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# The Global Corporate Governance Landscape



- A spate of high-profile corporate failures attributable to poor corporate governance, in particular Board of Director effectiveness.
- Exponential growth in shareholder activism.
- Promulgation of Corporate Governance related legislation and publication of Codes of Practice:
  - Sarbanes-Oxley Act 2002, United States.
  - Revised Combined Code 2003, United Kingdom
  - Revised King Code 2002, South Africa

“If a country does not have a reputation for strong corporate governance practices, capital will flow elsewhere.

If investors are not confident with the level of disclosure, capital will flow elsewhere.

If a country opts for lax accounting and reporting standards, capital will flow elsewhere”.

***Arthur Levitt***  
***(former Chairperson of the***  
***US Securities & Exchange Commission)***

“Successful governance in the world of the 21st century requires companies to adopt an inclusive and not an exclusive approach. The company must be open to institutional activism and there must be greater emphasis on the sustainable or non-financial aspects of its performance. Boards must apply the tests of fairness, accountability, responsibility and transparency to all acts or omissions and be accountable to the company but also responsive and responsible towards the company’s identified stakeholders. The correct balance between conformance with governance principles and performance in an entrepreneurial market economy must be found, but this will be specific to each company ”

***Russell M Loubser***  
***CEO JSE Securities Exchange***  
***July 2003***

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Within this context, a key aspect of Corporate Governance that has come under scrutiny and, as a result, is receiving significant attention, is that of Board of Director Effectiveness. In light of these developments, and based upon an overwhelming expression of concern from our client base as well as the broader market regarding compliance with this aspect of Corporate Governance, Deloitte & Touche Human Capital, in conjunction with Deloitte & Touche Legal and Deloitte & Touche Enterprise Risk Services have developed FOREFRONT™.



FOREFRONT™ is a suite of Executive Human Capital solutions that collectively address the myriad issues pertaining to and impacting upon Board of Director Effectiveness, for example, appointment, succession, performance evaluation, development and remuneration.

FOREFRONT™ therefore enables Deloitte & Touche to provide its clients with the opportunity to ensure compliance with Corporate Governance criteria on the one hand and alignment with global best-practice Executive Human Capital solutions on the other.



The primary focus of this presentation is on one of the four core components of FOREFRONT™, namely, Director appointment to the Board. Attention will be devoted to describing both the recommended and legislated Corporate Governance principles and guidelines relating to Director appointment, and how FOREFRONT™ ensures not only a robust compliance with these principles and guidelines but also an alignment with the associated global best-practice Executive Human Capital solutions.



# Corporate Governance in Respect of JSE Securities Exchange Listings Requirements



# 1 September 2003 - 8.63 (a)

In addition to complying with GAAP, paragraph 3.84 of the Listings Requirements, issuers are required to disclose information in the annual financial statements with regard to:

## **The King Code on Corporate Governance**

- A narrative statement of how it has applied the principles set out in the King Code, providing explanation(s) that enable(s) its shareholders to evaluate how the principles have been applied; and

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- a statement addressing the extent of the company's compliance with the King Code and reasons for non-compliance.



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## 1 September 2003 - 3.84 (a) (b)

In addition to complying with 8.63 (a) issuers must comply with the following specific requirements concerning corporate governance and must disclose their compliance therewith in their annual financial statements:

- There must be a policy detailing the procedures for appointments to the Board which must be formal and transparent and a matter for the Board as a whole. Where appropriate assisted by a Nomination Committee which must constitute only Non-Executive Directors, the majority of whom must be independent and should be chaired by the Board Chairperson.

- There must be a policy evidencing a clear division of responsibilities at board level. No one individual to have unfettered powers.



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## 1 September 2003 - 3.84 (C) (d)

- The Chief Executive Officer must not also hold the position of Chairperson.
- The issuers must appoint an Audit and Remuneration Committee and if required, given the nature of their business and composition of their board, a Risk and Nomination Committee. The composition of such committees, a brief description of their mandates, the number of meetings held, and other relevant information must be disclosed in the annual financial statements.

## 1 September 2003 (e) (f)

- A brief CV of each director standing for election or re-election at the annual general meeting should accompany the notice of annual general meeting contained in the annual financial statements; and
- The capacity of each director must be classified as Executive, Non-Executive or Independent Non-Executive according to the classification criteria listed in the King Code.

# Boards and Directors

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# The Implicit Duties of the Board

The Board should...

- ❑ Determine the company's core purpose and values.
- ❑ Determine the strategy to achieve the company's core purpose and to implement its values in order to ensure that it survives and thrives.
- ❑ Exercise leadership, enterprise, integrity and judgement in directing the company so as to achieve continuing prosperity for the company.

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- Ensure that the procedures and practices are in place to protect the company's assets and reputation.
- Monitor and evaluate the implementation of business strategies, policies, management performance criteria and business plans.
- Ensure that the company complies with all relevant laws, regulations and codes of best business practice.
- Ensure that the technology and systems used in the company are adequate to run the business properly and for it to compete through the efficient use of its assets, processes and human resources.

- Identify the key risk areas and key performance indicators of the business enterprise in order for the company to generate economic profit, so as to enhance shareholder value in the long term.
- Regularly assess its performance and effectiveness as a whole, and that of individual Directors, including the Chief Executive Officer.
- Ensure that the company has developed a succession plan for Executive and Non-Executive Directors and senior management.

# Good Governance Principles Governing Directors

- ❑ Directors must ensure that they have the time to devote to properly carry out their responsibilities and duties to the company.
- ❑ Directors should exercise both their care and skill any reasonable person would be expected to show in looking after their own affairs as well as having regard for their actual knowledge and experience.
- ❑ Directors must qualify themselves on a continuous basis with a sufficient understanding of the company's business and the effect of the economy so as to discharge their duties properly.

- Directors must be informed about the financial, industrial and social milieu in which the company operates.
- Directors must be satisfied that they are in a position to take informed decisions.
- Directors must be diligent in the discharging of their duties to the company,...and must acquire a broad knowledge of the business of the company so that they can meaningfully contribute to its direction.

## **Different Types of Director**

In law there is no real distinction between the different categories of directors. Nevertheless it is an established practice, however, to classify directors according to their different roles on the Board.

The classification of directors becomes particularly important when determining the appropriate membership of specialist sub-committees of the Board, and when making disclosures of the directors' remuneration in the company's annual report.

# Categories of Director

## **Executive Director:**

“Any individual involved in the day-to-day management and/or in the full-time salaried employment of the company and/or any of its subsidiaries”.

## **Non-Executive Director:**

“An individual not involved in the day to day management and not a full-time salaried employee of the company or its subsidiaries”.

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## **Independent Non-Executive Director:**

In essence, an Independent Non-Executive Director is a Non-Executive Director who:

- ❑ Is not aligned with any major shareholders.
- ❑ Has not been a high-level employee of the company for the past three years.
- ❑ Does not provide professional advice to the company or group.
- ❑ Has no significant business or contractual ties to the company or group.

The need for this third category of director is especially apparent in an environment where extremely complex and diversified group structures have evolved and where it has become common to share the same directors on all the the various Boards throughout the group.

It is also especially relevant to appoint an Independent Non-Executive Director when the roles of Chairperson and CEO are combined and also where both the Chairperson and CEO are Executive Directors.

The three different types of directors each bring a different area of focus to the Board:

- Executive Directors have an intimate knowledge of the workings of the company.
- Non-Executive Directors may have a better understanding of the issues facing the group as a whole.
- Independent Non-Executive Directors bring a totally unclouded viewpoint to the Board, as well as experience gained at other companies.

## **Board Sub-Committees**

The directors are generally empowered by the Articles of Association to form sub-committees and delegate certain of their powers to these committees.

The members of each committee are usually able to elect one of the members as Chairperson of the committee.

It is recommended that the delegation of powers to a sub-committee be made official, in order for the members to have formal terms of reference to determine the scope of their powers, and the responsibilities they bare.

Board sub-committee terms of reference would generally encompass the following:

- ❑ The composition of the committee.
- ❑ The objectives, purpose and activities.
- ❑ The powers that have been delegated.
- ❑ Any mandate to make recommendations to the Board.
- ❑ The lifespan of the committee.
- ❑ How the committee reports to the Board.

The most common Board sub-committees encountered are the following:

- Nomination
- Remuneration
- Risk Management
- Audit
- Executive

# The Nomination Committee

The role of the Nomination Committee is to review, on a regular basis, the composition of the full Board, and where it appears that the Board is lacking in knowledge, skills or experience in a certain area, to identify how best to rectify the situation. This may involve identifying skills that are required, and those individuals best suited to bring these to the Board.

The King Code suggests that the Nomination Committee should comprise at least three Non-Executive (and preferably Independent) Directors. It would not usually be appropriate for any Executive Directors to sit on the committee.

The ideal situation is for the Chairperson of the Board to also chair the Nomination Committee, failing which an Independent Non-Executive Director should act as the Chairperson.

The Nomination Committee is empowered to consider the balance of the full Board, and to make recommendations where, in the opinion of its members, improvements could be made. It remains the responsibility of the full Board of Directors to consider the recommendations made and to vote on any nominated appointments, or as the case may be, any removals.

One of the important considerations for the committee is whether there are adequate succession plans in place to mitigate the effects of losing key members of the Board, specifically Non-Executive Directors as these individuals may be more difficult to replace than Executive Directors who have followed a defined career path through the management of the company.



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# The Appointment of Directors

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The appointment of a director is one of the most important decisions that is put before the shareholders of a company.

From a legal perspective, it is important to ensure that the required procedures of the appointment are carried out correctly, to avoid any unwanted ramifications in the future.

# Who Qualifies as a Director ?

With a few specific exceptions, anyone can be appointed as a director of a company.

## Legal Qualities Required to be a Director

In the South African context, the Companies Act is the primary determinant of who may or may not be appointed as a director.

Section 218 of the Act in essence provides that any person may be appointed as a director, provided that he or she is:

- ❑ An individual (and not a juristic person).
- ❑ Over the age of 21 (or where the Court has determined that they are no longer a minor).
- ❑ Not under legal disability (where the Court has declared that the individual cannot manage their own affairs).

The Court is required to specifically approve the appointment of any of the following as directors:

- An unrehabilitated insolvent.
- Any person who previously held a position of trust, but was removed as a result of misconduct.
- Anyone who has ever been convicted of:
  - Fraud
  - Forgery
  - Perjury
  - Corruption
  - Any offence related to the setting-up or running of a company

# Director Appointment – The Status Quo

Despite the recognised and acknowledged importance of Board effectiveness to company performance and given the substantial challenges involved in achieving the right Board composition, a high level of informality continues to surround and typify the the process of appointing directors, in particular Non-Executive and Independent Non-Executive Directors.

Although the majority of Boards of listed companies (JSE Securities Exchange 100 and FTSE 100), have a Nomination Committee, it is all too often the least developed of these Boards' sub-committees, usually meeting irregularly and often without a clear understanding of the extent its role in the appointment process.

Research conducted as part of the recent review by Derek Higgs on “The Role and Effectiveness of Non-Executive Directors” in the UK revealed that almost 50% of the subjects (Non-Executive Directors) interviewed were recruited to their role through personal contacts or friendships. Only 4% had undergone a formal interview, and 1% had been appointed as the result of responding to an advertisement.

Higgs concluded that with regard to Non-Executive Director appointment that previous boardroom or top management experience is often the main, and sometimes the only competency that companies seek from candidates.

As a result of “traditional” Board selection and recruitment practices, many directors, in particular Non-Executive and Independent Directors, have been sourced from relatively narrow pools of people sharing common experiences, career patterns and backgrounds. Consequently, many Boards lack a diverse range of skills, experiences and perspectives that could help them address the diverse challenges confronting their companies.

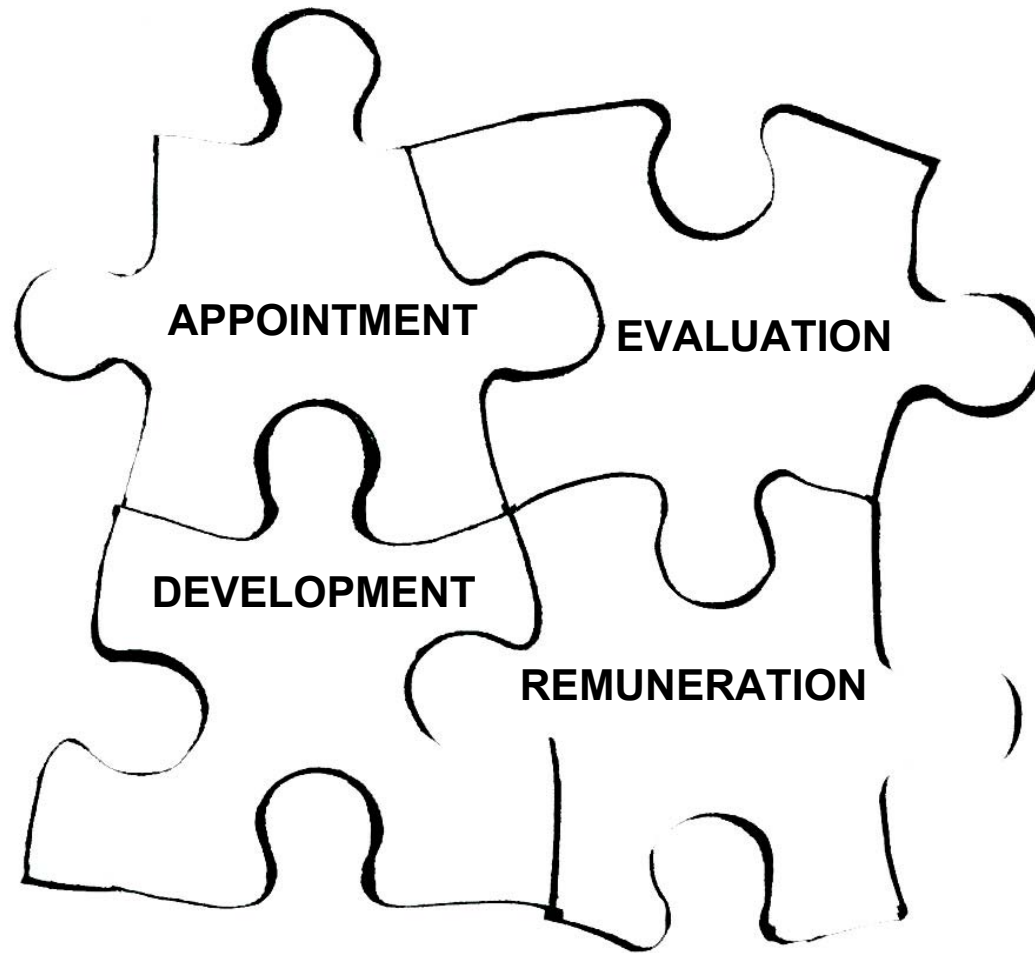


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**APPOINTMENT**



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**“The Board should be composed of individuals of integrity, who can bring a blend of knowledge, skills, objectivity, experience and commitment to the Board”**

***King Report II, Chapter 11, Section 6***

“Identifying individuals of suitable quality and background is essential for a high performing board. The nominations and appointments process is crucial to strong corporate performance as well as effective accountability”

*Higgs Report, Paragraph 10.2, Chapter 10*

“...a rigorous, fair and open appointment process is essential to promote meritocracy in the board-room and existing best-practice for nominating directors should be universally adopted”

*Higgs Report, Paragraph 10.8, Chapter 10*

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“Before making an appointment, the Nomination Committee should evaluate the balance of skills, knowledge and experience on the Board and, in light of this evaluation, should prepare a description of the role and a profile of the capabilities required for that particular appointment”

*King Report II, Section 11, Chapter 6*

“The best boards are composed of individuals with different skills, knowledge, information, power, and time to contribute. Given the diversity of expertise, information and availability that is needed to understand and govern today’s complex businesses, it is unrealistic to expect an individual director to be knowledgeable and informed about all phases of business. It is also unrealistic to expect individual directors to be available at all times and to influence all decisions. Thus, in staffing most Boards, it is best to think of individuals contributing different pieces to the total picture that it takes to create an effective Board”.

*Conger and Lawler, 2001*

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**FOREFRONT™** offers a range of services that provide support and consulting around:

- ❑ **Pre-Appointment Board and Company Due Diligence**
- ❑ **Sourcing of Candidates**
  - ❑ Extensive data-base of high-calibre candidates
  - ❑ Executive Search expertise
- ❑ **Nomination Committees**
  - ❑ Terms of Reference
  - ❑ Enablement
  - ❑ Professional advice

- ❑ **Director Success Profile Formulation**
  - ❑ Executive Job Challenges / Preparatory Experiences
  - ❑ Industry and Organisational Knowledge
  - ❑ Executive Competencies
  - ❑ Personal Attributes
- ❑ **Executive Assessment**
  - ❑ Global best-practice aligned
  - ❑ Multiple customisable assessment methods and configurations
- ❑ **Drafting of Letters of Appointment**
- ❑ **Appointment Formalities in terms of relevant Acts**
- ❑ **New Director Induction and Orientation**

EVALUATION

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“An effective board is recognised as one of the principal factors in a successful company. Without a robust evaluation process it is not possible for a company to know with any certainty whether it’s board is operating in the most effective way”

***Institute of Chartered Secretaries and Administrators,  
Board Performance Evaluation Guidelines, page 2.***

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“Effective and meaningful evaluation can only take place once the board has determined it’s own functions and identified the key roles and performance criteria and related performance standards for directors”

*King II Report, Section 3, Chapter 6*

“The board through the Nomination Committee should regularly review it’s required mix of skills and experience and other qualities such as it’s demographics and diversity in order to assess it’s overall effectiveness. This should be by means of self-evaluation of the Board as a whole, it’s committees and the contribution of each individual director”

*King II Report, Section 11, Chapter 6*

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Our services cover support and consulting around:

- **Role clarity definition**
  - Main Board
  - Sub-Committees
  - Individual Directors – Executive, Non-Executive & Independent
- **Board evaluation framework development**
- **Performance agreement drafting**
- **Performance evaluation enablement**
- **Professional legal advice on the removal of incompetent and / or non-performing directors**

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**DEVELOPMENT**

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“... an entrenched board-room culture tends to regard non-executive directors as being fully equipped for the role without the need for any further personal development. In some cases this presumption may be justified; in most, it is not”

***Higgs Report, Paragraph 11.12, Chapter 12***

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“...as part of the board evaluation process,...directors should regularly appraise their individual skills, knowledge and expertise, and determine whether further professional development would help them enhance their expertise and fulfill their obligations as members of the existing board”

*Higgs Report, Paragraph 11.13, Chapter 11*

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“Board succession should involve an assessment of the challenges and opportunities facing the company, and an evaluation of the skills and expertise that will be needed by the board in the future...Chairmen and Chief Executives should consider implementing executive development programs to to train and develop suitable individuals”

*Higgs Report, Paragraphs 10.13 and 10.14, Chapter 10*

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Our services cover support and consulting around:

- ❑ **Executive Management and Board Succession Management**
- ❑ **Training on Corporate Governance matters**
- ❑ **Development need prioritisation – based upon formal assessment and evaluation**
- ❑ **Professional advise on range of development solutions for Board members**
- ❑ **Development Plan Formulation**
- ❑ **Mentorship Enablement**
- ❑ **Executive Coaching**



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REMUNERATION

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“Companies should include a “Statement of Remuneration Philosophy” in their annual report and financial statements so that shareowners and stakeholders can comprehend the Board’s policy and motivation in setting remuneration for directors in a particular way or mix”

*King II Report, Section 1, Chapter 4*

**“Levels of remuneration should be sufficient to attract, retain and motivate executives of the quality required by the Board”**

***King II Report, Section 1, Chapter 4***

“Performance-related elements of remuneration should constitute a substantial portion of the total remuneration package of executives in order to align their interests with those of the shareholders”

*King II Report, Section 1, Chapter 4*

**“Companies should provide full disclosure of director remuneration on an individual basis, giving details of earnings, share options, restraint payments and all other benefits”**

***King II Report, Section 1, Chapter 4***

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Our services cover support and consulting around:

- **Executive Reward Strategy Formulation**
  - Pay mix and balance
  - Retention mechanisms
  - Long-term performance orientation
  - Shareholder value and sustainability
- **REMCO advice on executive pay and associated governance**
- **EXECUVAL™ job scoring / sizing and executive pay benchmarking**

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- **Non-Executive and Independent Director pay and pay structuring**
- **Long-term incentive design**
  - Share schemes
  - Phantom share schemes
  - Performance unit plans
  - Economic value pools
- **Global executive pay trends and best practice advice**

The combined expertise and experience from Deloitte & Touche Enterprise Risk Services, Deloitte & Touche Legal and Deloitte and Touche Human Capital Corporation ensure that FOREFRONT™ delivers its services at the highest levels of compliance, and in line with global, national and industry trends.





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