Unethical behaviour damages not only a company's health but also public virtues, and reputational capital is difficult to repair

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Corruption and poor ethics are often associated with the public sector. As a public-sector union, the Public Servants Association of SA (PSA) is aware of the simplistic narrative of the public sector being synonymous with bad governance, and the private sector being the paradigm of virtue. However, events of the past few years in SA have debunked this myth with some of the worst forms of rent-seeking or breach of corporate governance being found in the private sector.

This ranges from bribes, dodgy procurement contracts, accounting fraud, price fixing, and unproductive friction between boards and executive committees.

Whenever the opportunity arises, business elites have not hesitated to cultivate the patronage of politicians. In some instances, they have found elaborate ways of unburdening themselves of the responsibility to pay their fair share of tax, even if this means denying the government much-needed resources to undertake development programmes, fix infrastructure, galvanise public-sector institutions, and deliver services to the poor.

Unethical behaviour by business damages not only a company's health but also public virtues. Reputational capital is difficult to repair once it has been damaged.

One of the reasons why many corporates that still behave badly, with leaders that don't take ethics seriously, is that sometimes shareholders and boards place singular emphasis on competence and quantitative results at the expense of good behaviour. There are leaders who are competent technically, who get the job done, and show good quantitative results, yet are found wanting when it comes to ethics.

When management fails to produce the expected results, they use all manner of trickery to hide their incompetence or the fact that they are not all-knowing.

We saw this with Steinhoff in early 2018, when the company manipulated its financial statements to project a good bill of health when this was, in fact, not the case. Its financial results for two financial years since 2015 could not be relied on and had to be restated.

Problems came to light at Steinhoff when its auditor Deloitte refused to sign off on the company's statement for the financial year through to September 2017. Deloitte had previously signed off on similarly dodgy statements at the company. It is often professional auditing and accounting firms that abet these governance breaches in firms.

Hardly a year after the Steinhoff scandal, the sugar behemoth Tongaat Hulett announced that it would have to restate its 2018 financials owing to an inexplicable accounting hole. The same auditing firm, Deloitte, had signed off on these financials. The main issue here was that the previous financial statements had inflated the company's earnings by about R4.5bn, essentially deceiving shareholders and the public.

Companies engage in this deception to avoid shareholder scrutiny that is occasioned by decline in earnings, and which often negatively impacts the company's share price. The thrust of shareholder capitalism is a singular focus on the metrics of maximising shareholder value above all else.

It is assumed that the managers exercising stewardship over companies are competent and capable of delivering value to shareholders. Companies hardly place any ethical test other than the perceived

reputation of its executives or board members. When management fails to produce the expected results, they use all manner of trickery to hide their incompetence or the fact that they are not all-knowing.

When profitability declines and the managers' magic potion proves to be nothing more than ephemeral luck, they get embarrassed.

The incentive structure of corporates is tied to profitability rather than a set of values or a maximisation of broader stakeholder outcomes. Given the structure of incentives, it should not be surprising that a singular focus on shareholder value is bound to lead to a dark alley. Accounting firms that should uphold high ethical standards have done their fair share in eroding corporate governance. They are positioned to play a powerful assurance role, which they abuse.

Despite various governance regulations, such as the King codes of corporate governance (King IV), international financial reporting standards (IFRS), and the Companies Act, ethical behaviour in corporates does not seem to improve.

Multi-tiered failure

What we have seen in cases such as Steinhoff and KPMG are ethical failures at multiple levels: failure by auditors to perform their duties; failure by boards to play an oversight role; and failure by the executive to perform its stewardship.

In many of these companies, especially at board level, there is clear failure by audit and risk committees to provide the final line of assurance for investors and stakeholders. Another key dimension of ethical failure is weak diversity at board and executive levels.

There is no trade-off between great performance and ethical conduct

In the case of KPMG scandal in which the company had produced a questionable report on the existence of the so-called rogue unit at Sars and was implicated in unseemly relationships with the Gupta family, for which it was an external auditor, a woman was only appointed as CEO at the point of crisis. KPMG brought in Nhlamulo Dlomu at the time when the possibility of failure was greatest.

Taking short cuts to show "good" results may be part of an ingrained corporate practice, and therefore acceptable culture in some organisations. There is no trade-off between great performance and ethical conduct. In the long run, businesses that are imbued with an ethical culture and moral leadership do well even on quantitative metrics. There are other questionable practices that corporates engage in that on appearance may not look illegal but come across as clever tactics.

We saw this when ethical norms were also breached in the construction sector. Various large construction firms agreed to divide procurement opportunities among themselves for the construction of six stadiums for the 2010 Fifa World Cup. As a result of their collusion, each corporate entity managed to strike a comfortable profit margin of 17.5%. Clearly, their preoccupation was greed rather than offering a service and delivering at fair value.

As a result of their rigging, the market mechanism and the principle of fair value were undermined. Broader stakeholder interest was ignored. This meant that the government devoted more public funds than would have been necessary, had such underhanded dealings not taken place.

Ethical leadership is key to good governance. This is more of an internal imperative and has to be wired into the normative make-up and organisational culture in companies. Responsible corporate

citizenship, which assumes inter-dependence between corporates and citizens, imposes responsibility on corporates to act in ways that reinforce society's ethical standards.

Measures such as King IV, which place emphasis on principles rather than legalism, are designed to nudge corporates towards higher ethical standards. It is important for corporates to understand the unique and powerful role they occupy in society, and act in ways that strengthen rather than weaken public virtues and trust.

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