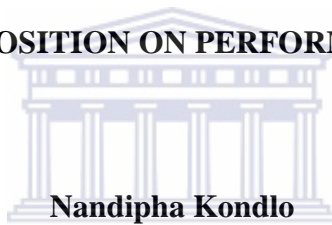




**UNIVERSITY *of the*
WESTERN CAPE**

FACULTY OF LAW

**THE IMPORTANCE OF CORPORATE GOVERNANCE IN SOUTH AFRICAN
FAMILY-OWNED COMPANIES: EFFECTS OF OWNERSHIP AND BOARD
COMPOSITION ON PERFORMANCE**



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KEYWORDS

Board Performance

Board Structure

Company Directors

Company Ownership

Corporate Governance

Executive Committee

Family-owned Companies

Family-Owned Firm

King Report

Non-Executive Committee

Shareholders

Stakeholders



DECLARATION

'I declare that **The Importance of Corporate Governance in South African Family-Owned Companies: Effects of Ownership and Board Composition on Performance** is my own work, that it has not been submitted before for any degree or examination in any other university, and that all the sources I have used or quoted have been indicated and acknowledged as complete references'.

Kondlo N



Signed December 2016

Prof MS Wandrag



Signed.....December 2016

DEDICATION

This work is dedicated to my family. To the soul of my father, Wiseman Lumkile Kondlo, who has valued and loved education and invested generously in me. To my mother Sylvia Kondlo who supported me throughout my years of studying and made my studies her priority. To my brothers who had faith and believed in me.



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ABBREVIATIONS

CEO Chief Executive Officer

GNP Gross National Product

IBGC Brazilian Corporate Law

JSE Johannesburg Stock Exchange

NEC National Executive Committee

NYSE New York Stock Exchange

OECD Organisation for Economic Co-operation and Development

UK United Kingdom

US United States

UN United Nations

SA South Africa

SMEs Small and Medium Enterprises



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CHAPTER 1

1.1 INTRODUCTION

Over time, corporate governance has become one of the most common terms in business.¹ Corporate governance does not have a specific definition but it is sometimes defined as the systems by which companies are directed and controlled.² This actually means that the responsibility for the practice of corporate governance in a company lies with the board of directors. Corporate governance is sometimes referred to as a set of relationships among the company's board, shareholders and stakeholders to ensure that the main objectives of the company are set and attained by monitoring the performance of the company.³ Corporate governance comprises various factors; however, this mini-thesis only focuses on the ownership and board composition aspects of corporate governance, and their impact on the performance and survival of family owned companies.

The definition of a family typically varies by culture. A family usually refers to parents, children, siblings as well as extended family who are related through blood or marriage.⁴ Therefore, a family business is considered as one in which the family has a major influence on the company. The terms 'family-owned firms' and 'family companies/businesses' are used interchangeably.

Family businesses are generally no different from other firms; the only difference between a family business and a non-family business is the separation of ownership from management. In a non-family company, managers are hired to fulfil their roles and responsibilities and are not impacted personally when the business fails, while in the family-owned company the managers are part of the family.⁵ A family business is described as one where the voting majority is in the

¹ Brunninge O & Wiklund J 'Corporate governance and strategic change in SME's: The Effects of Ownership, Board Composition and Top Management Teams' (2007) 29 *Small Business Economics* 295.

² Rossow GJ & Malan DP 'Corporate governance in South Africa' (2002) 37 *Journal of Business Ethics* 289.

³ Mallin AC *Corporate Governance* (2010) 85.

⁴ Uhlaner LM *Corporate governance and family business* (2013) 164.

⁵ Morris MH & Williams OR 'Correlates of success in family business transition' (1997) 12 *Journal of Business Venturing* 386 (hereafter Correlates of success in family business transition).

hands of the controlling family.⁶ Some authors describe a family business as an organisation where the shareholders belong to the same family, and who participate in the management and operation of the company.⁷

This study mainly focuses on small to medium family-owned companies and specifically on retail family-owned companies. The board composition is considered to apply best in medium to large family-owned companies as more family members become part of the business, so as to help in conflict resolution and to deal with the company's growth.⁸ This study discusses the history of family-owned companies. It provides the background to family-owned companies and greater understanding of the role played by family-owned firms. This study identifies the challenges that family-owned firms face and which may impact on their performance and survival. It therefore compares corporate governance and its role in developing countries such as South African, and Brazil as well as recommendations of corporate governance in a developed country, such as, the United States of America (US).

1.2 PROBLEM STATEMENT

Family-owned companies are the most dominant businesses around the world. In most countries, family businesses are the ones that bring economic growth and play a huge role in employment.⁹ For example, in Spain, family businesses contribute 65 per cent to the Gross National Product (GNP). In the US between 80 per cent and 90 per cent of businesses are family-owned and contribute more than 50 per cent of the GNP and to employment.¹⁰ Family businesses in some instances are small businesses which employ a few staff members while in other cases they are medium to large businesses and employ hundreds to thousands of staff. Family-owned companies face the complex challenges that not only affect the business but also the destiny of the owners, family members and employees.¹¹ As much as family-owned firms contribute to the economy, they however have a very short life span. These family-owned companies have

⁶Abouzaid S *Family Business Governance Handbook* (2011) 12.

⁷ Leach P *Family Businesses: The Essentials* (2007) 2.

⁸ Brenes ER & Requena B 'Corporate governance and family business performance' (2011)64 *Journal of Business Research* 281.

⁹ Abouzaid S *Family Business Governance Handbook* (2011) 12.

¹⁰ Morris MH & Williams OR 'Correlates of success in family business transition' (1997)386.

¹¹ Leach P *Family Businesses: The Essentials* (2007) 1.

survival stages which they go through, but most of them do not survive the third generation stage as they are likely to fail.¹² Statistics show that only 30 per cent of family-owned companies survive into the second generation, while 10 per cent of the companies are viable into the third generation, and 4 percent of family-owned companies operate into the fourth generation.¹³ Therefore this study investigates the reasons why family- owned companies fail and do not survive for a long time.

1.3 AIM OF RESEARCH

This study aims to explicate the importance of corporate governance in terms of ownership and board composition on family-owned firm performance. The main challenges associated with the performance of a family-owned business are highlighted, and structures and practices proposed that can mitigate these challenges to ensure the sustainability of the company. This study seeks to make a significant contribution to promoting good governance in family-owned firms. Furthermore this study aims to assess whether ownership and board composition affect the performance and survival of family-owned companies as they are likely to fail.

1.4 RESEARCH QUESTION

The study aims to examine the influence of corporate governance on the failure of family-owned companies.

The study focuses on the following aspects of corporate governance:

Can the board composition and ownership structure affect the performance of a family-owned business?

1.5 SIGNIFICANCE OF THE STUDY

This study seeks to make a significant contribution to promoting good governance in family-owned firms in South Africa, and to contribute to the success of family-owned firms which are

¹²Abouzaid S *Family Business Governance Handbook* (2011) 13.

¹³Brenes ER & Requena B 'Corporate governance and family business performance' (2011) 64 *Journal of Business Research* 281.

experiencing challenges regarding their ownership, board composition and firm performance. This study therefore seeks to assist family-owned companies by addressing the issues that affect their long term survival.

1.6 RESEARCH METHODOLOGY

The primary interest of this study is to show the impact that corporate governance structures have on the performance of family-owned firms. In view of the purpose of the study, the desktop research method is used which consists of the study of books, internet sources, journals articles, theses, dissertations and reports. Using this technique helps to get an in-depth understanding of how the corporate governance system helps the performance of family-owned firms.

A comparative approach is also adopted: the board composition and corporate governance structures from South Africa and Brazil are examined. These countries are both developing countries and consist of the majority of family owned businesses specifically Brazil. The United States is used as recommendations as it is a developed country and the business sector consists of majority family owned firms. Furthermore, these countries are all members of the United Nations (UN). Therefore the comparative study is important in analysing the corporate governance structures taking into account their level of development.

1.7 SCOPE OF THE STUDY

Although many factors of corporate governance could be understood to have an important impact on family-owned firms, this study focuses on only ownership and board composition structure in South Africa and their impact on the performance of a family-owned firm.

1.8 CHAPTER OUTLINE

The subsequent chapters deal with material as outlined below:

1.8.1 CHAPTER 2

This chapter consults an extensive body of literature in order to provide a general overview of corporate governance, the definition of the term ‘corporate governance’, the importance of corporate governance, and the development of a corporate governance code.

1.8.2 CHAPTER 3

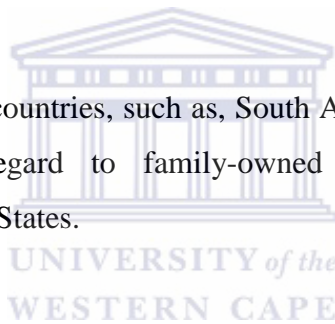
This chapter examines the main critical issues faced by family-owned firms. The challenges, the family life cycle, and the role of the board of directors are also discussed. This chapter also considers the importance of corporate governance in a family-owned firm, the advantages of having a formal governance structure in a family-owned firm, and the role of corporate governance in the performance of a family-owned firm

1.8.3 CHAPTER 4

This chapter compares how other countries, such as, South Africa and Brazil, exercise corporate governance specifically with regard to family-owned firms taking into account the recommendations from the United States.

1.8.4 CHAPTER 5

This chapter contains recommendations and identifies matters for further research.



CHAPTER 2

GENERAL OVERVIEW OF CORPORATE GOVERNANCE

2.1 INTRODUCTION

In today's world there is an increasing number of corporate collapses and scandals. Therefore the need for corporate governance is undeniable.¹⁴ It has been found that many companies do not survive for a long time, specifically family owned companies,¹⁵ and a lack of corporate governance could be one of the contributing factors. A study by the Asian Development Bank confirmed that poor corporate governance is one of the contributing factors to the vulnerability and crisis of a company.¹⁶

In addition to the argument above, there have been many cases of corporate scandals and collapses, which have forced government regulators and boards of corporations to reassess the essential issues of corporate governance, as they are important for the public interest.¹⁷

In this chapter, the evolution of corporate governance is examined, and the definition of the term 'corporate governance' by various authors is explained. The theoretical framework and the importance of corporate governance are explicated. Therefore this chapter focuses more on providing an understanding of what corporate governance is and how it was developed. The main reason for looking at corporate governance and its importance is because, this thesis is exploring the position of a family owned company and the direction in terms of rules, regulations, board structure and principles that most family owned companies should follow in order to be sustainable.

¹⁴Lim L 'Corporate Governance- A Survey of Australian and South East Asian system' (2010) 9 *Corporate governance eJournal* 3.

¹⁵Abouzaïd S *Family Business Governance Handbook* (2011) 13.

¹⁶Lim L (2010) 4.

¹⁷Keasey K Thomson S &Wright M The corporate governance problem competing diagnoses and solution (1997) 7.

2.2. OVERVIEW OF EVOLUTION OF CORPORATE GOVERNANCE IN SOUTH AFRICA

Corporate governance came into existence after the ownership of the company was separated from its control. This means that the owners of companies had no control over the management as the responsibility to manage relied more on the directors of the company. However, this created challenges as the directors were in a position to abuse their power for their own benefit. Therefore corporate governance was introduced in order to prevent this.¹⁸ In today's world the need for corporate governance is evident.

The development of corporate governance has been driven to a large extent by the need for transparency and accountability, to help re-establish the confidence of investors in the world's stock market after the damage caused by corporate collapses and scandals. Corporate governance includes codes and guidelines which are used by different bodies, ranging from committees to government departments.¹⁹ In South Africa (SA) these codes and guidelines consist of the King Reports and the Companies Act of 2008.

The first King Report was published in 1994 by the King Committee on Corporate Governance. The aim of the Report was to promote the highest standards of corporate governance in South Africa.²⁰ The focus of the King I Report was to promote good governance in the interest of stakeholders. The King Committee showed the need for corporate governance in companies in that it recognized that they no longer act independently from the society in which they operate. The Committee later reviewed the King I Report and proposed for it to be updated; and that is when the King II Code was developed.²¹

The King II Report on Corporate Governance was published by the King Committee in 2002. It contained a code of corporate practices and conduct. Therefore, the 2002 King II Report was a development from King I. The Report shows a shift from the single bottom line, which is profit for shareholders, to a triple bottom line, which embraces the economic and social aspects of a

¹⁸ Malan DP, Rossouw GJ & Van der Watt A 'Corporate governance in South Africa' (2002)37 *Journal of Business Ethics* 289.

¹⁹ King II Report on Corporate Governance for South Africa (2002) 9.

²⁰ King II Report on Corporate Governance for South Africa (2002) 7.

²¹ King II Report on Corporate Governance for South Africa (2002) 7.

company's activities. The King II Report emphasizes the issues of fairness, transparency, accountability and responsibility. This Report states that the focus should not be only on the shareholders but the stakeholders as well.²²

South Africa has governing legislation both for public and private companies in the Companies Act 71 of 2008. The Act is mandatory, and companies need to adhere to the principles set out in the Act without any exceptions. The companies act requires companies to have directors and the duty of directors applies to all companies and is complemented by the King III code of Corporate Governance principles.²³ The Companies Act 71 of 2008 enforced a need for the development of the King III Report. This Report was compiled by the King Committee along with the help of subcommittees.²⁴ On September 2009 the King III Report was released and became effective in March 2010.²⁵ The King III Report applies to all the entities whether they are public, private or non-profit organisations. The Report includes an 'apply' or 'explain' approach in its principles, where a company needs to apply corporate governance practices and if not should explain the reason for not applying them. According to the King III Report, the board of companies should comprise of a majority of non-executive directors of which the majority should be independent. The board should assess the independence of the directors and the results be reported at all times; thus showing transparency. According to the King III report, the board is responsible to manage corporate governance effectively. When the board determines the strategy of the company, it must ensure that strategy, risk, performance and sustainability are inseparable.²⁶ The King III Report is voluntary. Voluntary means that all entities even those listed on the Johannesburg Stock Exchange (JSE) should apply certain principles and if they cannot apply should at least explain the reason for not applying them. This level of disclosure allows stakeholders to challenge the board to improve the level of governance within an organisation.²⁷ The need for companies to use the 'apply and explain' approach came into place and the development for King IV came into effect. Recently the draft King IV report was published in November 2016 and will come into effect in April 2017. The report became necessary due to the developments in

²² King II Report on Corporate Governance for South Africa (2002) 7.

²³ The Companies Act No. 71 of 2008. South Africa.

²⁴ King III Report on Corporate Governance for South Africa (2009) 6.

²⁵ King III Report on Corporate Governance for South Africa (2002) 6.

²⁶ Principle 2.2 of King III Report on Corporate Governance for South Africa (2009).

²⁷ King III Report on Corporate Governance for South Africa (2002) 8.

corporate governance since King III came into effect in 2009.²⁸ The King IV report consists of principles, practices and outcomes which serve as the benchmark for corporate governance in South Africa.²⁹ The King IV report has been developed in order to compete with an increasingly demanding and dynamic external environment for different kinds of organisations which consists of Small to Medium Enterprises (SME's), Non-profit organisations, Public sector organisations and entities, Municipalities and entities, Municipalities and Pension funds. The need for good corporate governance is essential for these organisations in order to be able to compete successfully. According to the King IV report, an organisation that adopts good corporate governance in South Africa contributes to the sustainable value creation.³⁰ The objectives of King IV are to promote good corporate governance which will be accessible and fit to all kinds of organisations which vary by the sizes, resources and complexity of their strategic objectives and operations. The King IV is different from King III with regards to 'apply or explain' approach. It requires companies to use the 'apply and explain' approach as corporate governance principles applies to all kinds of organisations.³¹ King IV principles also apply to SMEs and the adaptation of these principles depends on the growth cycle, size, and complexity of the business. The supplements for the King IV report and its board structure are most relevant for the discussion of board structure of family owned companies in the next chapter, as they relatively start small.

Corporate governance structures, codes and practices are essential for businesses in most countries. Corporate governance is no longer restricted to only apply to public listed companies but to all corporations. Most countries, specifically the developing countries, should adopt corporate governance practices so as to attract investors from developed countries.³² The institutional investors need to be certain that the companies they want to invest in are financially sound and transparent, and will continue to be so in the future.³³

²⁸ King IV Report on *Corporate Governance for South Africa* (2016) 2.

²⁹ King IV Report on *Corporate Governance for South Africa* (2016) 2.

³⁰ King IV Report on *Corporate Governance for South Africa* (2016) 1

³¹ King IV Report on *Corporate Governance for South Africa* (2016) 2

³² Rachagan S 'Controlling Shareholders and Corporate Governance in Malaysia- Would the Self-Enforcing Model Protect Minority Shareholders' (2007)3 *Corporate Law Review* 6.

³³ Mallin AC *Corporate Governance* (2010) 45.

It is submitted that corporate governance should apply to all entities. However, corporations differ in size and structure; therefore, each company should apply corporate governance practices that best suit their corporation as King IV provide sector supplements for different kinds of organisations. It has been argued above that in order for companies to grow they need to attract institutional investors for funding specifically from the developed countries. For these investors to have interest in investing in a particular business, they will need to be assured that the business is financially sound through being transparent to the public. The published annual report should give all the detailed relevant information which will create a true picture of the position of the company.³⁴

2.3 DEFINITION OF CORPORATE GOVERNANCE

It has been found that there is no set definition of corporate governance. This often means that people have an idea or know what corporate governance is but there is no accurate definition.³⁵ The UK Cadbury Report (1992) and the South African King Report (1994) define corporate governance as the 'system by which companies are directed and controlled'.³⁶ This definition implies that the responsibility of corporate governance to be practised rests with the board of directors of a company.

According to the Organization for Economic Co-operation and Development (OECD), corporate governance is 'a set of relationships between a company's management, its board, its shareholders and other stakeholders. It also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined'.³⁷ This definition implies that corporate governance comprises the relationship between all the shareholders as well as the stakeholders of the company, working together to ensure that the goals and objectives of the company are met.

Corporate governance can also be defined as: 'The process of controlling management and balancing the interests of all the internal stakeholders and other parties (external stakeholders,

³⁴ King III Report on Corporate Governance for South Africa (2009).

³⁵ Du Plessis JJ, McConvil J & Bagaric M *Principles of Contemporary Corporate Governance* (2005) 1.

³⁶ Du Plessis JJ et al *Principles of Contemporary Corporate Governance* (2005) 2.

³⁷ OECD 'Principles of corporate governance' (OECD September 2015) available at www.oecd.org/daf/ca/Corporate-Governance-Principles-ENG.pdf (accessed 22 November 2016).

governments and local communities) who can be affected by corporation's conduct in order to ensure responsible behaviour by corporations and to achieve the maximum level of efficiency and profitability for a corporation'.³⁸ This definition emphasizes the importance of taking into consideration the interest of all stakeholders and other related parties of the company. This means that the interest of all stakeholders should be taken into account.

According to La Porta, corporate governance refers to 'a set of mechanisms through which outside investors protect themselves against expropriation by the insiders'.³⁹ This definition implies that the outside investors face risks when financing the firms as they might lose their investments; therefore corporate governance is there to protect the outside investors. Huse proposes four definitions of corporate governance. These four definitions are divided into four different groups, which are: Managerial definition, Shareholder Supremacy definition, Stakeholder definition, and Firm definition.⁴⁰

2.3.1. The Managerial definition

The Managerial definition puts more emphasis on the management and internal actors of the company. The board members and external actors are known to be the instruments of management. The role (and accountability) of these board members is to serve the management. Therefore, according to the managerial perspective, corporate governance is used to design systems that can secure the interest and values of the management. The challenges that arise with the Managerial definition are its managerial values and objectives when they come into conflict with the values and objectives of other stakeholders.⁴¹

2.3.2. The Shareholder Supremacy definition

The Shareholder Supremacy definition became the leading corporate governance definition during the 1990s.⁴² The Shareholder definition puts more emphasis on the shareholders. The management and the board members are perceived to be the instruments of the shareholders. The

³⁸ Du Plessis JJ et al *Principles of Contemporary Corporate Governance* (2005) 6.

³⁹ La Porta R, Lopez-de-Silanes F, Shleifer A, Vishny R 'Investor Protection and Corporate Governance' (2000) 58 *Journal of Financial Economics* 4.

⁴⁰ Huse M *Boards, Governance and Value* (2007) 18.

⁴¹ Hendrikse JW& Hendrikse LH *Corporate Governance Handbook Principles and Practice* (2012) 110.

⁴² Huse M *Boards, Governance and Value* (2007) 21.

board is considered to be accountable to all the shareholders, through monitoring managerial opportunism and the potential exploitation of minority shareholders by majority shareholders. The Shareholder definition shows a separation between the ownership and leadership of the corporation.⁴³

2.3.3. The Stakeholder definition

The Stakeholder definition is also called the Triangulation or Interaction definition. Corporate governance in this approach is perceived to be the outcome of interactions between multiple stakeholders. Corporate governance in this regard is defined as the relationship between stakeholders who are in the process of making decisions and exercising control over firm resources. The main actors are employees, customers, suppliers, creditors and the community.⁴⁴

2.3.4. The Firm definition

The Firm definition puts more emphasis on the independence of the board. The main focus of corporate governance in the firm definition is to create value. The board members are required to do what is best for the company and act objectively and fairly when representing all stakeholders. The board members are accountable to act in the best interest of the corporation and create a balance between the interests of internal and external actors. Therefore the purpose of corporate governance in this regard is to facilitate co-operation while resolving conflicts between stakeholders and monitoring control.⁴⁵

In comparing these definitions, the Managerial definition emphasises on what is best for the management. The Shareholder Supremacy definition emphasises on protecting shareholder value. The Stakeholder definition emphasises on the interaction between the relationships of all the relevant stakeholders. According to the Firm definition, its emphasis is on value creation by the board members.⁴⁶

In conclusion, the above definitions of corporate governance can be assumed to apply to big corporate companies which are listed on the JSE. However, the challenges that most companies

⁴³ Hendrikse JW& Hendrikse LH *Corporate Governance Handbook Principles and Practice* (2012) 153.

⁴⁴ Huse M *Boards, Governance and Value* (2007) 22.

⁴⁵ Huse M *Boards, Governance and Value* (2007) 23.

⁴⁶ Huse M *Boards, Governance and Value* (2007) 24.

face in terms of growth forces many of them to apply corporate governance practices in order to exist for a long time.⁴⁷ In sum, it can be concluded that corporate governance has no set definition as there are many definitions provided. However, this research will only focus on the definition of the OECD which states that corporate governance is ‘a set of relationships between a company’s management, its board, its shareholders and other stakeholders. It also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined’. This definition is used to test whether good corporate governance plays a significant role in family owned businesses. Corporate governance does not only focus on its evolution and definition but also on the theories of the development of corporate governance.

2.4 THEORETICAL FRAMEWORK OF CORPORATE GOVERNANCE

There are many theories that have influenced the development of corporate governance. Some of these theories include: Agency theory, Shareholders theory, Stakeholder theory and Stewardship theory.⁴⁸ These theories are discussed as they generate the principles of corporate governance.

2.4.1. Agency theory

According to Mallin⁴⁹, the role of the Agency theory is to identify the relationship between two parties where the owner of the company (principal) delegates the work to the manager (agent).⁵⁰ The Agency theory is concerned with resolving the challenges that may occur between the owners of the company and the management.⁵¹ This relationship may have many challenges as the manager of the company might not act in the best interest of the company.⁵² The Agency theory is against the Chief Executive Officer (CEO) being the chairperson of the same company as there will be conflict of interest. It argues that management will be more favoured while sacrificing the interests of owners.⁵³ The perspective of this theory suggests that managing and

⁴⁷ Naidoo R *Corporate Governance: An Essential for South African Companies* (2009) 38.

⁴⁸ Mallin AC *Corporate Governance* (2010) 42.

⁴⁹ Mallin AC *Corporate Governance* (2010) 42

⁵⁰ Mallin AC *Corporate Governance* (2010) 43.

⁵¹ Eisenhardt KM ‘Building theories from case study research’ (1989) 14 *Academy of Management Review* 532.

⁵² Mallin AC *Corporate Governance* (2010) 43.

⁵³ Donaldson L & Davis HJ ‘Stewardship Theory or Agency Theory: CEO Governance and Shareholder Returns’ (1991) 16 *Australian Journal of Management* 51.

lowering the conflict between shareholders and managers is one of the main functions of a board of directors.⁵⁴

2.4.2. Shareholder Theory

A shareholder is defined as the person who holds shares issued by a company.⁵⁵ The rights of shareholders are protected by law in which the effectiveness of its protection differs by country. Shareholders have a vested interest in the company to ensure that the resources are used to maximise profits and benefit the society as a whole. The shareholders believe that they invested capital in the company therefore they are entitled to profits.⁵⁶ The operations of the company are dependent on the capital that shareholders provide to the company. Shareholders ensure that a company is managed efficiently as they have a vested interest in it.⁵⁷ The shareholder theory states that the interests of the stakeholders of the company should be taken into consideration to an extent that it would be in the interest of shareholders as well.⁵⁸ Therefore shareholders can also be viewed as stakeholders which is discussed next.

2.4.3. Stakeholder theory

The stakeholders in a corporation are the individuals and constituencies that contribute directly or indirectly to the company. Stakeholders are individuals who are affected by the activities of the business. They may have a direct or indirect interest in the corporation. They are divided into two groups: internal and external stakeholders. The internal stakeholders consist of shareholders and, employees and the external stakeholders consist of customers, creditors, suppliers, government and the community.⁵⁹ Employees have a right to purchase shares in a company they work for. A stakeholder approach to corporate governance ensures that the interests of all the company stakeholders are looked at and taken care of, this creates trust between the company, internal and external stakeholders.⁶⁰

⁵⁴ Jaskiewicz P & Klein S 'The Impact of goal alignment on board composition and board size in family businesses' (2007) 60 *Journal of Business Research* 1080(hereinafter *The impact of goal alignment on board composition and board size in family businesses*).

⁵⁵ Hendrikse JW& Hendrikse LH *Corporate Governance Handbook: Principles and Practice* (2012) 146.

⁵⁶ Wiese T *Corporate Governance in South Africa: With International Comparison* (2014) 8.

⁵⁷ Mallin *Corporate Governance* (2010) 64.

⁵⁸ Wiese T *Corporate Governance in South Africa: With International Comparison* (2014) 7.

⁵⁹ Du Plessis JJ, McConvil J & Bagaric M *Principles of Contemporary Corporate Governance* (2005) 19.

⁶⁰ Principle 3.2 (33) of King III Report on Corporate Governance (2009) 56.

2.4.3.1 Shareholders

Companies raise capital in the market by issuing shares to the public. Shareholders are people who invest in a company by purchasing its shares. The main focus of shareholders is return on investment. Shareholders are stakeholders in a corporation as they have a vested interest in the business; however, stakeholders are not always shareholders. The emphasis of shareholders is on profitability over responsibility⁶¹

2.4.3.2. Employees

Employees are a big part of a company as they spend most of their daily lives working in it and benefitting as well in terms of their livelihood. A company cannot operate without employees and therefore they need to be treated with care and respect. A company should ensure that the interests of its employees are well taken care of. In some instances, employees are offered an opportunity to buy and own shares in a company. This is a good strategy to make employees feel part of the company which will result in productivity and loyalty. Companies should have all the proper procedures so as to ensure that should there be any inappropriate misconduct then the employees can feel free to report on them.⁶²

2.4.3.3. Customers

Customers are very important to a company. They need to feel part of the company. The company should build a relationship with its customers so as to have loyal customers who would not purchase the same product from other companies. Therefore a good and healthy relationship between a company and its customers is essential. Furthermore, customers should be aware of the ethical and social aspects of a company's behaviour so as to ensure that it is socially responsible.⁶³

2.4.3.4. Creditors

Most companies borrow money for their start-ups from banks and financial institutions. Therefore it is in the best interest of a company to maintain the confidence of finance providers.⁶⁴ It is submitted that a company should always have a good credit reputation.

⁶¹ Surbhi S Difference between Shareholders and Stakeholders available at <http://keydifferences.com/difference-between-shareholder-and-stakeholder.html> (August 2015).

⁶² Du Plessis JJ et al *Principles of Contemporary Corporate Governance* (2005) 20.

⁶³ Mallin AC *Corporate Governance* (2010) 44.

⁶⁴ Du Plessis JJ et al *Principles of Contemporary Corporate Governance* (2005) 23.

2.4.3.5. Suppliers

Suppliers are interested in the sustainability and continuance of a company as they will wish to have a long-term outlet for their goods and services. Therefore, suppliers retain an interest in the company in order to be certain they will be paid at an agreed time. If a company is going through cash flow problems the suppliers also become alarmed since they get their money from the company. Suppliers build a long term relationship with the company to ensure that they are the only suppliers of the company. Suppliers become concerned when a company is not performing well as they wish for it to exist for a long time.⁶⁵

2.4.3.6. Government

The government has an interest in the company as it ensures that the company acts in a socially responsible way. It ensures that the social, ethical and environmental factors are taken into account. The government does not only show interest in social factors but also market supply of and demand for goods and services.⁶⁶

2.4.3.7. Community

A community ensures that companies in the area act in an environmentally friendly way so as to avoid pollution of soil and the local environment. A community shows interest in the long term sustainability of a company by local employees making sure that it operates in an efficient manner which will benefit the community.⁶⁷

2.4.4. Stewardship theory

The purpose of this theory is not about maximising wealth of the corporation but serving a social purpose. This theory motivates that everyone in society needs to be involved in the governance of a corporation. Stakeholders are encouraged to be part of a company's governance as that will lead to more effectiveness and productivity.⁶⁸ Stewardship theory argues that the roles of CEO and Chairman be unified and held by the same person. This theory believes that the CEO should have complete authority over the corporation so as to avoid confusion and doubt as to who has the responsibility for a certain matter. This theory motivates that a corporation will be more effective and able to produce superior returns should the roles of CEO and Chairman be

⁶⁵ Mallin AC *Corporate Governance* (2010) 44.

⁶⁶ Du Plessis JJ et al *Principles of Contemporary Corporate Governance* (2005) 28.

⁶⁷ Du Plessis et al *Principles of Contemporary Corporate Governance* (2005) 24.

⁶⁸ Hendrikse JW& Hendrikse LH *Corporate Governance Handbook Principles and Practice* (2012) 154.

unified.⁶⁹ It is found that the board of directors and the CEO should always act in the best interest of the company and not in their own interests.

It is submitted that the Agency theory contradicts the Stewardship theory with regard to the CEO's and Chairman positions. It has been argued above that the Agency theory separates the role of the CEO from that of Chairman; however, the Stewardship theory supports that the roles of CEO and Chairman be unified. Therefore there is a contradiction between these two theories of corporate governance. For the purpose of this research, the Stakeholder theory is most appropriate and an important characteristic of corporate governance and is used for the discussion on corporate governance, as it does not only focus on one aspect of corporate governance but covers the theories related to both the shareholders and the stakeholders of a company.

2.5. CHARACTERISTICS OF CORPORATE GOVERNANCE

Corporate governance has important characteristics that companies should always apply in order to grow and be transparent to the public. These characteristics include discipline, transparency, independence, accountability, responsibility, fairness, and social responsibility.⁷⁰

2.5.1. Discipline

Corporate discipline requires the senior management of a company to behave in a recognised and accepted manner. The emphasis is on the senior management to comply with the principles of good governance.⁷¹

2.5.2. Transparency

Corporate transparency requires the management of a company to make sure the necessary information is accurate and available to the shareholders and other stakeholders. The investors should get a clear picture of what is happening inside the company. The company should be

⁶⁹ Donaldson L et al Stewardship Theory or Agency Theory: CEO Governance and Shareholder Returns' (1991)16 *Australian Journal of Management* 52.

⁷⁰ Mallin AC *Corporate Governance* (2010) 56.

⁷¹ Principle 18.1 King II Report on Corporate Governance for South Africa (2002) 11.

transparent as regards to its actions, economic fundamentals and financial and non-financial aspects relevant to the business.⁷²

2.5.3. Independence

It has been found that in all corporations there will always be conflicts. Therefore, corporate independence provides mechanisms which will minimise or avoid potential conflicts which may exist. These mechanisms provide for the composition of the board, the committees of the board and other external parties, such as auditors.⁷³

2.5.4. Accountability

An individual or a group of people that makes decisions for a company and take action on issues pertaining to them are known to be accountable to the company. The mechanisms for accountability need to be effective so as to provide investors with all the information they might need to assess the actions of the board and its committees.⁷⁴

2.5.5. Responsibility

Corporate responsibility is the process that allows for (corrective) action towards all stakeholders. The management of a company needs to put in place certain measures that would set the company in the right direction. The board of a company needs to be accountable and act responsibly towards the stakeholders of the company.⁷⁵

2.5.6. Fairness

Corporate fairness refers to a company's systems which involves taking into account the interests of both shareholders and stakeholders. The interests of these groups need to be respected and acknowledged at all times. The minority shareholders should not be treated any lesser than the majority shareholders. There should always be fairness within the company.⁷⁶

⁷² Principle 18.2 King II Report on Corporate Governance for South Africa (2002) 12.

⁷³ Principle 18.3 King II Report on Corporate governance for South Africa (2002) 12.

⁷⁴ Principle 18.4 King II Report on Corporate governance for South Africa (2002) 12.

⁷⁵ Principle 18.5 King II Report on Corporate governance for South Africa (2002) 12.

⁷⁶ Principle 18.6 King III Report on Corporate governance for South Africa (2002) 12.

2.5.7. Social responsibility

Corporate social responsibility refers to a company being aware of social issues and responding to them in accordance with ethical standards. A company that is a good citizen in the community is likely to benefit through a good corporate reputation.⁷⁷

2.5.8. IT governance

Information systems are built into the strategy of the business. There are risks which come about with information technology and are essential in the business. These risks include the operational risks which are connected with service providers due to information that leaves the company. In IT governance, a company seeks confidentiality, integrity and availability of the functioning of the system. The authenticity, possession and the assurance that the system is useful is pursued in IT governance. The unauthorised use of the system and the changes to it become a concern to the company. The steps by the company need to be taken into consideration in ensuring that information technology operates smoothly in an ethical manner.⁷⁸

2.5.9. Risk Management

In any type of business risk for reward is involved. Risks are undetermined as they can occur any time in a business and could impact on the achievements of the company's objectives. A risk is sometimes taken by a company to pursue an opportunity and in such cases a company should have strategies in place to mitigate risks which may occur. Risk management is the process of identifying and analysing the risk of the business and further take necessary steps to manage it. Risk management may imply mitigating the risk or eliminating it completely. Risk management is essential in all types of companies with different sizes and complexity. Risk management is vital in small companies as they are likely to fail.⁷⁹ It is submitted that family owned companies need to apply risk management policies as they are in a position to fail and miss opportunities.

⁷⁷ Principle 18.7 King II Report on Corporate Governance for South Africa (2002) 12.

⁷⁸ King III report on Corporate Governance for South Africa (2009) 17.

⁷⁹ Principle 4.2 of King III Report on Corporate Governance for South Africa (2009) 73.

2.5.10. Ethical Leadership

The foundation for corporate governance is ethics (integrity and responsibility). Good corporate governance calls for integrity, transparency and accountability which is essentially about effective and responsible leadership. A leader in a company needs to first define the strategy, provide the direction and achieve sustainable performance. The board is required to ensure that the company is run ethically and with integrity. When this is done, the company earns an approval to operate from those who are affected by the operation.⁸⁰

These characteristics are the most important factors of corporate governance. Investor confidence is achieved through the use of these characteristics. Transparency and disclosure are found to be the most important characteristics of corporate governance as the information needs of investors and other interest groups of businesses increase. These two main characteristics serve a bridging role between companies and the public. A company which practises these characteristics stands a better chance of sustainability and this further leads to the benefits discussed below.

2.6. BENEFITS OF CORPORATE GOVERNANCE

Corporate governance is an important tool to be adopted and used by companies. However, it does not have a 'one size fits all' approach. Companies differ in many different aspects, including size and structure. Therefore some of the mechanisms of a company's corporate governance may not be fit to be implemented by other companies. However King IV provides supplements for different organisations as a guideline on how they should exercise good corporate governance. Therefore; a company needs to set down the mechanisms and practices of corporate governance which best suit it.⁸¹ Corporate governance is important to be adopted and established as it impacts positively on the company's growth due to the principles, policies, guidelines, and practices that are set out to help companies in the right direction. It changes the attitude of the people who are in the business. The business gets taken seriously. It further changes the responsibility of directors in the board. The directors have a responsibility to shareholders and stakeholders of the company. Corporate governance contributes to the success

⁸⁰ Principle 2.3 of King III report for Corporate Governance in South Africa (2009) 55.

⁸¹ Du Plessis JJ et al *Principles of Contemporary Corporate Governance* (2005) 11.

of the business by ensuring that sound decisions are made that will benefit the business with regards to returns and reduce the risks.⁸²

2.6.1. Reduction of Fraud and Corporate Collapse

In recent years there have been an increasing number of company collapses due to fraud, scams and corrupt practices.⁸³ These corporate collapses have had many effects on shareholders, employees, suppliers as well as local and international communities. Corporate governance is good for companies to practise. Fraud and company collapse tend to be reduced in companies that practise good corporate governance.⁸⁴ Corporate governance guides companies to conduct the affairs of the business with integrity and honesty.⁸⁵

2.6.2. Creation of Wealth and Improved Performance

Good corporate governance can increase wealth by improving the performance of honestly managed and financially sound companies.⁸⁶ Companies that practise good corporate governance gain added value through making institutional investors pay a premium for their shares as they are well aware of their interests being taken into account.⁸⁷ Therefore, companies with good corporate governance structures tend to attract investors.

2.6.3. Protection of Shareholders and Stakeholders

Corporate governance caters for the shareholders and other stakeholders of the company. It provides mechanisms that ensure that the interests of all the internal stakeholders and other parties who are part of the corporation are taken care of. The board of directors has to protect the interests of all the shareholders, employees, customers, suppliers and local communities. Protection of shareholders and stakeholders will lead to employee productivity.⁸⁸

⁸² Hendrikse JW& Hendrikse LH *Corporate Governance Handbook Principles and Practice* (2012) 105.

⁸³ Fernando AC *Business Ethics and Corporate Governance* (2009) 20.2.

⁸⁴ Mallin AC *Corporate Governance* (2010) 48.

⁸⁵ Hendrikse JW& Hendrikse LH *Corporate Governance Handbook Principles and Practice* (2012) 104.

⁸⁶ Du Plessis JJ et al *Principles of Contemporary Corporate Governance* (2005) 12.

⁸⁷ Du Plessis JJ et al *Principles of Contemporary Corporate Governance* (2005) 12.

⁸⁸ Rachagan S 'Controlling Shareholders and Corporate Governance in Malaysia- Would the Self-Enforcing Model Protect Minority Shareholders' (2007) 3 *Corporate Law Review* 20.

2.6.4. Improves efficiency

Corporate governance has the ability to change the ownership structure of a company. Corporate governance puts pressure on the management of the company to be more efficient, transparent and accountable. The management has the duty to protect social groups and the environment.⁸⁹

2.6.5. Increased access to financing

Another reason for the importance of corporate governance is the increased access to financing. Increased access to financing can lead to larger investment, higher growth and creation of employment. Research shows that there is a relationship between corporate governance and access to financial services. Good corporate governance leads to a better developed financial system which is associated with small and medium enterprises.⁹⁰ It is submitted that corporate governance is important as it provides opportunities for financing. Corporate governance includes policies and structures which make companies transparent while protecting the rights of shareholders and stakeholders. A company that is transparent makes it easier for financial institutions to finance it.

2.6.6. Higher firm valuation and better operational performance

In addition to the arguments above, corporate governance practices do not only affect access to funding but also the firm's valuation and operational performance. Outsiders are more resistant to provide finance to companies where corporate governance practices are not implemented. Furthermore, the outsiders will also charge higher rates if they are not assured that they will get an adequate rate of return.⁹¹ Corporations who do not practise corporate governance are more likely to have conflicts with regard to cash flow and voting rights. With good corporate governance a firm's performance is improved through more efficient management, better asset allocation, labour policies and any other efficiency improvements. Therefore, good operational performance which is done by allocation of resources and good management creates wealth.⁹²

⁸⁹ Rachagan S '(2007) 34

⁹⁰ Claessens SP & Yurtoglu B 'Corporate Governance & Development- An Update (2012) *International France Corporation*' 20.

⁹¹ Claessens S Corporate Governance and Development (2006) 21 *The World Bank Research Observer* 102.

⁹² Claessens SP & Yurtoglu B 'Corporate Governance & Development- An Update (2012) *International France Corporation*' 20

2.6.7. Better relations with other stakeholders

Public and private corporations have relevant stakeholders that play an important role in the corporations. These include banks, bondholders, and local and national governments. These stakeholders play significant roles within a corporation which include monitoring, motivating and ensuring discipline. As it has been discussed, stakeholders hold a very important position in a firm and corporate governance includes policies which protects the rights of stakeholders. A firm cannot operate without them. When the employees are being treated fairly, the company benefits as well, through more output being produced by employees. It is submitted that corporate governance improves labour relations issues which helps both the corporation and the stakeholders.⁹³ Workers will be treated fairly which will result in more work being done and will also attract investors, as they will be happy with the quality of work being done by stakeholders. A firm's financial performance can be improved through a high degree of corporate responsibility in relation to all the stakeholders of the firm. Determining the responsiveness of a company to its stakeholders is not easy; therefore, the effectiveness of stakeholder management depends on the company's transparency and its reputation to the industry.⁹⁴

Good corporate governance assists the board and management to pursue objectives that are in the interest of the organization and its stakeholders, facilitates effective monitoring, and encourages the organization to use its resources more efficiently. Corporate governance is important because it makes good business sense.⁹⁵

The role of the board is to delegate certain functions to board committees, however the board should not abandon its own duties and responsibility. Formal terms of reference should be put in place for these committees. It has been found that corporate governance consists of rules, principles and practices that determine the management and control of a company.⁹⁶ The distribution of power between the shareholders and management of a company is covered under the wing of corporate governance. Corporate governance provides rules and guidelines on the operation of a board of directors, and their duties and responsibility in a company. Good corporate governance provides a balance between the performances of the company while

⁹³ Claessens S Corporate Governance and Development (2006) 21 *The World Bank Research Observer* 107.

⁹⁴ Claessens SP & Yurtoglu B (2012) 28.

⁹⁵ Mallin AC *Corporate Governance* (2010) 49.

⁹⁶ OECD Principles of Corporate Governance available at www.oecd.org/daf/ca/Corporate-Governance-Principles-ENG.pdf (accessed 14 December 2016).

preventing risks of corporate collapse. Good corporate governance promotes the value of transparency of the company as well as ensuring that the interests of both the shareholders and stakeholders are respected and taken into account. Therefore corporate governance is a stability factor for companies in terms of social, political and favourable investments.⁹⁷

2.7 CONCLUSION

It has been found that corporate governance has no set definition. However it is vital for companies to use corporate governance as it provides policies and practices that guide companies in the right direction. There has been an issue with corporate scandals and collapses for which a lack of corporate governance could be the driving force. Corporate governance regulation in SA consists of the King Reports and the Companies Act 2008 which serve as guidelines for companies' boards of directors. Corporate governance provides characteristics which ensure that transparency, accountability, honesty and integrity are practised in companies. Good corporate governance can contribute to the growth and stability of a corporation. The development of corporate governance has been driven by the need to restore investor confidence.

Corporate governance is there to ensure that boards of directors are more accountable, the directors play their key role, and that committees are able to operate effectively. Corporate governance comprises definitions, policies and theories which are set out as guidelines in order to help with the sustainability and growth of companies. There is a great link between corporate governance principles, and guidelines and their characteristics and the failure of family owned companies. For the purpose of this report the Stakeholder theory and OECD definition of corporate governance is used as the ideal for corporate governance and for effective management of family owned companies. This mini thesis in the next chapter, is examining the main critical issues faced by family-owned firms. The challenges faced by family-owned firms are discussed as well as the advantages of having a formal governance structure in a family-owned firm.

⁹⁷ Rachagan S 'Controlling Shareholders and Corporate Governance in Malaysia- Would the Self-Enforcing Model Protect Minority Shareholders' (2007) 3 *Corporate Law Review* 6.

CHAPTER 3

CHALLENGES OF FAMILY OWNED COMPANIES AND BOARD COMPOSITION STRUCTURE

3.1 INTRODUCTION

It has been established that the global economy is well built on family owned firms. The majority of largest multinational companies started as family owned firms and more than 50% of the businesses in the world can be defined as family firms both in developed and emerging markets.⁹⁸ Family dimensions, family characteristics and family involvement constitute the definition of family businesses.⁹⁹ Family businesses are pursued by a family member or few family members in order to fulfil their vision and for the company to be sustainable through generations. Therefore it can be concluded that a family business is a type of business operation where a group of related people come together and have an interest in the corporation.¹⁰⁰ A personal relationship between family members and non-family members is one of the important issues that ensures the survival of the company. Family and non-family members need to nurture their relationship for the continued growth of the business. Although family owned companies are known to have achieved greater outcomes than non-family companies, there are challenges that arise among the stakeholders in the company.¹⁰¹

This chapter seeks to provide an analysis of the family business context, life cycle of a family owned company, board composition and ownership structure. The main critical challenges facing family owned companies are discussed as they affect the survival of the company. A conclusion and recommendations are given based on the information gathered to show family companies could improve their strength and weaknesses. This chapter primarily focuses on medium to large family owned companies that require corporate governance.

⁹⁸ Sarbah A & Xiao W 'Good corporate governance structures: A must for family businesses' (2015) 3 *Journal of business and management* 42 (hereinafter Good corporate governance structures).

⁹⁹ Sarbah A Xiao W *Good corporate governance structures* (2015) 42.

¹⁰⁰ Sarbah A Xiao W *Good corporate governance structures* (2015) 43.

¹⁰¹ Venter E Merwe VD & Farrington S 'The Impacted of selected stakeholders on family business continuity and family harmony (2012) 16 *South African Business Review* 70.

3.2 FAMILY BUSINESS CONTEXT

Families go into business for many different reasons. For some it could be planned, unintended and coincidental. Other family members get an idea of going into business after they have retired from their jobs in order to provide a source of income, avoid starvation and poverty. Other family members grow existing family companies in order to continue the legacy of the past generation. Some start a family business having a desire to create financial stability. All these reasons for starting a family company might either lead to company success and growth or failure in the business.¹⁰² Family owned companies provide an essential co-operation between parents, siblings and other related family members in assisting one another for the success of the business. For the continuing success of the business there has to be smooth interpersonal communication and the relationships between the family members need to provide a good foundation for communicating openly. In order for smooth operation of the business there has to be a level of trust between shareholders and employees; therefore one of the advantages of having a family business is trust between family members. In a family owned company, there are stages that occur throughout the existence of the company which will help with a better understanding of the functioning of the company as well as its strengths and weaknesses.¹⁰³ For this reason, the life cycle of a family owned company is explained.

3.3 LIFE CYCLE OF A FAMILY OWNED COMPANY

It is a standard norm that each family has its own history, rules, values and unique ways of doing things. The structure of the business changes as the family expands, particularly with the participation of the second and third generations. The changes in the business can impact negatively or positively on the business depending on the governance structures in place adopted by the company.¹⁰⁴ The family life cycle consists of three generation stages.

In the first generation, there are few individuals who are owners and shareholders. These shareholders are members of the board of directors and team managers of the company. This approach encourages simplicity in the business. However, if there is no distinction between the

¹⁰² Osi C 'Family business governance and independent directors: The challenges facing an independent family business board' (2009) 12 *Journal of Business Law* 184.

¹⁰³ Carter B & McGoldrick M *The Changing Family Life Cycle: A Framework for Family Therapy* (1989) 1.

¹⁰⁴ Moin MF *The Corporate Governance Guide: Family-owned Companies* (2008) 7.

owners and managers, third parties might find it difficult to have confidence in the company.¹⁰⁵ The first stage is sometimes called the founder controlling owner stage. This is the first stage in the existence of the family business. The company is managed by the founder/owner. The founders in this stage might ask for advice from other business associates but the majority of decisions are taken by the founder. Corporate governance issues are very limited in this stage as the ownership and control still lie with the founder. The most important issue is succession planning as the founder needs to groom the next leader of the company so that the company can survive from generation to generation.¹⁰⁶

The second stage is sometimes called the sibling partnership stage. This is when the ownership of the business is being transferred to the children of the founder. The founder is no longer the owner/manager. There is no simplicity in this stage, things become complex and corporate governance is required. There are challenges that are faced by siblings in terms of harmony, formalising processes and procedures, efficient communication channels and succession planning for management positions.¹⁰⁷ The ownership has been transferred by the founder and not everyone who is part of the ownership has the same interest in the company. In most cases the siblings develop different views about the business which might lead to potential conflicts.¹⁰⁸

The third stage is sometimes referred to as the cousin confederation stage. In this stage, most family members (directly and indirectly) are involved and the running of the business becomes complex. These family members have different views on how the business should be run. The conflicts become more complex in this stage as siblings and cousins have different views on the operation of the company. The challenges that family companies face at this stage consist of family member's role in the business, family conflict resolution, family shareholding rights, shareholding liquidity and family vision and mission.¹⁰⁹ The business requires a high degree of professionalism. In this stage there is a huge need for outside management and corporate governance practices.

¹⁰⁵ Leach P *Family Businesses: The Essentials* (2007) 44.

¹⁰⁶ Abouzaid S *Family Business Governance Handbook* (2011) 15.

¹⁰⁷ Abouzaid S *Family Business Governance Handbook* (2011) 15.

¹⁰⁸ Leach P *Family Businesses: The Essentials* (2007) 45.

¹⁰⁹ Abouzaid S *Family Business Governance Handbook* (2011) 15.

Each of these stages present different issues and challenges; however, they need to be managed properly in order to ensure continuity in the business. It has been found that most family owned companies are successful during the first stage as the decisions are taken by the founder of the company. In the long run the corporate governance structures and mechanisms need to be put in place in order to allow for efficient communication and clear definition of roles in the family company as it is important in the economy.¹¹⁰

3.4 BOARD COMPOSITION STRUCTURE OF A FAMILY OWNED COMPANY

The board of directors is one of the important mechanisms in a family owned company. The research on board of directors mainly focuses on medium to large family owned companies.¹¹¹ Boards of directors bring advice and expertise to the company; therefore, the company needs them in order to minimise potential conflict.¹¹² The role of a board of directors differs from the medium sized and unlisted companies with regards to the presence of the owners managing the company. There is a formal link that a board of directors provides between the owners and the managers who are responsible for the running of the day- to- day business. The board is known as the head of the firm's decision control system.¹¹³ Shareholders in a company are not in good position to effectively control the managers; therefore they install an independent board of directors which are outside members.¹¹⁴

3.4.1 Non-Family Members

It has been argued that a solid board structure of a family company should include non-family members as they are in a position to better see opportunities and pitfalls for the company than family members.¹¹⁵ Non-family members refer to people who are involved in the business through offering their skills and expertise. Non-family members include outside professionals,

¹¹⁰ Ward J *Creating Effective Boards for Private Enterprises* (1991) 1.

¹¹¹ Jaskiewicz P & Klein S 'The Impact of goal alignment on board composition and board size in family businesses' (2007) 60 *Journal of Business Research* 1080(hereinafter *The impact of goal alignment on board composition and board size in family businesses*).

¹¹² Carlo O 'Family business governance and independent directors: The challenges facing an independent family business board' (2009) 12 *Journal of Business Law* (2009) 197.

¹¹³ Brunninge O Nordqvist M Wiklund J 'Corporate Governance and Strategic Change in SMEs: The Effects of Ownership, Board Composition and Top Management Teams' 2007 297.

¹¹⁴ Jaskiewicz P & Klein S *The impact of goal alignment on board composition and board size in family businesses* (2007) 1080.

¹¹⁵ Duller C & Kepler J 'Corporate Governance of Family Firms In Subsequent Generations' (2013) 12 *International Business & Economics Research Journal* 351.

experts, advisors, and consultants who offer an extra dimension of competence, experience and objectivity to issues affecting both the family and the business. There is a considerable role that non-family members play in the business as they maintain positive relationships between family members as well as avoiding conflict between family members. These non-family members perform these duties in order to achieve long-term growth of the company. Non-family members provide new ideas for the company and are in a better position to take advantage of external skills which might help the company be able to grow and successfully respond well to change.¹¹⁶

3.4.2 The Role of the Board of Directors

According to Young et al¹¹⁷ members of the board of directors have a role to ensure that agency costs in a company are reduced. Furthermore, the board structure may have an influence on the strategic choices of a company and plays a significant role in the decision making process. Most family owned companies determine their board structure by having family members as the executives so that they can keep their legacy within the family.¹¹⁸ A family controlled firm has a more centralized decision making system.¹¹⁹ Medium to large family owned companies have a majority of family members on the board of directors.¹²⁰ The role of these board members is to advise and supervise within the company as follow:¹²¹

- Board members ensure that the assets and resources are used properly.
- The responsibility to hire and fire the CEO lies with the board members
- The development of long-term strategies and their approval depends on the board of directors
- Board of directors protect the interests of the shareholders.
- The board oversees the participation of the family within the business.
- The big corporate decisions of a company are taken by the board

¹¹⁶ Venter E & Farrington S (2012) 77.

¹¹⁷ Young J Shapiro D & Klein P 'Corporate Governance, Family Ownership and Firm Value: The Canadian Evidence' (2005) 13 *An International Review* 770

¹¹⁸ Carney M 'Corporate Governance and Competitive Advantage in Family Controlled Firms' (2005) 29 *Entrepreneurship Theory and Practice* 250.

¹¹⁹ Morris MH & Williams OR 'Correlates of Success in Family Business Transition' (1997) 12 *Journal of Business Venturing* 38.

¹²⁰ Carlo O 'Family Business Governance and Independent Directors: The Challenges Facing an Independent Family Business Board' (2009) 12 *Journal of Business Law* 192.

¹²¹ Carlo O (2009) 193.

- The board is very critical where the succession is concerned.
- The management should be asked challenging questions by the board.
- The co-ordination between directors and the CEO must be done through the human resources department to ensure a fair and reasonable selection process.
- The board of directors should develop a succession plan in order to prevent the founder of the company from overly extending their term of office or delaying their retirement.

According to Carlo¹²², most of the independent directors in family owned companies are CEOs of other large institutions, deans and professors at Universities or professionally trained individuals.¹²³ Therefore an independent board of the company comprises non- family members. An independent board of directors should not be part of family quarrels; however, they should help by overcoming any arising challenges. The board should structure a communication process between rival family members.¹²⁴

Family owned firms strive to be the best as compared to their competitors. The need for a professional approach is as important in family owned firms than in non-family firms. They need to prepare for the survival of the firm by establishing governance structures. The strength of a family owned company come from the values of the founder which gives a clear identity in an increasingly corporate world.¹²⁵

The above discussion of the board structure of family owned businesses has been said to apply to medium and large family owned companies. Recently King IV has been developed and contains sectoral supplement for SME's, which is the level the majority of family businesses relatively start at. The King IV SME supplement proposes a board structure that family owned companies should follow and is discussed next.

¹²² Carlo O 'Family Business Governance and Independent Directors: The Challenges Facing an Independent Family Business Board' (2009) 12 *Journal of Business Law* 193.

¹²³ Carlo O (2009) 193.

¹²⁴ Carlo O (2009) 196.

¹²⁵ Gimeno A& Coma-Cros J Family Business Models: Practical Solutions For the Family Business Models (2010) 25.

3.5 BOARD STRUCTURE FOR SME'S

According to the SME supplement board structure of the King IV report, businesses should exercise independence in their board structure for the interest of the company. These businesses should have an experienced non- executive director to serve on the board. In a case where a company does not have enough resources to have a full time non-executive director, they should invite an ad hoc director to sit in the meetings so as to get an inside understanding of the business and be objective when making decisions until a company is able to have a full time non-executive director. As the company grows in its capacity, the board should increase the number of non-executive board directors.¹²⁶ Independent non-executive members need to be appointed by the board in order to provide leadership to the business. In a case where a chair is not a non-executive member, a lead independent non-executive director needs to be appointed as to avoid conflict of interests. The roles of the CEO and Chairman should be separated as the CEO cannot be the chairman of the board. The roles and functions of the chair should be stated in writing and be documented.¹²⁷ The directors who do not have the skills or experience should undergo corporate governance training in order to develop the necessary skills and fulfil their fiduciary duties. A formal process should be followed for the appointment of non-executive members of the board of directors and the obligations of each member should be agreed upfront. To have a mixture of executive directors, non-executive directors and independent members in the board helps with mitigating the risks of taking decisions with emotions specifically in family owned companies where the family members are resistant to change the authority of the founder.¹²⁸ Furthermore full disclosure of each individual should be made so that the shareholders can make their own assessment of the proposed directors.

According to the resources and capacity of SME, It is not necessary for the board to have committees as recommended by the principle. Therefore; it is the duty of the board to fulfil any duties of the board committee which the company lacks. Separate meetings can be held for the

¹²⁶ King IV SME supplement on *Corporate Governance for South Africa* (2016) 5.

¹²⁷ Principle 3.2 of King IV Report on *Corporate Governance for South Africa* (2016) 42.

¹²⁸ King IV SME supplements on *Corporate Governance for South Africa* (2016) 6.

roles of absent board committees in order for the board to focus on specific topic which was the role of the absent committee.¹²⁹

There are certain factors to be taken into consideration when determining the number of members in the board which include the nature and needs of the business. There should be a mixture of executives, non-executive and independent members in the board. Members should have a collective of skills, knowledge, and experience.¹³⁰

It is submitted that the development of King IV can assist in the survival of family owned businesses in South Africa as it is the first regulation to accommodate family owned companies and requires businesses to use the 'apply and explain' approach. However King IV has just been published recently and therefore there is no guarantee that this report will be effective and make any significant contribution to the survival of the family owned companies in South Africa.

A board needs to be established by successful family owned firms. The family involvement is important through dedicated channels such as a family council. The board is very essential in family owned businesses as it ensures the stability in the firm and its values are achieved. The board helps in properly managing strategic issues of the company.¹³¹

The outside directors contribute the success of the firm as they bring new ideas and experiences into the company. They assist with the internal issues of the company ensuring that there is equal treatment between family and non-family executives.¹³²

3.6 FAMILY-OWNED FIRMS AND GOVERNANCE

The majority of family owned firms start relatively small and family members are able to manage and direct the company. The agency problem is rare in a family firm due to ownership and control being one instead of being split, therefore the problems of opportunistic behavior are lessened. A family owned firm is at an advantage of having the ability to be less driven by the short term demands of the market.¹³³ They are more flexible as to when and how they want to

¹²⁹ King IV SME supplements on *Corporate Governance for South Africa* (2016) 7.

¹³⁰ Principle 3.2 of King IV Report on *Corporate Governance for South Africa* (2016) 40.

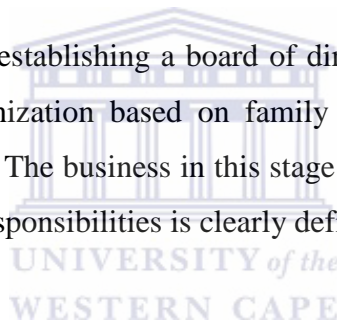
¹³¹ Poza JE & Daugherty MS *Family Business* (2014) 262.

¹³² Leach P *Family Businesses: The Essentials* (2007) 16.

¹³³ Poza JE & Daugherty MS *Family Business* (2014) 2.

make profit. As much as family owned firms start small, there may be tension and division among family members as each person will want to take action in the business which will result in affecting the day to day operations of the business and the long term development of the company. The siblings and different generations might argue about how the business should be and who should hold which position. Therefore the need to have a family forum is vital where each member express their views and the development of the business is discussed. As the business expands and more family members join the business, the establishment of a family council is advisable. When the business expands and the relationships amongst family members affect the effectiveness of the business operation then the need to develop a more formal governance structure is desirable. The advisory board in a family firm may also come into play; however, it does not provide the same benefits as the defined board structure with independent directors and non-executive directors.¹³⁴

According to the Cadbury report, establishing a board of directors in a family owned company means progressing from an organization based on family relationships to one that is based primarily on business relationship. The business in this stage is no longer managed informal; the process for taking decisions and responsibilities is clearly defined.¹³⁵



3.6.1 Advantages Of a Formal Governance Structure in a Family Owned Company.

A formal governance structure contributes positively in a family owned company. It has certain advantages which will be discussed below:¹³⁶

- Corporate governance requires family owned companies to have a defined structure with defined channels for decision making and clear lines of responsibility.
- The sensitive areas may be tackled by the board from a family view point but nonetheless need to be dealt with, such as succession planning (deciding who will fill the key roles in the business should the existing incumbents move on, die or retire). The shareholders also like to know the succession plan of the firm.

¹³⁴ Gimeno A& Coma-Cros J *Family Business Models: Practical Solutions For the Family Business Models* (2010) 14.

¹³⁵ Mallin C (2010) 85.

¹³⁶ Carney M 'Corporate governance and competitive advantage in family controlled firms' (2005) 29 *Entrepreneurship Theory and Practice* 249.

- The directors should be appointed on the basis of their knowledge and their experience that they can bring to the family firm. A good governance system will help the family company achieve its objectives.
- Family companies with good governance structures and views from non-family members will be in a better position to grow in the future.
- Family owned companies with sound corporate governance tend to encourage both transparency and accountability which investors are increasingly looking for in both corporate management and corporate performance.
- The advantages of a formal governance structure include defined channels for decision making and clear lines of responsibility. The sensitive areas from a family view point can be tackled objectively through succession planning.
- A company with good corporate governance is more likely to attract external capital flows than one without.
- A family owned company can benefit from having a good governance structure that will keep the business focused and be able to take views from outsiders that are non-family members so that it can be in a better position to evolve and grow in the future.

It is submitted that having a formal corporate governance structure has a positive contribution to organisations specifically family owned companies. Lack of corporate governance tends to weaken the company. Access to capital can be easily accessible as investors use their resources and contacts for financial support. A formal governance structure can help a company improve its performance through important decisions which may involve the quality of decisions and the goals of the business. The talents and skills of directors can be utilised effectively as members of the company have the required qualifications.

3.7 CHALLENGES OF FAMILY OWNED COMPANIES

Family businesses are inclined to face serious challenges that affect the survival of the company. Many of these challenges arise between family members and relate to family values of the company. These challenges include:

3.7.1 Decisions not Beneficial to the Company

Family owned businesses may not always maximise the welfare of all the stakeholders involved in the company. The decisions that may be taken may not always be for the benefit of the business. In some cases the controlling family members might give jobs to their children while they do not deserve to be part of it. The financial needs of the family might force the family to make the decisions which are not in the best interest of the company so as to maintain their financial status. Family members might keep an unproductive family member on the payroll of the company simply because they are part of the family; further entering into a lease agreement for a building that is owned by a family member and having suppliers which are from within a family and buying the products at uncompetitive prices.¹³⁷

3.7.2 Informal Decision Making in a Family Owned Company

The decisions made in family owned businesses may not be as organised as that of public companies. In a public company, decisions are taken formally unlike in a family owned company where they can take decisions in an informal way which can further disrupt the survival of the company. Furthermore, family members who provide input might have different goals to that of the company. The decisions in the family might be taken for the interest of the related parties and not the company. For instance, the boardroom becomes a forum for acting out deep rooted family conflicts which is caused by tension they had since childhood.¹³⁸

3.7.3 Concentration of Ownership

The ownership of a family owned company is concentrated and privately held therefore it is difficult for an unhappy family member to escape from the company and sell its shares. In a public company members who are unhappy sell their shares and exit the company. Therefore, family members who are unhappy and wishes to exit the company place it at risk of failing as it will be difficult to raise cash. The unhappy family member will force the operating members to borrow money in order to purchase the shares; this puts a company's continued viability at risk.¹³⁹

¹³⁷ Tannenbaum DF & Ratner LP 'All in the Family: Corporate Governance Issues Facing Family-Owned Businesses' (2002) 2

¹³⁸ Tannenbaum DF & Ratner LP (2002) 2.

¹³⁹ Ernesto J *Family Businesses* (2014) 96

3.7.4 Succession Planning

The succession planning in a family owned company is not always based on merit. The founder of the company might be a genius and the company be known through that. The next generation might not have the same drive, vision and passion as that of the founder. Moreover, the next generation may want to prove themselves or be motivated by fear. The outside investors might lose confidence in the company when the founder retires and next generation takes over.¹⁴⁰ Furthermore; the majority of family companies are relatively inactive when it comes to succession planning. The founders of the company are often uncomfortable to talk about succession. However; succession planning has a positive effect in ensuring that a future leader with much needed experience is considered and additional training is provided.¹⁴¹

3.7.5 Resistance to Change

Most family businesses are resistant to change as they believe that things should be done the same way as their parents did before. These family members believe that certain practices worked best when their parents were in charge; therefore there is no need for change.¹⁴² It can be submitted that family members might resist changing the way things are done in the business especially if the change comes from non-family members.

3.7.6 Raising Capital

There is a wide range of capital available for public businesses; however, the opportunities of raising funds for family owned companies are limited. Family businesses find it difficult to raise capital from outside sources as they fear loss of control. They believe that outsiders will acquire influence over how the business is run.¹⁴³ It can be submitted that family members are hesitant to look for funding from outside as they want to keep the business within the family; therefore, are scared that outside funding might risk them losing control of the business.

¹⁴⁰Tannenbaum DF & Ratner LP 'All in the Family: Corporate Governance Issues Facing Family-Owned Businesses' (2002) 3.

¹⁴¹ Carlo O (2009) 196.

¹⁴²Ernesto J *Family Businesses* (2014) 95.

¹⁴³ Leach P *Family Businesses: The Essentials* (2007) 13.

3.7.7. Nepotism and Family Member Issues

The issue of nepotism and selfishness between family members tend to harm the long term operation and efficiency of family owned companies.¹⁴⁴ There may be tensions and divisions among the family members who may take different courses of action that will affect the day- to-day activities in the way in which the business operates, and its long term development. Family owned companies are not governed as effectively and efficiently as non-family owned companies First, family companies face the difficulties of having to deal with family members who want to become part of the company while they have no qualification or experience in the industry. In most cases unqualified family members are asked to participate in positions which exceed their skills and level of experience, while there is someone with the skills to fill up the position.¹⁴⁵ Secondly, managers in a family company do not act in the best interests of outside members as they are supposed to. Thirdly different generations of the family might have different views on how the company should be run.¹⁴⁶ The family members might argue about various things, eg who should hold which position, and these differences might impact negatively on the running of the company. It has been argued that ownership of a family owned company tends to have a higher level of trust which leads to less monitoring of management activity. The managers in a family owned company may act for the controlling family rather than the stakeholders in general.¹⁴⁷

3.8 IMPORTANCE OF FAMILY OWNED COMPANIES IN THE ECONOMY

Family owned companies are important in the economy because they offer powerful opportunities for economic and social empowerment. It has been found that these companies create jobs and wealth more efficiently than non-family companies, and are less likely to lay people off.¹⁴⁸ Furthermore, they provide a better rate of return on investments. It has been found that during the period 1987 to 1992, family companies that were listed on the JSE recorded an overall rate of 36% growth. In comparison, non-family companies returned a rate of 27 per cent

¹⁴⁴ Carney M (2005) 249.

¹⁴⁵ Poza JE & Daugherty *Family Businesses* (2014) 93.

¹⁴⁶ Poza JE & Daugherty MS *Family Business* (2014) 93.

¹⁴⁷ Mallin AC (2010) 89.

¹⁴⁸ Foundation for Family Businesses 'Publicly traded Family Businesses' available at www.familienunternehmen.de. (accessed 16 December 2016).

growth.¹⁴⁹ The statistics are evidence that family companies show more growth than non-family companies. Many companies believe that as the business grows, it will require financial assistance from outside investors in order to pursue its expansion; therefore, outside investors will only invest if they know that their rights and interests are protected both in the context of corporate governance as well as the legal framework of the country. It is found that the majority of investors would be prepared to pay a premium to invest in a company with good corporate governance.¹⁵⁰ Family owned firms are more likely to give out to charity organisations in their respective communities and hardly get into debt.¹⁵¹

Family owned companies run their businesses the way they see fit which can be detrimental to the success and survival of the company. These challenges that have been discussed are the causes of non- continued existence of family owned companies to the second and third generation. Good governance in family owned companies can have a positive effect on the business as there are many challenges. Good governance contributes to the most challenging issues of the business through the board of directors using their expertise. Having a stronger governance and succession strategy helps in persevering the long term vision of the founder and many generations. Family owned businesses have so many challenges for them to deal with in order to succeed in the market. There are always competing priorities for any business therefore every company should ask themselves how much value can they create if good governance and succession planning is a priority to their company. Moreover; good corporate governance in family owned business makes investors and non-family employees gain more trust from shareholders.¹⁵²

3.9 CONCLUSION

Family owned companies do not have a general definition; however, they are firms run by a majority of family members. A personal relationship between family and non-family members is one of the contributing factors to the growth of the company. As the family keeps growing and

¹⁴⁹ Venter E et al 'The Impact of Selected Stakeholders on Family Business Continuity and Family Harmony' (2012) 16 *Southern African Business Review* 70.

¹⁵⁰ Mallin AC (2010) 90.

¹⁵¹ Family Firm Institute, INC available at www.ffi.org/page/globaldatapoints (21 November 2016).

¹⁵² McGee T Rosone B 'Perspectives on family-owned businesses- Governance and succession planning' available at <http://www2.deloitte.com/content/dam/Deloitte/us/Documents/Deloitte%20Growth%20Enterprises/us-dges-fobgovernanceandsuccession-052413.pdf> (accessed 21 July 2016)

being part of the company, the family starts experiencing challenges in reaching sound decisions which will affect the growth and survival of the company. The corporate governance structure can help the company develop successfully and provide means for accountability that would enable the family to benefit from the contribution of independent non-executive directors, and help to ensure a more transparent and fair approach in the way the business is organized and managed. Corporate governance is of high importance to family owned firms. The structures of corporate governance contribute to the development of the firm. Family owned firms are able to benefit from the contribution of independent non-executive directors and a more transparent and fair approach is the way forward for the business. A family company that complies with the King codes set by the King Committee is in a better position to grow. Family companies are the ones that mostly need corporate governance as they often do not survive to the next generation. A family company needs to have a good board structure where there will be executive and non-executive members who are not part of the family as they will make sound decisions that will benefit the company as a whole and not only specific members who are part of the family. Therefore a solid governance structure is required in a family company.

Corporate governance in developing countries needs to be explored so as to get an in-depth understanding of how other countries practise governance in family owned companies. For this reason the next chapter compares the board structure of corporate governance in South Africa and Brazil with regards to family owned companies as well as take recommendations from corporate governance in the US.

CHAPTER 4

COMPARISON OF CORPORATE GOVERNANCE IN SOUTH AFRICA AND BRAZIL SPECIFICALLY IN BOARD COMPOSITION STRUCTURE OF FAMILY OWNED COMPANIES.

4.1 INTRODUCTION

The term ‘corporate governance’ can be defined in very broad terms.¹⁵³ Corporate governance has been defined as the relationship between the board of the company, management, shareholders and stakeholders. Corporate governance places structures in place which were developed to attain the objectives of the company as well as monitoring its performance.¹⁵⁴ This chapter compares two developing countries, namely South Africa (SA) and Brazil with regards to their corporate governance developments. These countries are diverse in their board structure and corporate governance principles. A comparison of the board composition structure between these countries is explained. Furthermore, recommendations from a developed country such as the United States are discussed, including how it exercises corporate governance specifically with regard to family-owned companies. The recommendations from the United States are used as it is a country with a majority of successful family owned companies. This chapter first analyses the state of family owned businesses in SA as well as legislation which consist of principles and practices to guide these family owned companies for their survival.

4.2 FAMILY OWNED COMPANIES IN SOUTH AFRICA

The majority of family owned businesses in SA start relatively small as ‘Small-Medium Enterprises’ (SMEs).¹⁵⁵ These businesses start operating as informal then later change to a formal sector. The formal sectors contribute to the economic development through job creation

¹⁵³ Hubbard P ‘Corporate Governance in Brazil- An International Trade Union Perspective’ (2010) HBS-TUAC 6.

¹⁵⁴ OECD ‘Principles of Corporate Governance’ (OECD September 2015) available at www.oecd.org/daf/ca/Corporate-Governance-Principles-ENG.pdf (accessed 22 November 2016).

¹⁵⁵ The Small, Medium and Micro Enterprise Sector of South Africa *Commissioned by the Small Enterprise Development Agency* (2016) 5.

and economic growth.¹⁵⁶ It has been found that family owned businesses in SA account for 65% of all business enterprises; however less than 33% of family owned businesses survive to second generation and less than 18% survive to third generation.¹⁵⁷ Any business irrespective of the size has governance challenges and needs to implement governance practises within the framework of the company. As soon as the company has shareholders and stakeholders the corporate governance regime for South African companies consist of the King III report as guidelines which they need to comply with. The King report has a board structure that companies need to apply. The composition of the board for South African companies is explained next.¹⁵⁸

4.3 BOARD STRUCTURE IN SOUTH AFRICA

South Africa has a unitary board structure which means that there is a single board of directors comprising executive and non-executive directors.¹⁵⁹ Companies in South Africa differ in their board composition structure depending on the type of business. The King III report applies to all entities regardless of the size or the form of the entity. Therefore its board composition is used in this report. King III follows an ‘apply or explain’ basis approach which means that entities need to apply the principles and should they decide not to apply then explain the reason for not applying.

4.3.1 Composition of the Board of Directors

The King III states that the board should comprise of a balance between executive and non-executive directors. The majority of directors should be non-executive directors as this prevents any possible conflict of interest. The directors should compose of different skills, experiences, and backgrounds. There should be a balance of power between directors so as to prevent any individual from dominating the decision making of the board.¹⁶⁰ South Africa has recently developed King IV which caters for SME’s and recommends them to have a board structure

¹⁵⁶The Small, Medium and Micro Enterprise Sector of South Africa *Commissioned by the Small Enterprise Development Agency* (2016) 5.

¹⁵⁷ Dynes M ‘Africa Investor’ available at <http://www.africainvestor.com/article.asp?id-7949> (accessed 22 November 2016).

¹⁵⁸ Principle 4.2 of King IV Report on *Corporate Governance for South Africa* (2016) 2.

¹⁵⁹ ‘Differences between unitary and two-tier board structures’ available at <http://www.bestboardpractices.blogspot.co.za> (accessed 16 December 2016)

¹⁶⁰ Principle 1.17 of King III Report on *Corporate Governance for South Africa* (2009)

which should disclose practices but may vary from SME depending on the size, resources, and complexity of strategic objectives and nature of the operations and impact of the business.¹⁶¹

4.3.1.2 DUTIES OF THE BOARD OF DIRECTORS

- The board is responsible to act as the focal point for corporate governance.
- The board should have a charter which states its responsibilities.
- The board is responsible to direct, and govern in ensuring the effectiveness of the company.¹⁶²
- The focal point of the corporate governance structure is the board. Furthermore it serves as the link between the company and the stakeholders. The stakeholders should be engaged in the business so as to create trust and confidence in the company.
- The values that should be adhered to in the company should be set by the board.
- The board has a responsibility to put strategies into place in order to account for changing external environment and market conditions.
- The appointment of the Chief Executive officer depends entirely on the board of directors.
- The succession plan for the CEO, senior executives and other board members should be put in place.
- The board has a responsibility to provide leadership and taking the company in the right direction so as to achieve continual survival of the company.
- Risk management in a company is the board's responsibility. The board should oversee the risks areas in a company and be able to take certain measures to prevent such risks.
- The board should always act in the best interest of the company. The decisions taken by the board should place the interest of the company first and not of the individual person.¹⁶³

It is submitted that board of directors are the main important pillars of any organisation. A company without board of directors might end up making wrong decisions. The board of directors are much needed for their skills and expertise to operate effectively in a changing

¹⁶¹ King IV SME Supplements (2016) 4.

¹⁶² Principle 1.8 (30) of King III Report on Corporate Governance for South Africa (2009) 24.

¹⁶³ Principle 1.8 (30) of King III Report on Corporate Governance for South Africa (2009) 24.

environment. Boards are expected to act in the interest of the company in order to take solid decisions for the company.

4.3.2 Selection Process of Directors

The appointment process of directors should be done formally and transparent by the board as a whole. It is the duty of the board to ensure that the potential directors are competent and will bring positive contribution to decisions taken by the board. The background of the potential directors should be investigated to ensure that they have not been declared delinquent or serving probation.¹⁶⁴ King IV recommends that prior to the appointment of a candidate the governing body should consider various factors which include the skills, knowledge and experience of the candidate, reputation, existence of conflict of interest and diversity.¹⁶⁵ There are some developments in King IV as the report considers the existence of conflict of interest when selecting the board of directors as well as diversity being one of the factors that should be considered which will impact positively on the organisation to attract investors.

4.3.3 Qualifications of Board Members

The board should consider the academic qualifications, technical expertise, relevant industry knowledge, experience, nationality, age, race and sex. The effectiveness of the board should be considered based on the size, diversity and demographics.¹⁶⁶ It is submitted that the members of the board should be diverse with regards to gender, race and age. Male and female with different ages that are of different race should qualify to serve on the board. Furthermore should possess academic qualifications and expertise which are in line with the company.

4.3.4 Number of Members in the Board

One of the factors that need to be taken into account when forming a board structure is the needs and circumstances of the company;¹⁶⁷ However, the number of board members should comprise a minimum of two executive directors for all types of companies stated by King III which is the

¹⁶⁴ King III Report on Corporate Governance for South Africa (2009) Principle 1.20 36.

¹⁶⁵ Principle 3.2 of King IV Report on Corporate governance for South Africa (2016) 41.

¹⁶⁶ King III Report on Corporate Governance for South Africa (2009) Principle 1.17 (71) 31.

¹⁶⁷ Principle 1.17 (70) of King III Report of (2009) 30.

CEO and the finance function director.¹⁶⁸ King IV states that in order to determine the number of members who should serve on the board, certain factors should be considered:¹⁶⁹

- The circumstances, needs and nature of its business should be considered.
- A mixture of executive and non-executive and independent members
- A sufficient qualified members should be part of the board
- The skills, knowledge and experiences of members are considered.
- Diversity of members

With regards to the number that should serve on the board, both the South African legislation there are not much changes from the King III to King IV as they both state that members should be skilled and experienced however both these legislations do not state the maximum number of directors who should serve on the board but only state the minimum number of two directors which should be the CEO and at least one other executive.

4.3.5 Independence of Board Members

An independent director is a person who is not an executive officer or employee of the company. An independent director must not have a relationship which would be seen as interfering with the exercise of independent judgement in carrying out the responsibilities of a director.¹⁷⁰ When electing the board members, there should be a balance of power and authority on the board. The majority of members should be preferably independent directors as this reduces any risks of potential conflicts of interests.¹⁷¹ The board should be led by an independent non- executive chairman, and should the chairman not be independent the company should disclose in the integrated report and provide reasons to justify.¹⁷²

4.3.6 Compensation of Board Members

A company is recommended to adopt policies and practises for remuneration that will impact positively by creating value in a company over the long term. These adopted policies should be aligned with the strategies of the company as well as the contribution of the executives to

¹⁶⁸ Principle 1.17 of King III Report of 2009 (73).

¹⁶⁹ Principle 3.2 of King IV Report of Corporate Governance in South Africa (2016) 41.

¹⁷⁰ Principle 1.17 of King III Report of Corporate Governance in South Africa (2009) 31

¹⁷¹ Principle 1.17 (67) of King III Report of (2009) 30.

¹⁷² Principle 1.18 (79) of King III Report of (2009) 32.

performance which needs to be reviewed regularly. When assessing the remuneration of executives, the factors which are outside the influence of the executives should not be taken into account.¹⁷³ It is the responsibility of the board to ensure that a company promotes a culture that supports innovativeness with short and long term related rewards that are fair and achievable.¹⁷⁴ The remuneration committee works hand in hand with the board in setting and administering remuneration policies in the long term interest of the company. The annual bonuses should be related to the annual objectives achieved by executives.¹⁷⁵

4.3.7 Chairman of the Board

The chairman of the board should be appointed and the roles of chairman and CEO should be separated.¹⁷⁶ The chairman is recommended by the King III to be an independent non-executive. The appointment of the chairman should be done on an annual basis.¹⁷⁷ The chairman should be free from conflict of interest on appointment. A lead independent non-executive director can be appointed at the absence of the chairman. King III emphasises on the independence of the chairman which should be monitored; furthermore, the role of the chairman is to monitor the conflicts in a company. The role that is obviously played by the chairman is to govern the workings of the board which include directing the meetings of the board and a peacemaker when elements of the board differ. However, the board should not use its power to towards certain agendas.¹⁷⁸

4.3.8 Conflict Resolution

The internal and external disputes are resolved efficiently and effectively by the board. The board ensures that mechanisms are put in place in order to manage disputes when they arise and resolve them as effectively as possible.¹⁷⁹

¹⁷³ Principle 1.26 (158) of King III Report of (2009) 43.

¹⁷⁴ Principle 1.26(159) of King III Report of (2009) 43.

¹⁷⁵ Principle 1.26 (165) of King III Report of (2009) 44.

¹⁷⁶ Principle 3.2 of King IV Report of Corporate Governance in South Africa (2016).

¹⁷⁷ Principle 1.18 (78) of King III Report of (2009) 31.

¹⁷⁸ Principle 1.18 of King III Report of (2009) 31.

¹⁷⁹ Principle 1.14 of King III Report of (2009) 28.

4.3.9 Committees of the Board

The board is responsible to appoint the audit, risk, remuneration and nomination committees. There is no need for small companies to establish formal committees but they should ensure that the functions are appropriately addressed by the board.¹⁸⁰ The audit and remuneration committees are required to be chaired by independent non-executive director. The establishment of risk, remuneration and nomination committees is vital and is part of the governance process which should be clearly agreed. Board committees should be disclosed in the integrated report.¹⁸¹ King IV report recommends an additional committee which is the social and ethical outcomes committee. The social and ethical outcomes committee is a statutory requirement for some companies however companies should consider establishing it as it a matter of good practice to report on organisational ethics and sustainable development and stakeholder inclusivity.¹⁸²

4.3.10 Accounting and Auditing

The establishment of an audit committee is vital which comprises of a majority of independent non-executive directors. The majority of these members should be financially literate. The chairperson of the committee should be an independent non-executive director. The company should disclose its annual report and if the committee has adopted the terms of reference and if these have been complied with.¹⁸³

4.4 CORPORATE GOVERNANCE IN BRAZIL

Brazil is mainly represented by 85% family owned businesses. Brazil's family business sector is largely composed of small-sized firms – only 15% of the country's family businesses are large.¹⁸⁴ Since 1985, Brazil became a free country when the military-ran government gave up control to the people of Brazil. This caused Brazil to grow to be the 5th largest country in the world by population and 8th largest economy.¹⁸⁵ The economy brought jobs and new

¹⁸⁰ Principle 1.24 of King III Report of Corporate Governance in South Africa (2009) 41.

¹⁸¹ Principle 1.24 of King III Report of Corporate Governance in South Africa (2009) 42.

¹⁸² Principle 3.2 of King IV Report (2016) 47.

¹⁸³ Mallin AC Corporate Governance (2010) 320.

¹⁸⁴ Giulia C ' Infographic: Brazilian Family Businesses' available at <http://www.campdenfb.com/article/infographic-brazilian-family-businesse> (accessed 22 November 2016).

¹⁸⁵ Largest Countries in the World available at <http://10mosttoday.com/10-largest-countries-in-the-world/> (accessed 17 December 2016).

opportunities along with lawlessness and corruption. In the past, Brazil's perception in business was a country with high risk to do business. Groups such as the Brazilian Institute of Corporate Governance (IBGC) were formed in order to minimize the risks and remove negative views on investing in Brazil. Brazil has few government rules to follow with regards to corporate governance therefore companies are not bound by any rules but it's entirely up to them to comply.¹⁸⁶

The law that regulates corporate governance in Brazil is the Brazilian Corporate Law, the Brazilian Securities and Exchange Commission (CVM) and the rules of the Sao Paulo Stock Exchange (BM &FBovespa). Recommendations on Corporate Governance were published by the CVM in 2002 which are voluntary. Brazil has a non-profit organisation called the Brazilian Institute of Corporate Governance (IBGC). The aim of this organization was to promote good corporate governance practices in Brazil. The IBGC published the Code of Best Practice in 2010 of Corporate Governance which is the Brazilian Corporate Governance code. The guidelines of this code apply to any kind of organization and adherence to the code is voluntary. Therefore it is submitted that family owned companies can adhere to the Code of Best Practice of Corporate Governance as the codes apply to any kind of organisation.¹⁸⁷

4.5 BOARD STRUCTURE IN BRAZIL

The board of directors consists of a collective body where the performance depends entirely on characteristics of each member and their individual respect. Brazil has a two-tier board system. A two-tier board system consists of two separate boards of directors that work together to govern the business. These two boards consist of the Management board and the Supervisory board.¹⁸⁸ An advisory board is considered as an informal group which consists of internal and independent members who encourages the adoption of best practices of corporate governance. It is particular for companies who are in the early stages of adopting good corporate governance practises. The difference with the advisory board to the normal management board of directors is that it does not have the power to make decisions. It acts as an advisor and proposes recommendation to the

¹⁸⁶ Eddis C Gray M Miller J Moklestad M & Oskvig J 'Corporate Governance Comparison and Analysis: Brazil (2013) 3 *Drave Management Review* 89.

¹⁸⁷ Brazilian Institute of Corporate Governance *Code of Best Practices of Corporate Governance* (1995) 15.

¹⁸⁸ 'Differences between unitary and two-tier board structures' available at <http://www.bestboardpractices.blogspot.co.za> (accessed 16 December 2016).

company. The advisory board is recommended especially to private and family owned companies.¹⁸⁹

Each member in the board possesses certain characteristics which allow them to make reliable decisions for the betterment of the organisation. The composition of board of directors must consist of members with different attributes such as age, gender, diversity of knowledge, experiences, behaviours, and cultural aspects. In addition, the executive management must define and promote policies which allows for women to have equal opportunities for high positions within the organisation.¹⁹⁰

4.5.1 Composition of the Board of Directors

The board is the principal of the organisation and oversees that the objectives of corporate governance are met. The main objectives of the board are to serve as the guardian of the principles, values, purpose and system of governance of the organisation. The board is responsible to monitor the executive management putting the interest of the organisation first. It is recommended that every organisation should have a board structure which comprises of between five and nine members which are elected by its owners and the stakeholders should be taken into account.¹⁹¹

4.5.1.2 Duties of Board of Directors

- According to the IBGC, the implementation of the board should be considered by every organisation.¹⁹² It is submitted that family owned companies should also practise the principle of having a board in its structure as stated by the IBGC.
- The board is responsible for ensuring that the values and principles of the organisation are identified, discussed and distributed. The strategies identified by the board should be defined and decisions taken that protect the value of the organisation. The board should

¹⁸⁹ Principle 2.18 of Brazilian Institute of Corporate Governance (1995) 56.

¹⁹⁰ Principle 2.2 of Brazilian Institute of Corporate Governance (1995) 42.

¹⁹¹ Principle 2.1 of Brazilian Institute of Corporate Governance (1995) 39.

¹⁹² Principle 2.1(a) of Brazilian Institute of Corporate Governance (1995) 40.

promote an environment where the people in the organisation can express their thoughts and ethical dilemmas.¹⁹³

- The role of the board is to ensure that all the stakeholders receive benefits which are appropriate with the organisation and risks which the stakeholders are exposed to.¹⁹⁴
- The board should ensure that the decisions and actions are aligned with the principles and values of the organisation. It should propose the application of corrective measures as provided by the code of conduct.¹⁹⁵
- In order for board the board to fulfil its mission, it must clearly define the purpose, principles and values of the organisation and ensure they are protected.¹⁹⁶
- The board is responsible to select the Chief Executive Officer (CEO) in an organisation and other executive management members.¹⁹⁷
- The board's role is to value and protect the organisation while ensuring that the return on investments of the company are met as well as taking the interests of all the stakeholders into consideration.¹⁹⁸
- The board is responsible for the sustainability of the company as well as corporate risk management through the use of social and environmental considerations in its decision making.¹⁹⁹
- The general meeting is essential for the appointment of the members of the board of directors. These members of the board are responsible to guide and oversee the management of the board while being accountable to the shareholders. The board is also responsible to appoint and dismiss the CEO.²⁰⁰

4.5.2 Selection Process of Board of Directors

The process for selecting directors must be observant of the principles and values of the organisation as well as the level of maturity, its strategy and expectations with regards to the performance of the board. It is recommended that the profile of the desired candidate be

¹⁹³ Principle 2.1 (b) of Brazilian Institute of Corporate Governance (1995) 40.

¹⁹⁴ Principle 2.1 (d) of Brazilian Institute of Corporate Governance (1995) 40.

¹⁹⁵ Principles 2.1 © of Brazilian Institute of Corporate Governance (1995) 40.

¹⁹⁶ Principle 2.1. (e) of Brazilian Institute of Corporate Governance (1995) 40.

¹⁹⁷ Principle 2.1 of Brazilian Institute of Corporate Governance (1995) 41.

¹⁹⁸ Principle 2.2 of Brazilian Institute of Corporate Governance (1995) 41.

¹⁹⁹ Principle 2.3 of Brazilian Institute of Corporate Governance (1995) 41.

²⁰⁰ Principle 2.1 of Brazilian Institute of Corporate Governance (1995) 41.

disclosed in advance as well as desired qualifications and expectations which are required for the position.²⁰¹

4.5.3 Qualifications of Board Members

Board members should possess certain characteristics which include:²⁰²

- Strategic vision for the organisation
- The member should show commitment to the organisation principles, values and code of conduct.
- The member should have the ability to communicate with other members of the board
- The member should be knowledgeable with regards to corporate governance practices.
- The member should be able to work as part of the team.
- The member should have the knowledge with regards to corporate legislation and regulation.

4.5.4 Number of Members in the Board

The recommended number of board members should be between five and eleven. This number differs according to the size of the organization, its complexity and the stage where it is in its life cycle and whether the creation of committees is viable.²⁰³ The reason for this low number of directors in Brazil is due to the fact that companies in Brazil are run by families that have founded the organization.²⁰⁴

4.5.5 Independence of Board Members

Once the board members have been elected they have the responsibility to fulfil their duties to the organisation regardless of whoever appointed them to the position. The members should perform their duties without any emotional attachment involved. Furthermore; they must perform

²⁰¹ Principle 2.2.1 of Brazilian Institute of Corporate Governance (1995) 42.

²⁰² Principle 2.2.2 of Brazilian Institute of Corporate Governance (1995) 42.

²⁰³ Principle 2.2.3 of Brazilian Institute of Corporate Governance (1995) 43.

²⁰⁴ Eddis C at al'Corporate Governance Comparison and Analysis: Brazil (2013) 3 *Drave Management Review* (2013) 86.

their duties without being personally influenced. They must put the interest of the organisation without the influence of any personal or professional relationship. It is submitted that board members should perform their specified duties without pushing any personal gain agendas. The majority of directors should be independent.²⁰⁵ These independent directors must not have a previous tie with the company and be outsiders to the company's internal workings. The independence of directors should be assessed by the board. The board members who are conflicted on a specific matter should not take part in the decisions on that specific issue.²⁰⁶

4.5.6 Compensation of Board Members

The board members must be effectively compensated taking into consideration the market conditions, the qualifications and the value that is generated by the organisation and the risks involved. Proper compensation motivates the members to fulfil their duties adequately and prevents conflicts of interest. The organisation must have transparent and proper procedures for compensation of board members. The members should be compensated based on the dedication and productivity of work they have done. The Chairman may receive additional compensation based on the work performed but should not be overly compensated greater than the other board members. The annual compensation of board members should be individually disclosed.²⁰⁷

4.5.7 Chairman of the Board

The chairman of the board has a responsibility to seek performance from the board and from the individual members. The guidance of the board as well as a trained diversified board of directors contributes positively to a dynamic board. One of the recommendations by the Brazilian code is that the Chairman and Chief executive officer (CEO) positions should not be held by the same person. Furthermore the CEO should not be a member of the board.²⁰⁸ First, the chairman is responsible to define the objectives and program of the board. Secondly the chairman ensures that the board receives all the required information to exercise its duties in a timely manner. Thirdly, the chairman is responsible to chair the meetings as well as organise and coordinate the

²⁰⁵ Principle 2.16 of Brazilian Institute of Corporate Governance (1995) 54.

²⁰⁶ Principle 2.3 of Brazilian Institute of Corporate Governance (1995) 44.

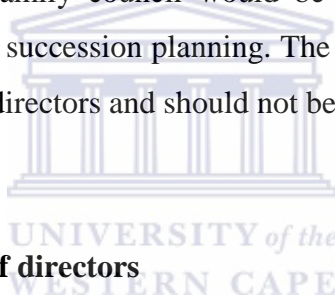
²⁰⁷ Principle 2.16 of Brazilian Institute of Corporate Governance (1995) 54.

²⁰⁸ Principle 2.8.2 of Brazilian Institute of Corporate Governance (1995) 49.

agenda. Fourthly, the chairman has a responsibility to coordinate activities, assign deadlines and monitor the evaluation process to board members. Finally the chairman has a responsibility to create a relationship with the chief executive officer, communicating the resolutions which are adopted by the board of directors.²⁰⁹

4.5.8 Conflict Resolution between Members

Shareholders are recommended to have a right to vote. The conflicts that may arise in the organization should be resolved through mediation and if that fails, arbitration should take place in order to resolve conflicts.²¹⁰ The Brazilian corporate governance recommends the existence of a family council for any potential conflicts. The family owned companies in Brazil are recommended to have a family council in order to discuss the position and expectations of the business. The main role of the family council would be to set boundaries between family interests and business interests and succession planning. The objectives of the family council are different from that of the board of directors and should not be confused.²¹¹



4.5.11 Committees of the board of directors

The members of the committees should be formed by members of the board of directors. They should possess relevant knowledge and experience to the organisation. The board committees in Brazil consist of the audit committee, finance committee, human resources or compensation committee. In each of these committees there should be at least three members who have the knowledge in the specific field as well as one expert in the respective subjects. Any type of organisation is recommended to have an audit committee regardless of its nature or its life cycle stage. One of the important functional aspects in Brazil is the fiscal board. Fiscal boards differ slightly from audit committees as they do not get much involved in the planning and supervision of the audit process, hiring and firing of auditors and other key aspects of corporate risk

²⁰⁹ Principle 2.8 of Brazilian Institute of Corporate Governance (1995) 48.

²¹⁰ Principle 1.10 of Brazilian Institute of Corporate Governance (1995) 36.

²¹¹ Principle 1.10 of Brazilian Institute of Corporate Governance (1995) 36.

management and handling conflicts of interests The purpose of the fiscal council is to provide oversight and control of the administration.²¹²

4.5.12 Accounting and Auditing

The establishment of the audit committee is vital which comprises of members with finance knowledge. There should be at least one member that represents the minority shareholders. The financial statements should be published quarterly long with the details of the factors that affected the performance of the business over the quarter.²¹³

In a study by the Brazilian Institute of Corporate Governance (IBGC), it was found that family owned companies that practice corporate governance principles are more successful than companies that do not.²¹⁴ The IBGC concluded that family owned companies that incorporate corporate governance practices and principles are on average, more profitable, and more finance leveraged than those without corporate governance. The IBGC concluded that the adoption of corporate governance practices is an essential step towards the success of the business.

4.6 COMPARISON BETWEEN BRAZIL AND SOUTH AFRICA

Corporate governance in Brazil has similarities and differences with corporate governance in South Africa. First, one of the similarities is that the recommendations are voluntary but compliance with the listings is compulsory in both countries.

The framework of corporate governance in Brazil is more complex than the corporate governance framework in South Africa. The IBGC is a self-regulatory forum in Brazil which is for privately held and government owned companies. The Brazilian code has become used as the primary reference for corporate governance practices in general. South Africa has a unitary structure while Brazil consists of a two tier board structure. Both these countries require independent executive directors who have the relevant skills, education and experience; however the difference with Brazil is that family owned companies are required to have an advisory board which encourages the adoption of practises of corporate governance. Therefore Brazil recommends a better board structure which caters for family owned companies; however South

²¹² Principle 2.21 of Brazilian Institute of Corporate Governance (1995) 60.

²¹³ Principle 2.21 of Brazilian Institute of Corporate Governance (1995) 59.

²¹⁴ Brazilian Institute of Corporate Governance (1995) 6.

Africa has recently developed King IV which caters for SME's and recommends them to have a board structure which should disclose practices but may vary from SME's depending on the size, and nature of the business.

In both these countries, the interests of stakeholders are emphasized, transparency, equal treatment of shareholders and disclosure requirements.

The formal selection process for both these countries differs. South Africa recommends the process for selecting members be done formally and transparent and the selected candidate have the relevant skills, knowledge and experience. Brazil recommends that the selection process for directors must observe the principles and values as well as the strategy of the organisations. In a case where the board renews its term, it must define the profile of the candidate in advance which discloses the required qualifications and expectations regarding the position.

In both these countries the appointment of the CEO depends entirely on the board. The role of the board in Brazil and South Africa is to ensure that the company is managed and controlled in the right direction.

The number of members in the board structure of South Africa should be a minimum of two executive directors whilst Brazil has a minimum of 5 and maximum of eleven. South Africa does not state the maximum number of directors that should serve on the board.

South Africa and Brazil both focuses on having a board that has majority independent members.

Proper compensation of directors is recommended in both these countries which serve as a motivation in order for directors to perform and exceed on their duties.

The roles of CEO and chairman in South Africa and Brazil should be separated.

The conflict that arises in South African family owned companies should be resolved by the board; however, in Brazil the conflict is resolved through mediation by a family council. A family council is an organ that is responsible to maintain family matters which are separate from the organisation in order to prevent family conflicts that arise between family members in the business. A family council's objective is not the same as the objectives of the board of directors.

A family owned company should create a family council in order to discuss family matters and the association of the expectation of members in relation to the organisation.²¹⁵

Responsibilities of the Family Council:

- A family council is responsible to define the limits between the family and the interest of the organisation.
- A family council protects and stabilises family values using the organisation in promoting unity amongst members and continuity in the family.
- Family council defines the criteria that protect the assets, growth, diversification and administration of the organisation of the family.
- It defines criteria for family members who will be appointed to act as employees in the organisation.
- It further defines succession, transmission of property and inheritance plans.²¹⁶

SA has committees in its board structure which comprises of remuneration, risk, audit and nomination committee whilst Brazil has, finance, audit, human resource, and compensation committee; however, the fiscal committee is the most important functional committee. The South African and Brazilian financial and auditing committee is very vital and requires members with finance knowledge. In South Africa, the members in the committee should comprise of majority independent non-executive directors.

4.6 RECOMMENDATIONS FROM UNITED STATES CORPORATE GOVERNANCE

The United States corporate governance is regulated by legislation as well as rules of stock exchanges. The family owned business is the strength of the economy in the United States. It has been found that 85% of all the businesses in the US are family owned;²¹⁷ furthermore, 60% of the employees are part of family owned businesses. In 2000 the gross domestic product for family owned businesses accounted to 50%, and the result for this was a proper governance of

²¹⁵ Principle 1.10 of Brazilian Institute of Corporate Governance (1995) 36.

²¹⁶ Principle 1.10 of Brazilian Institute of Corporate Governance (1995) 37.

²¹⁷ Sarbah A Xiao W 'Good corporate governance structures: A must for family businesses' (2015) 3 *Journal of business and management* 43.

family owned companies.²¹⁸ Just over half of the public listed companies in US are family owned. The growth of jobs in US represents more than 75% of net growth.²¹⁹ This further shows that US small-medium family owned companies practice corporate governance as they grow to be large listed companies on New York Stock Exchange (NYSE).

The United States' rules are continually updated with changing legislative and market requirements. The standards of corporate responsibility, integrity and accountability to shareholders must be maintained. The boards of directors in the US must comprise of majority independent directors.²²⁰ Furthermore a board that functions well can comprise of more than one non-independent director and that person must be familiar with the company and its operations. A board that is effective should have skilled, experienced and educated members. The board is required to ensure that appropriate risk management plan be in place so as to prevent any challenges that may occur.²²¹

There must be regular meetings with non-executive directors.²²² There must be a compensation committee which is entirely made up of independent directors. The compensation committee will determine the performance of the CEO against the goals of the company and determine the CEO's compensation level as well as the compensation for other executives and the incentives they are entitled to.²²³

The focus of corporate governance in the United States is on public listed companies and the compliance is mandatory. The US laws requires full disclosure of executive remuneration. The board must comprise of majority independent non-executive directors. The US rules states that the role of the CEO and chairman need not be separated. Furthermore a code of conduct is required from companies. The US regulations do not acknowledge the interest of stakeholders other than the shareholders except in a requirement of fair deal by the directors.²²⁴

²¹⁸ Tannenbaum DF Gould & Ratner LLP 'All in the Family: Corporate Governance Issues Facing Family-Owned Businesses' 2002 1.

²¹⁹ Family Business Statistics <http://www.europeanfamilybusinesses.eu/uploads/Modules/Publications/family-business-statistics.pdf> 2012.

²²⁰ Section 303 A. 01 of the New York Stock Exchange of 89 (2009).

²²¹ Section 303.A 02 of the New York Stock Exchange of 89 (2009).

²²² Section 303 A. 03 of the New York Stock Exchange of 89 (2009).

²²³ Section 303A.05 (b) of the New York Stock Exchange of 89 (2009).

²²⁴ Section 303A.05 (b) of the New York Stock Exchange of 89 (2009).

Companies in the US must disclose corporate governance guidelines which consist of director qualifications, director responsibilities, director access to management, director compensation, director continuing education, management succession and annual performance evaluation of the board.²²⁵ The business code of conduct must be adopted and disclosed along with the ethics for directors, officers and employees. The conduct should address the conflict of interest, confidentiality, compliance with the rules and to promote ethical behavior through the encouragement of whistle -blowers.²²⁶ A company that violates the listing standards will be issued a public reprimand letter and for companies that continue violating the rules will be penalised through delisting or suspension.²²⁷

4.10 CONCLUSION

The basis of this chapter was to do a comparative study between South Africa and Brazil in terms of corporate governance practises with regards to family owned companies. It appears at first glance that both countries have same features both economically and cultural to a certain extent and that the corporate governance practices are similar. These two countries have different board structures. Brazil consists of a two-tier board which comprises of Management board and Advisory board; moreover, South Africa has a unitary board which consists of Management board. It has been shown that Brazil has an advisory board which focuses on family owned companies and South Africa had no board that primarily focused on family owned-firms; however, recently King IV has been developed with supplements that cater for SME's. Family owned companies in Brazil are recommended to have a family council which will help in conflict resolution between members; however South Africa does not have any family council which primarily focuses on conflict resolution between family members. Conflicts in South Africa are recommended by King III to be resolved by board members of whom the majority of family owned companies do not really practise King III recommendations. South Africa has shown to recommend only a minimum number of members who should serve on the board while Brazil has both minimum and maximum number of board members.

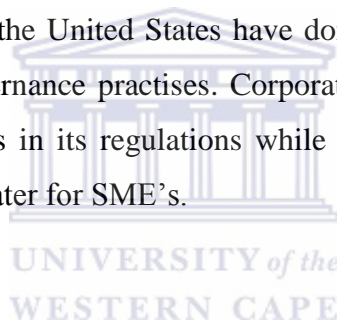
²²⁵ Section 303A.09 of the New York Stock Exchange of 89 (2009).

²²⁶ Report of the New York Stock Exchange Commission (2010) 22.

²²⁷ Section 303 A.13 of the New York Stock Exchange of 89 (2009).

The comparison between Brazil and South Africa has shown that Brazil has a better board composition structure as compared to South Africa. There were gaps in South African board structure which might have affected the survival of family owned companies; however recently the King IV report has been developed and has recommendations which will focus on SME's.

The research literature has shown that the United States is having a different way of corporate governance practises which are much more effective. It is also worth mentioning that in the United States family owned companies are compelled to practise corporate governance and those who fail to comply will be penalised through delisting or suspension where as in South Africa and Brazil companies should apply the corporate governance practises or explain the reason for applying and there is no penalty enforced to non-compliance therefore it is important to move from the Brazilian or South African approach and try to improve their corporate governance laws by copying some of the US laws. Therefore the final finding suggest that both South Africa and Brazil will gain by copying what the United States have done in terms of issuing penalties for non-compliance of corporate governance practises. Corporate governance in Brazil and US do cater for family owned companies in its regulations while South Africa just recently adopted King IV supplements which will cater for SME's.



CHAPTER FIVE

FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 FINDINGS OF THE RESEARCH

The main purpose of this work was to establish the importance of corporate governance in terms of ownership and board composition on family-owned firm performance. A regulatory framework for corporate governance in South Africa does exist but further improvements are required which will have to focus more on family owned companies. King IV report has been developed which also focuses on SME's, however, it has just been recently developed and is no guarantee that family owned companies will practice it. The most challenging issue facing family owned companies is the poor enforcement of the laws and regulations with regards to board composition structures. Brazil has a two tier board system which comprises of Management board and Advisory Board. The Advisory board focuses on family owned companies. South Africa has a unitary board which is a single board system which comprises of executive and non-executive directors.

The recommendations for South African companies is the King report which is voluntary for listed companies, and IBGC for Brazil which is voluntary; however, the United States is ruled by the Sarben Oxly and New York Stock Exchange which is mandatory for listed companies.

The development of corporate governance has been influenced by many theories which comprises of Agency theory, Shareholder theory, Stakeholder theory and Stewardship theory. The stakeholder theory was used in the research as Brazil and South Africa put more emphasis on the importance of stakeholders in an organisation.

The key findings of this research have similarities between Brazil and South Africa. A number of corporate governance mechanisms have been identified such as the regulatory framework, the ownership structure; board composition of directors; shareholders' and other stakeholders' rights.

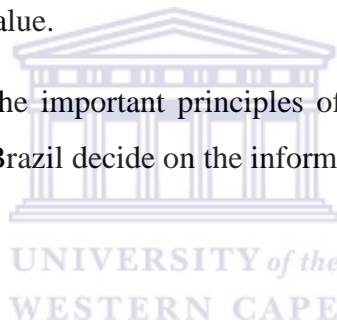
Both United States and Brazil have a minimum and maximum number of directors in their board structure whilst South Africa only has a specified minimum number of directors that should serve on the board.

It has been shown that the roles of the members of the board need to be formalised and clear so as to be able to evaluate the performance of each board member.

In sum it can be argued that corporate governance mechanisms in Brazil and South Africa are similar in many ways. Both these countries require independent non- executive directors in the board and the number of directors should be small as they are more effective.

The board members in Brazil and South Africa are similar with regards to the number of independent directors in the board as they are likely to work in the best interest of the company towards maximizing shareholder value.

Transparency and disclosure are the important principles of corporate governance, however it has been found that companies in Brazil decide on the information they want to disclose.



5.2 CONCLUSION

It has been shown that corporate governance has no set definition; however the need for it is undeniable. Corporate governance comprises of policies, and practises which serve as the guidelines for the companies' direction. These mechanisms are both mandatory and voluntary. The majority of family owned companies do not practice some of these corporate governance practises specifically with separating ownership from control of the business as they feel that they will lose the control of the business. South Africa has a well-developed corporate governance code. The revised codes in South Africa are found to be the most comprehensive in the world; however Brazil is still in the process to encourage compliance with its corporate governance codes.

Corporate governance in South Africa comprises of the King Reports and the Companies Act. The King reports require companies to apply their policies and explain. However, the Companies

Act has principles that are mandatory for companies to apply. Corporate governance ensures that the members of the board of directors are accountable for the running of the business. Investor confidence is achieved through the use of corporate governance characteristics which are transparency, accountability, and disclosure.

It today's world the need for corporate governance is important and a strong enforcement of regulatory systems of corporate governance is extremely important for the continued existence of family owned companies. South Africa has the regulatory systems for corporate governance; however family owned companies do not practice it as it just a recommendation. The majority of family owned companies are aware of corporate governance mechanisms but do not practice them as the rules do not really cater for them.

The need to have a good corporate governance regime has been established as important for the country to attract investors. Investors will not take the risk of investing their capital in a country that does not protect their interests. Investors will examine the existence of corporate governance rules and regulations of that country prior to investing in any country.

The board structure of a company plays a big role in the effectiveness of corporate governance of family owned businesses. This research has pointed out that the role of CEO and the Chairman is likely to be held by the same person in family owned companies; however, it is recommended that these roles be separated as it will create conflicts in the board specifically in family owned companies.

Family owned companies in South Africa and Brazil do not survive to the third generation as they are likely to fail. The reasons for non- survival of these family owned companies are caused by various issues. As the family expands and family members become part of the company, the challenges start arising which will impact on the survival of the company. It has been argued that family owned companies are hesitant to include non-family members in the board structure of the company as they are scared of losing ownership of the family business. It can be submitted that family members in a company put their personal interest before of that of a company.

The board structure is the main principal of any organisation. The decisions which may affect the company depend entirely on the board of directors. The stakeholder interests depend on the board of directors. An organisation without a proper board structure is likely to fail. Family

owned companies are likely to fail due to a lack of effective board structure; therefore, it can be concluded that board composition structure does affect the performance of a family owned company. The interests of all the stakeholders need to be taken into consideration at all times as they attract outside investors.

5.3 RECOMMENDATIONS

Companies with good corporate governance are in a better position to grow, and are able to retain and attract investors. As a family owned company has its challenges which might impact negatively on the growth of the firm, corporate governance is mostly needed to be practised.

First, a family owned company should be able to employ outside people who will be part of the management, and not only have family members. This will help with making sound decisions that will benefit the company and not the individual family members.

Secondly, a family owned company should have a formal board structure that has both executive and non-executive members who are not part of the family so that the decisions taken can benefit the shareholders and stakeholders of the company. Furthermore, the company should have a good board structure where the Chairman of the company is different from the CEO as there will be conflict of interests if the CEO is the same as the Chairman.

Thirdly, a family owned company should have a family council where they discuss their family issues and disputes which might impact on the business as soon as there are conflicts amongst them. As the family business grows and succeeds to the next generation, there are bound to be conflicts between family members on different views about the future of the business. Carlock and Ward define conflict as '*a natural part of human relationships, whether in a family or business setting. Conflict is neither positive nor negative; if handled correctly it leads to new thinking, better planning and decision – and a stronger sense of trust and commitment*'.²²⁸ In a family owned company, it is recommended to have a family governance which will help in aligning the needs of both the family and the business which will help with developing the vision for the future of the business. Having a family council will also help in reducing potential

²²⁸ Carlock R & Ward J *When Family Businesses are Best* (2010) 3.

conflicts between family members and discussing any issues of concern which need clarity. The family council can have a family constitution which will be a detailed document which outlines the values of the family and states the rules which family members have agreed upon. Therefore South Africa should copy from Brazil with regards to having an advisory board for family owned companies in their board structure.

Fourthly, a family owned company should not hire family members simply because they are related to them and do not deserve to be part of the company due to their inadequate qualifications and experience; they will not bring any growth to the company but can only bring conflict and challenges to it.

Family owned companies should compensate their employees properly and give them rewards for their performance in order to motivate them to work harder.

Brazil can copy from South Africa in its selection process of the board of directors as it is done formally and transparent and that could lead to Brazil attracting investors as transparency is the core for attracting investors.

It has been shown that the majority of family owned companies have only family members in the board, however; the outside non-executive directors are important for the board structure of the family business as they offer potential benefit of a more objective, fresh perspective on the business which can lead to greater business performance.

The United States has formal governance mechanism for small and large companies and these mechanisms seem to be working for the survival of these companies. Family owned companies in South Africa and Brazil should adopt formal governance mechanisms for both small and large businesses as they have a positive impact on the performance of the company. Adopting these mechanisms will help family members keep their fingers on the pulse of the progress of the business. Furthermore, the adoption of corporate governance mechanisms will help family members facilitate agreements and communicate better with other parties involved in the business.

It has been identified that the board structure plays an important role in the effectiveness of the company. This research has identified that South Africa does not have a maximum number of

members who should serve on the board. It is recommended that the board members should be a maximum number of at least twelve directors in the board.

It is recommended that evaluation of the boards should be performed on the individual directors and CEO. Evaluation should be based on the actual performance and decision making of directors adhering to corporate governance principles.

On the basis of the above conclusions, it has been argued that South Africa and Brazil have corporate governance laws; however, the challenge is that companies do not practice them as they are a recommendation. The research recommends that South Africa and Brazil should strengthen their legal and regulatory framework of corporate governance to be mandatory to some extent so that companies can apply them.

It has been found that family owned companies have no specific legislation to govern them and this could be the result of high rate of failure. South Africa has already introduced King IV supplements which primarily focus on SME's. The implementation of King IV supplements can have a positive effect on family owned companies as they will now be required to apply and explain the principles stated by King IV.

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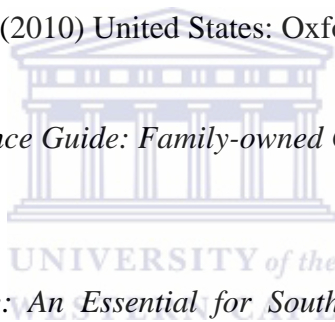
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