:45, principle 2.22); and
- ✓ The results of such evaluations should also be considered by the HR and remuneration committee to guide the board in determining the remuneration of the CEO and other executive directors. The King IV Report's (2016:50) principle 3.5 recommends that the governing body should ensure that the performance evaluations of the members are conducted in a professional way.

6.2.16 Recommendations regarding the term of SOE boards

The researcher supports and recommends the following principles:

There is no legislative framework governing boards regarding how long board members should serve on the board, although different SOEs have different terms of office for board members. The King III Report (2009) recommends a three-year term for board members. The King IV Report (2016) recommends that a succession plan should be considered when the term for serving on the board has ended.

6.2.17 Recommendations regarding the risk committees of SOEs

The researcher supports and recommends the following principles:

Unlike the King I and King II reports, the King III Report (2009) suggests that companies should have a standard risk committee (Wixley & Everingham 2010:77). The King III Report (2009) recommends that the risk committee should include executive directors and may also have members who are not directors.

The PFMA require requires the appointment of a risk committee.

The general provisions of the Companies Act regarding membership of board committees are contained in section 72 of the Act.

The King III Report (2009) recommends that the board should appoint a risk committee to assist the board in discharging its duties and responsibilities in respect of risk management. It also recommends that its function should be assigned to another committee; it is recommended that the audit committee board should take into consideration the resources of the audit committee when assigning such function.

The risk committee must be chaired by a non-executive director. In terms of the composition, the risk committee must have at least three members, but are not limited to three only.

Principle 4.3 of the King IV Report 2016 recommends the total independence of the risk committee. It should be separated from the audit committee and it should deal with risk management to ensure transparency.

6.2.18 Recommendations regarding the internal auditing of SOEs

The researcher supports and recommends the following principles:

Umgeni Water's annual report reflects that the board has appointed an audit committee. The King III Report (2009) recommends that the board of directors must ensure via the CEO that there is an effective risk-based internal audit section (Cassim 2012:494). The internal audit section also provides support to the audit committee.

Cassim (2012:482) indicates that the King III Report (2009) further recommends that the internal audit section should provide a written assessment of the effectiveness of the company's system of internal control and risk management.

Cassim (2012:482) recommends that the audit committee should be responsible for overseeing the internal audit.

6.2.19 Recommendations regarding other committees of the board

The researcher supports and recommends the following principles:

6.2.19.1 Governance committee

The results of the interviews with the board secretariat and the management of Umgeni Water confirmed the establishment of a governance committee.

The purpose of this board committee is to assess the scope and effectiveness of the company's corporate governance programme (Hendrikse & Hefer-Hendrikse 2014:295).

The functions of the governance committee are to monitor the governance of the company in relation to the nine principles of good corporate and business governance, and to intervene in conflicts of interest or possible conflicts of interest (Hendrikse & Hefer-Hendrikse 2014:295).

The governance committee is a useful forum to keep non-executives up to date with development affecting the company (Wixley & Everingham 2010:81). Wixley and Everingham (2010:81) recommend that the governance committee should consist of non-executive directors.

Hendrikse and Hefer-Hendrikse (2014:295) recommend that the governance committee should consist only of non-executive directors, or, preferably, totally independent members. There should be at least three members on the committee: a shareholder/investor representative, for example a corporate attorney; a financial representative, for example a chartered accountant; and a business strategist related to the business sector/industry.

It is recommended that this committee must ensure that all aspects of corporate governance are considered by the board and its other committees (Wixley & Everingham 2010:81).

6.2.20 Recommendations on the appointment of the CEO of an SOE

The researcher supports and recommends the following principles:

One of the most important functions of the board of directors is to appoint a CEO, to ensure he/she is appropriately remunerated, and to oversee and monitor his/her achievement of the strategy developed by the board (Naidoo 2009:193).

Furthermore, Naidoo (2009:193) states that the selection of a suitable CEO has a profound impact on a company's success. The appointment of an effective CEO is the responsibility of the board as a whole, in spite of the recommendation by the nomination committee. The collective responsibilities of management are vested in the CEO and as such the CEO bears ultimate responsibility for all management functions. The board delegates to management via the CEO, who will in turn delegate to those reporting to him/her (Naidoo 2009:193).

The King III Report (2009) recommends that the board should appoint the CEO and also recommends the establishment of a framework for the delegation of authority as per principle 2.17 (Wixley & Everingham 2010:64). The King III Report of 2009 recommends that there should be at least two executive directors in the board (Wixley & Everingham 2010:64).

The King II Report (2002) recommends that the executive director's service contract should not exceed three years. This recommendation does not appear in the King III Report. However, section 30(4)(e) of the Companies Act now requires disclosure in a company's annual financial statements, that are audited, of the details of service contracts with all current directors and prescribed officers.

The King III Report (2009:12) recommends in principle 1.19 the following important responsibilities of the CEO:

- Achieving financial and operating goals and objectives;
- Ensuring that a long term strategy is developed;
- Ensuring that a positive and ethical work climate exists;
- The CEO should be the chief spokesman of the company; and

- While the CEO should not be a member of Board Committees, he should attend meetings by invitation.

Naidoo (2009:193) further recommends that the CEO should ensure that the day-to-day business affairs of the company are appropriately monitored and managed based on the authority delegated to him/her by the board.

Naidoo (2009:193) recommends that, on the advice of its HR and remuneration committee, the board must decide on the terms and conditions of the CEO's appointment, including his/her remuneration package and service conditions.

It is recommended that the practice for the appointment be finalised in a formal written contract which sets out, *inter alia*, the respective objectives of the company and the CEO, the criteria by which the latter's performance will be measured, and the elements of performance-based remuneration included in the remuneration package (Naidoo 2009:193).

6.2.21 Recommendations regarding the role of the Minister, Cabinet, and Parliament in the governance of SOEs with specific reference to water utilities

The researcher supports and recommends the following principles:

Gumede (2012:38) argues that executive authorities have three roles in relation to SOEs: they are simultaneously the owner/shareholder, policymaker, and regulator; and SOEs must report to an executive authority, i.e. the line minister/department.

Gumede (2012:38) further explains that the executive authorities have oversight over whether SOEs implement policies and deliver services and products according to their mandates or executive policy directives. Gumede (2012:38) further argues that the line minister acts as a shareholder, and is responsible for ensuring that SOEs meet service delivery requirements.

Section 52 of the PFMA recommends that the board of SOEs provides annual budget plans to the line minister or the department. The PFMA also recommends that National Treasury must provide financial oversight over the SOEs. Treasury Regulation 30.2 prescribes that SOEs provide quarterly reports to the executive authority.

The executive authority, only the executive authority (Minister) has the power to dismiss or to reward the SOE board for non-performance or performance (Gumede 2012:40). Gumede (2012) further states that, unfortunately, it is only recently that the line ministers have incorporated key performance indicators (KPIs) in annual shareholders' compact agreements between a specific SOE and the executive authority.

The Companies Act instructs the total independence of SOEs. The King III Report (2009) recommends that the board and directors must be appointed after following a proper nomination process.

6.2.22 Recommendations regarding the separation of the roles of the COB and the CEO

The researcher supports and recommends the following principles:

According to Cassim (2012:488), the King III Report (2009) recommends that the board of directors should elect a chairperson who is an independent, non-executive director. It further recommends that the CEO of the company should not also fulfil the role of the chairperson as this leads to excessive concentration of power in one person, as well as that the board should delegate specific functions to the CEO (Cassim 2012:488).

6.2.23 Consequences of SOEs' non-compliance to King III and King IV best practices

The researcher supports and recommends the following principles:

The King IV Report (2016) is a set of apply or explain principles and good practices of corporate governance. If the principles of the King IV Report clash with any legislation that is relevant to the governing of the company, the Companies Act and the PFMA shall prevail.

For those entities listed on the JSE, certain aspects of the King IV Code of 2016 are compulsory by virtue of the listing requirements that impose obligations on issuers to comply therewith.

Although the King IV Report (2016) is based on apply or explain basis, it does not mean that there are no legal consequences arising from non-compliance. In this instance, a court will consider the King IV Report (2016) when evaluating what is regarded as a practice at that particular moment of the court case for the adjudicating presiding officer, especially where governance duties are involved.

Those companies that fail to meet corporate governance practices, and with implications set out in the King IV Report (2016), can invoke liability of the board in certain circumstances.

Ongoing monitoring and evaluation on the side of the Companies and Intellectual Property Commission (CIPC) is required to ensure that companies comply with the King III and King IV Reports, which will improve and transform the governance framework for the SOEs in South Africa.

6.3 POSSIBLE FUTURE RESEARCH

The importance of corporate governance in the world is increasing and is becoming a focus point of the exploration of governance structures and research areas. These corporate governance components build the organisation. More research is needed to answer all the unanswered questions.

Such a study of corporate governance will add value to the role of SOEs and will expand the body of knowledge.

The King III and King IV Reports play a major role in the improvement of governance management of South African SOEs.

Naidoo (2009) shares the same sentiments regarding the importance of corporate governance and those areas of importance in the governance of the organisation.

6.4 FINAL CONCLUSION

This chapter provided a summary of the findings, together with recommendations and conclusions.

The main objective of the research was to explore and to investigate the governance framework for Umgeni Water with specific reference to the King III and King IV

Reports. The research provided an explanation and assessment of the governance framework for Umgeni Water's structures and profiles.

The research addressed the following questions, which are most critical for the transformation of Umgeni Water's governance framework with specific reference to the King III and King IV Reports:

- Is the recruitment and appointment processes of the board codified and legislated?
- Is there a legislative directive that regulates the appointment of the independent and non-executive directors?
- Is there general compliance with the legislative dictates on board appointment?
- What is the process of recruiting and appointing board members in SOEs?
- What is the role that the (a) Minister, (b) Cabinet, and (c) Parliament or others play in the appointment of board members?
- Are the board's terms of office of SOEs codified and, if so, in which legislative dictate? How many terms can each board member serve? Is it legislated or is it in the King III and King IV Reports?
- Is the board composition of SOEs aligned to their mandate?
- How many board members sit on the board of SOEs?

Finally, it can be concluded that the management of SOEs needs urgent attention to be sustainable. Training on legal requirements, existing policies, and procedures is essential. The abovementioned recommendations should also be recognised by other SOEs in order to be successful.

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ANNEXURES

ANNEXURE A: RESEARCH CONFIRMATION LETTER (PROGRAMME DIRECTOR)



11 August 2017

TO WHOM IT MAY CONCERN

I, the undersigned, hereby declare that **Mr J. Makhaye, student number 2004055303** is a registered student in the Master's Degree in Governance and Political Transformation at the University of the Free State for 2017.

Please note that to successfully complete his Mini-dissertation, the student needs to conduct research at your institution.

Please be so kind as to allow Mr Makhaye to do interviews and collect information in order to write his Mini-dissertation.

If you have any queries in this regard, please do not hesitate to contact me on 0514012271.

Yours sincerely,

.....
DR TANIA COETZEE
PROGRAMME DIRECTOR
PROGRAMME GOVERNANCE AND POLITICAL TRANSFORMATION
DEPARTMENT POLITICAL STUDIES AND GOVERNANCE
UNIVERSITY OF THE FREE STATE



ANNEXURE B: RESEARCH CONFIRMATION LETTER (UMGENI WATER)



'Improving Quality of Life and Enhancing Sustainable Economic Development'

Ref: External Research/reviews

Your Ref: Student Number - 2004055303

Enquiries: Sbusiso Madonsele – 0333411066

Date: 14 September 2017

THE UNIVERSITY OF FREE STATE
P. O. BOX 339
BLOEMFONTEIN
9300

Dear Sir / Madam,

RE: CONFIRMATION OF INTERVIEWS WITH THE COMPANY SECRETARY DURING THE PERIOD FROM 25 AUGUST 2017 UNTIL 15 SEPTEMBER 2017.

The above refers.

This serves to confirm that interviews and engagements between the above mentioned student (Mr Jabulani Makhaye Student Number – 2004055303) and the Company Secretary took place between the periods mentioned above. The purpose of the interviews was to assist Mr. Makhaye in his research for his Master's Degree in Governance and Political Transformation, in order to fulfill the requirements for the Degree.

I also confirm that at no point did I divulge any confidential or sensitive information to Mr Jabulani Makhaye during period above.

Our discussions were based, broadly, on the governance structures and frameworks of Umgeni Water, contrasted against prevailing legislation, best governance practices and procedures prevalent within the state owned entities. Further to that some of the questions and or answers were captured in the attached questionnaire provided to us.

UMGENI WATER

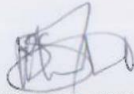
HEAD OFFICE • P.O.Box 9 • Pietermaritzburg 3200
310 Burger Street • Pietermaritzburg 3201 • Republic of South Africa
Telephone (033) 341-1111 • Fax (033) 341-1084
E-mail: info@umgeni.co.za
Internet: <http://www.umgeni.co.za>

Acting Chief Executive / Accounting Authority: Mr. Thami Hlongwa

Umgeni Water is a National Business Enterprise created in terms of the Water Services Act 108 of 1997 and is listed in Schedule 3B of the Public Finance Management Act, 1 of 1999. It complies with a variety of legislation that is applicable to it, and where required, adheres to the provisions of the Companies Act 71 of 2008.

We note that Mr. Makhaye had taken his time to go through all relevant publicly available documents on Umgeni Water prior to his engagement with us. We have no doubt that we can gain invaluable contribution from his work and look forward to having sight of his research (if possible) so that we can also gain his insights and improve where we have been found wanting.

Yours sincerely,



SBUSISO MADONSELA

COMPANY SECRETARY

e-mail: sbusiso.madonsela@umgeni.co.za

office: 033 341 15 44 / 1066

cell: 072 907 2145

UMGENI WATER

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Acting Chief Executive / Accounting Authority: Mr. Thami Hlongwa

ANNEXURE C: DRAFT QUESTIONNAIRE

BOARD AND DIRECTORS

Is the chairman of the board an independent non-executive director and a director other than the CEO?

	2	3	4	5
--	---	---	---	---

Is the board adequately represented in terms of gender?

	2	3	4	5
--	---	---	---	---

Does the board have a mix of knowledge, skills and experience?

	2	3	4	5
--	---	---	---	---

How many board members do you have?

	2	3	4	5
	10 -20	20 - 30	30 – 40	40 - 50

THE CHIEF EXECUTIVE OFFICER (CEO)

How often is the performance of the CEO evaluated?

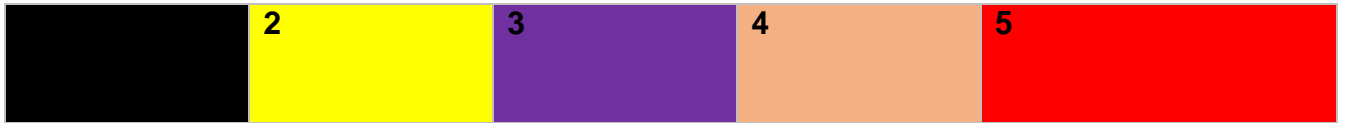
None	Once a year	Twice a year	Every years	two	When necessary
	2	3	4		5

Are the performance of the CEO and other executive directors evaluated at least once a year by the chairman or a remuneration committee appointed by the board?

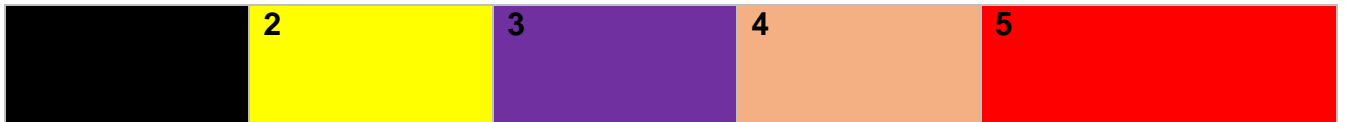
None	Once a year	Twice a year	Every years	two	When necessary
	2	3	4		5

AUDIT COMMITTEE

Is the chairman of the board not an audit committee member?



Is the chairman of the audit committee appointed by the board?



What is the composition of the audit committee?



THE GOVERNANCE OF RISK

Does the risk committee comprises a minimum of three members?



Does the risk committee convene at least twice per year?



THE GOVERNANCE OF INFORMATION TECHNOLOGY

Did the board establish and implement an IT governance charter and policies?



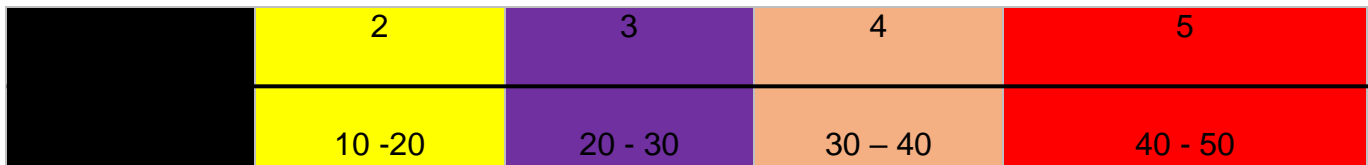
COMPLIANCE WITH LAWS, RULES, CODES AND STANDARDS

Is the CEO accountable to the board with respect to the compliance function?



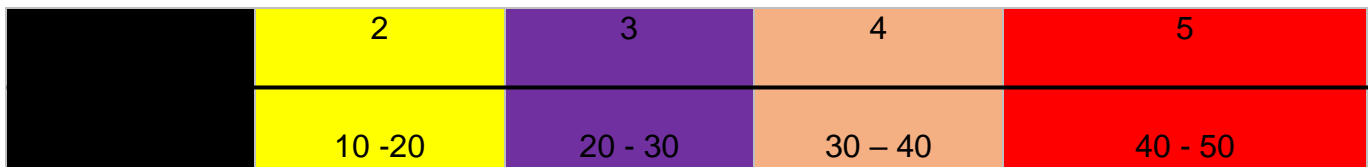
THE RISK COMMITTEE

What is the composition of the risk committee?



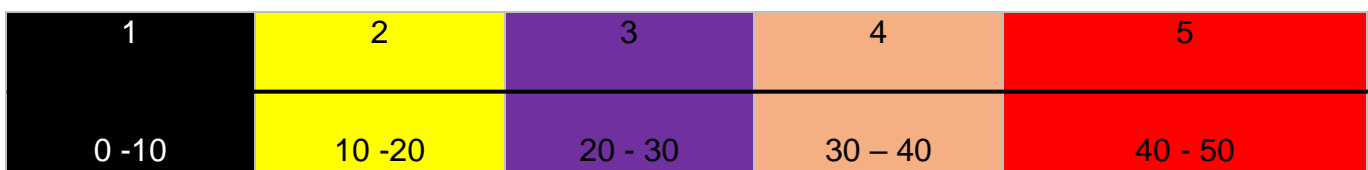
THE REMUNERATION COMMITTEE

What is the composition of the remuneration committee?



THE SOCIAL AND ETHICS COMMITTEE

What is the composition of the social and ethics committee?

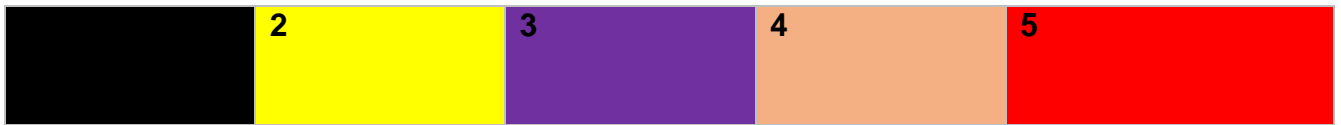


INTERNAL AUDIT

Does the company have an internal audit function?

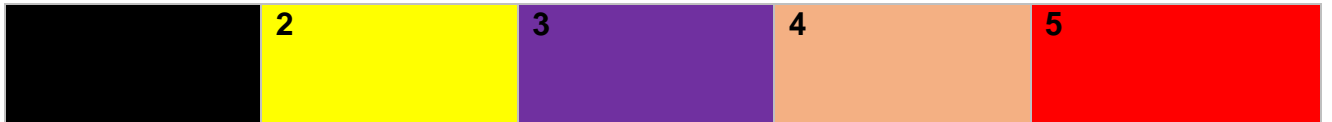


Does the company has an internal audit charter?



GOVERNING STAKEHOLDER'S RELATIONS

Does the board identify important stakeholders?



Does the board have policies relating to stakeholders?

