Critical Analysis of Principle One and Two of King IV Report on Corporate Governance: Leadership and Ethics

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Abstract: Principle one and two of King IV Report on Corporate Governance which came into effect on the 1 April 2017 indicates that governing body should lead ethically and effectively, while principle two demonstrates that the governing board should guide the ethics of organisations in a way that supports the establishment of ethical culture. According to King IV report, principle one indicates that it is the responsibility of the governing body to cultivate collectively or individually, the six ethical characteristics, which are: Integrity; Competence; Responsibility; Accountability; Fairness; and Transparency. The six characteristics should also assist the governing body in setting the tone at the top to lead the organisation ethically and effectively, and the governing body should also be held accountable for them. Principle two indicates that the governing board should govern the ethics of the organisation in a way that support the establishment of the ethical culture in the organisation. Research methodology adopted for this study is qualitative. The existing literature and practices of organisations were systematically reviewed and synthesised. The process involved the review of journal papers, books, Commissions reports, and internet sources. The systematic review of the literature was an attempt to answer the research question aimed at drawing a more reliable finding from which conclusion could be drawn. The governing body should, therefore, take the responsibility of ensuring that there is the governance of ethics in the organisation. This is a conceptual paper, and critically analyses assess and discuss the envisaged ethics as per King IV report on corporate governance. Ethical leadership in the organisation remain an evasive commodity; hence, the many failures experienced in the different organisations.

Keywords: Accountability, Ethical culture, Ethics, Governance, Governing body, Integrity

1. Introduction

The concept of good corporate governance is principally about effective, ethical leadership (Schermerhorn Jr & Dienhard, 2004:60; Naidoo, 2012:25). With the release of the King IV report on November 2016, it has raised South African status to one of the world leaders on issues of corporate governance (Ernst & Young, 2016). According to King IV, when compared to the previous King reports, particularly King IV, the issue of ethical leadership has been elevated to an unprecedented level of prominence (Chauke & Sebola, 2018:294). According to Naidoo (2002:1), how companies are managed and controlled that constitute governance.

Companies must clearly and visibly set their ethical framework that guides their activities and against which their performance may be measured (BR, 2016:7; Ernst & Young, 2016:9). A robust ethics framework revolves around codifying ethical values, continuously developing value frameworks within how the organisation operate and within leaders, managers and employees and monitoring the extent to which ethics are implemented throughout the company (Fulmer, 2004:307-308; Tuan, Ernst & Young, 2016:8; 2017:136-137). To be successful, a company's ethical construct must permeate all aspect of activities (Chauke & Sebola, 2018:294; Schermerhorn Jr & Dienhard, 2004:56-58). It is not sufficient to only have an ethical code, there must also be existing standard practice, and such should be reviewed annually in order to take the lead from the ethical framework perspective (Fulmer, 2004:307-308; BR, 2016:7).

The strengthening ethical leadership in organisations by mainstreaming the ethical behaviour throughout the culture of the organisations has become vital to good governance (Naidoo, 2012:25; Othman & Rahman, 2014:360; BR, 2016:13). Principle one and two of King IV Report on Corporate Governance which was published on the 1 November 2016 and coming into effect on the 1 April 2017 indicates that governing board should lead ethically and effectively, while principle two indicates that the governing board should govern the ethics of organisations in a way that supports the establishment of ethical culture

(Chauke & Sebola, 2018:294; Webley & Werner, 2008:411; Ernst & Young, 2016:8)

This is a conceptual paper, and it seeks to critically analyse, assess and discuss the envisaged ethics as per King IV report on corporate governance and will be contrasted with the prevailing practice in organisations in South Africa, mainly the State-Owned Enterprises. Ethical leadership in the organisation remain an evasive commodity; hence the many failures experienced in the different companies and the country at large (Chauke & Sebola, 2018:260; Schermerhorn Jr & Dienhard, 2004:56-58; Othman & Rahman, 2014:360; BR, 2016:13). In essence the paper will investigate the impact of ethical leadership on organisations, evaluate the influence of ethical leadership on organisational ethical culture and determine the role of organisational ethical culture on the staff

2. Principle Framework

This paper is premised on principle one and two of King IV Report on corporate governance which indicates that governing board should lead ethically and effectively, while principle two indicates that the governing board should govern the ethics of organisations in a way that supports the establishment of ethical culture. According to King IV report, principle one indicates that it is the responsibility of the governing body to cultivate collectively or individually, the six ethical characteristics, which are: Integrity, Competence, Responsibility, Accountability, Fairness and Transparency.

King IV report on corporate governance recommends that the governing body should drive the six ethical characteristics in ensuring that they will be able to offer effective leadership that will assist the organisation to achieve strategic objectives and positive outcomes. The six characteristics should also assist the governing body in setting the tone to lead the organisation ethically and effectively, and the governing body should also be held accountable for them. The first principle makes it clear that the ethical tone of the organisation should be set at the top and specifically in the governing body (Fulmer, 2004:307-308; Kimber & Lipton, 2011:202). The governing body has the responsibility to lead to ethically and effectively and ensure that there is ethical leadership (Naidoo, 2012:25). This principle encompasses the characteristics the governing body should possess, both individually and collectively and should, therefore, exhibit such (Ernst & Young, 2016; Netcare, 2017). The King IV Report focuses on the character of the people that are involved with governance. Good governance principle starts with the character of those with the responsibility to promote governance and not with rules and procedures. This is a timely reminder in South Africa as there are myriad of governance failures that have been experienced by organisations both in the public and private sector. Principle two indicates that the governing board should govern the ethics of the organisation in a way that support the establishment of the ethical culture in the organisation. The role of the principle two is to establish an ethical culture in the organisation (Ernst & Young, 2016:8). The governing body should, therefore, take the responsibility of ensuring that there is the governance of ethics in the organisation (Tuan, 2017:136-137).

3. Literature Review

According to the King III Report, a reference was made to the cardinal values that were to underpin and inform good governance and referred explicitly to the values include responsibility, accountability, fairness and transparency. King IV has retained the values that were in King III but has added two more values, which are integrity and competence. The adding of integrity and competence is essential, as these two characteristics make the most significant difference in the way how governance is carried out in South Africa (Schermerhorn Jr & Dienhard, 2004:58-64). It is precisely the absence of these two characteristics among leaders that causes organisations to underperform, and even fail in their ethical responsibilities (Kimber & Lipton, 2011:192). The second principle of King IV indicates that the governing body should govern the ethics of the organisation in a way that encourages the establishment of an ethical culture. The governing bodies are given the mandate to ensure the maintenance and development of ethical culture in the organisation. King III also contained a principle that dealt with organisational ethics; however, its focus was on the management of ethics. According to King IV, unlike its predecessor report, indicates that the management of ethics in an organisation is not sufficient until it results in the establishment of ethical culture (Schermerhorn Jr & Dienhard, 2004:61.64). The emphasis of ethical culture in the King IV report, compared to management of ethics as was the case in King III does not reduce the importance of ethics management. To support this view, the second principle of King IV discusses several aspects that pertain to managing ethics in organisations (Sanlam, 2017). The aspects that are discussed with regard to managing ethics, includes setting of ethics strategy for the organisation, and ensuring that there are ethical standards that will guide internal and external stakeholders in their interactions, and ensuring that they are familiar with, and adhere to these ethical standards (Webley & Werner, 2008:412-413; Kimber & Lipton, 2011:202). The process of dealing with aspects of ethics management can be done through the implementation of the principles of King IV which integrates the aspirations of good corporate governance and succours the governing board in realising its specific governance outcomes as set out in King IV.

3.1 Corporate Governance

According to King IV, corporate governance is defined as the exercise of ethical and effective leadership by the governing body to achieve the governance outcomes of ethical culture; good performance; effective control and legitimacy (Schermerhorn Jr & Dienhard, 2004; Ernst & Young, 2016). The concept of ethical leadership is displayed by integrity, competence, responsibility, accountability, fairness and transparency and is applied to prevent any negative consequences in the organisation (Fulmer, 2004:307-308; Naidoo, 2012:25; Othman & Rahman, 2014:360). The area of effective leadership entails being results-driven, wherein the strategic objectives could be achieved with consideration of the overall impact that goes beyond the internal focus (Ernst & Young, 2016:8). It is therefore expected that the ethical and effective leadership should complement each other (Fulmer, 2004:307-308; BR, 2016:13). Corporate governance is, therefore, the application of effective leadership that is performed by the governing body (BR, 2016:13; Ernst & Young, 2016:8).

Good governance includes, amongst other things, participation, transparency, accountability and the rule of law. Good governance also involves effectiveness and equity in governance activities (Kimber & Lipton, 2011:202). Good governance ensures that political, social and economic priorities are based on broad consensus in the society and that the voices of the poorest and the most vulnerable are heard in decision-making over the allocation of development resources. In the South African context, King IV introduced 17 principles. The principles on which this paper will focus are principle one and two, which deals with ethical leadership and ethics in the organisations.

3.2 The Ethical Leadership

The concept of good corporate governance is principally about effective, ethical leadership (Othman & Rahman, 2014:360; IoDSA, 2016:11). The matters of leadership start in the board with the responsibility embedded on each director and find its expression through the board or the governing body. The board set the tone, which is referred to as ethical governance (Kimber & Lipton, 2011:202). According to King IV, governance of ethics as the role of the governing body is to ensure that there is an ethical culture within the organisation which is aligned to the tone that is set by the governing body (Schermerhorn Jr & Dienhard, 2004:61-64; Kimber & Lipton, 2011:202). The tone of ethical leadership should be implemented through appropriate policies and practices (Fulmer, 2004:307-308; Naidoo, 2012:25).

With the advent of the release of the King IV report, in November 2016, South Africa has been positioned as being one of the world leaders on matters of corporate governance. When King IV, is compared and contrasted with the predecessor King Reports, King IV's emphases of ethical leadership has been elevated to an unprecedented level of prominence. The King IV report focuses on ethical leadership rather than ethics management, and sets the tone from the top, particularly the board of directors or governing bodies. Emanating from the recent scandals from both private and public sector in South Africa, there is a growing need for governing bodies and boards to act ethically and effectively and for the organisations have to because being responsible citizens of the societies in which they operate is no longer sufficient.

The King IV report on Corporate Governance is not different from the King III Code in some aspects that also have similar chapters consisting of three principles (Woolworth, 2018; PSG, 2018). When King IV and King III are compared and contrasted, their difference in terms of prominence is that King III consisted of 65 governance principles, while King IV consists of 16 principles, which can, therefore, be deduced that three out of the 16 principles is now specifically focused on ethics (PWC, 2016; Sanlam, 2016). The three ethical principles as contained in King IV deal respectively with ethical leadership, ethical culture in the organisation, and the ethical responsibilities of organisations to the environment and society in which they operate (Kimber & Lipton, 2011:192-202; Othman & Rahman, 2014:360). In this regard, King IV Report focuses on the character of the people that are involved in governance (PSG, 2018). Good governance, therefore, does not start with principles, rules and procedures, but with the character of those tasked with governance. This is a timely reminder at a time when governance failures have become rampant in South Africa.

Another critical change in King IV is that it exceeds its predecessor report King III, by indicating that management of ethics in organisations is not sufficient until it results in the establishment of an ethical culture (PWC, 2016). Organisational ethical culture is widely understood as to how things are done and thus suggests that ethics should become a regular part of 'how things are being done in the organisation (Schermerhorn Jr & Dienhard, 2004:61-64). Steinhoff is an appropriate example of the failure of ethical leadership and ultimately, lack of organisational ethics (Naude, Hamilton, Ungerer, Malan & de Klerk, 2018:15-21). Steinhoff was once a jewel and an example of South African success on the global stage, but its failure in upholding ethics has resulted in its share price plummeting and only remaining with 10% of its initial value (Tuan, 2017:136-137, Naude, *et al*., 2018:15-21). It is very evident from the outcome of the investigation that poor ethical perception of a company has a direct impact on peoples' willingness to make use of the services and to invest in such entities and this will hold the same even if it were a public sector entity. When the ethics of an organisation falters, unethical behaviour creates problems related to employees as well as employee productivity. An unethical organisation will find struggle to keep honest employees, as the employees will battle to work in an unethical business environment, and that could result in increased absenteeism and therefore the lack of productivity becoming inevitable.

When ethics fail in an organisation, honest employees end up leaving such employ and that resulting in a high employee turnover with having many capable and skilful employees parting (Tuan, 2017:136-137). The loss of critical skills will ultimately affect productivity, and those that remain will be promoting unethical behaviours and as such tending to exercise bias towards their other income-generating activities that they perform during working hours and abusing organisation's resources (Fulmer, 2004:306-307). Leadership sets the tone, the only successful counter to unethical conduct as manifested in acts of bribery, fraud, theft, deceit, financial crimes, extortion and similar acts (Fulmer, 2004:312).

It is the responsibility of leaders to build a workplace that is based on integrity and honesty, and there be the higher performance from their employees, greater loyalty and retention, and lower levels of employee fraud and misdemeanours. On a national level, the citizen copies what the elected political officials do, and if citizens see corruption being committed, they will emulate the same corrupt behaviours (Naidoo, 2012:25). Citizens are always observant, and when they see ethical behaviour, they will act ethically (Mostovicz *et al*., 2011:490). Poor behaviour is costly that the real costs of poor behaviour do not depend on corrupt leaders getting caught. The issue of ethics in leadership boils down to the practice of instilling ethical behaviour revelations by former Finance Minister Nhlanhla Nene on his meetings with the controversial Gupta family sparked outrage among South Africans and was met with calls for his axing. In his testimony to the Zondo Commission on State Capture, the former Minister was faced with the stark outcome of his ethical decisions. The leadership of an organisation sets the direction on how things should be done.

Reign of investment opportunities. Taking a look purely at a corporate level, if the business has a positive reputation, people will want to work for and buy service or product.

4. The Character of Board Room Ethical Leadership

In ethical leadership model, the substantive engagement and oversight are required, and a mere process focus will not be good enough (Naidoo, 2012:25; Othman & Rahman, 2014:360). Despite that fact that leadership of an organisation starts with each director and the fiduciary responsibility that comes with the role, the expression of the ethics comes through the board or the governing body as a collective, setting the appropriate example and tone which is referred to as ethical governance (Fulmer, 2004:312). When an ethical culture is understood correctly, and well embedded in the organisation, the desired corporate values and conduct results and getting reflected in the daily habits and practices of the executives and the employees on how they are evaluated, work, and decision on who is hired, promoted, rewarded. It also shows how employees act in the absence of the managers and when they are expected to use personal judgement to issues as well as the business partners (Schermerhorn Jr & Dienhard, 2004:61-64; Othman & Rahman, 2014:369).

Corporate governance as an internal system encompasses the policies, the processes and the people who serve the needs of the stakeholders and shareholders by directing and controlling management activities with shrewdness, objectivity and integrity leadership, and ethical leadership (Naidoo, 2012:25; Othman & Rahman, 2014:366). When ethical leaders are at the core, there are likely to be good policies that will drive economic growth, investment and jobs are the natural outcomes. Social cohesion cannot happen in any country without ethical leadership (Agbin, 2018:23). The matters of ethical leadership are not the preserve and responsibility of boards and executives only, and ethical leadership should flow throughout the society and organisations as a whole. This is because ethical leadership should be a reflection of societal values (Naidoo, 2012:25; Agbin, 2018:23).

The emphasis on ethical culture in King IV, and not ethics management as in King III, does not mean that ethics management has become less critical. However, in the discussion of the second principle in King IV, several aspects of managing ethics in organisations are especially relevant. This includes setting an ethics strategy that is required for the organisation, ethical standards to guide internal and external stakeholders in interacting, and ensuring that they are familiar with, and adhere to these ethical standards (Webley & Werner, 2008:412-413). There is also explicit provision being made for providing safe reporting, in the form of whistle-blowing, which is a mechanism for persons who wish to report unethical conduct confidentially. Ethics management is a goal in itself, or a mere tick-box exercise, but rather, ethics management must be adopted, approached and applied in a way that will result in the inculcation and maintenance of the ethical organisational culture over time (Schermerhorn Jr & Dienhard, 2004:65-68; Deloitte, 2016:14-21).

The fourth King Report on corporate governance goes beyond mere recognition of the existence of social and ethics committees, and, has made many important recommendations that have the potential of improving the impact and effectiveness of these committees. King IV report recommends that all organisations should have a governance structure that takes responsibility for governing the social and ethical performance of the organisations. The Companies Regulations only require listed companies, state-owned companies, and companies with the public interest to have mandatory social and ethics committees (Sea Harvest, 2017:89). King IV, recognises that the social and ethical performance of all types of organisations has an impact on the success, and ultimately, on their sustainability. It, therefore, recommends that the governing bodies of all organisations or one of their existing sub-committees should take responsibility for governing their social and ethical performance.

King IV recommended that the mandate that is linked to social and ethics committee should also be broadened to include oversight of some areas that are not part of what is mentioned in the mandate of the committee in terms of the Companies Regulations. These include areas of fair remuneration and responsible and transparent tax practices and ensuring that there is a transparent practice (Mostovicz *et al*., 2011:490). What is essential in this case is that the governance of ethics is also included in the mandate about the social and ethics committee. This represents a necessary correction of the oversight in the Companies Regulations. The latter, ethics only appears in the committees, but never in its mandate.

King IV further recommends that the composition of the social and ethics committee, which is one of the newly introduced committees, should be such that there is a majority of non-executive members of the governing body on the committee. This, once more, is an essential correction that pertains to Companies Regulations that will allow for a composition of the committee in wherein the majority of prescribed officers and executive directors are on the committee. The most conventional structure is the latter, as this is the ideal governance arrangement because it puts executive directors in a position to oversee their own social and ethical performance. Moreover, as we all know, one tends to be not very objective when marking their homework." In the decade since the advent of state capture in South Africa, there have been painful lessons about corporate governance in both the private and public. These lessons and learnings are not unique to South Africa or state-owned enterprises (SOEs) in developing countries generally as this is also prevalent in other countries as was the case in Enron case (Mostovicz *et al*., 2011:490).

The failure of Enron in late 2001 which filed for bankruptcy apart from signalling the largest corporate bankruptcy in the US, threw up multiple questions about the effectiveness of contemporary accounting, auditing and corporate governance practices (Mostovicz *et al*., 2011:490; Agbin, 2018:20-21). In order to sustain corporate performance, there should be a rule-based application of business ethics developed as a response to the growth rate and the level failures in this space and corporate wrongdoing (Laczniak & Murphy, 2003:3-25; Agbin, 2018:20-21) when it comes to the application of these measures that have not yielded any desired results. The practice has been to cut back the power of boards or governing body and to turn over some functions that have been improperly used by corporate and government executive leadership.

In recent years' ethical scandals that have manifested themselves, it has become commonplace, followed by the number of top management executives of corporate giants like Arthur Anderson, Lehman Brothers and WorldCom in the US, Satyam Computer Services of India amongst others. Steinhoff in South Africa, for instance, grew throughout five decades to become one of the largest companies in the country (Again, 2018:20-21; Naude *et al*., 2018:15-21). The stakeholders never expected that top executives' management could be embroiled in unethical practices because the company had a code of ethics (Tuan, 2017:136-137; Agbin, 2018:25). Emanating from the collapse of these respected Corporates, it was found that profits that were declared by Steinhoff were false which pointed towards the lack of ethics and some of the company executives saw wrongdoing and decided to ignore it, and as such it could be inferred that the top executive's management ignored the code of ethics (Webley & Werner, 2008:406; Naude *et al*., 2018:15-21). Put differently, the code of ethics that was about protecting Steinhoff's interest rather than inculcating ethical values, virtues and norms in the organisation (Webley & Werner, 2008:410; Tuan, 2017:136-137; Naude *et al*., 2018:15-21). It can in the same vein be indicated that some executives in multinational auditing firm KPMG fell into trap and greed and decided to flout corporate governance and corporate social responsibility practices in South Africa in their involvement with Gupta aligned companies and Venda Building Society ('VBS') (Motau, 2018). Organisations formed with noble intentions and premised on ethics and righteousness have not escaped the pervasive malignancy and greed of corruption (Mostovicz *et al*., 2011:490; Naidoo, 2012:25). The continuing of illegal and unethical business activities by top executive managers in SOEs and the private sectors is a pointer that a code of ethics is not enough for an organisation to be ethical it also needs to be implemented (Webley & Werner, 2008:406). Emanating on the post-state capture period in South Africa, the leading governance challenges for government and corporate South Africa will not be on how to enforce rules but how to ensure we cut back dependence on their enforcement. The Institutional compliance is weak, and the rise of transactional leadership has led to the emergence of the public sector and corporate corruption (Schermerhorn Jr & Dienhard, 2004:65-68; Mostovicz *et al*., 2011:490; Naidoo, 2012:25). The failure in ethics has posed threats and challenges posed by the post-Enron governance debacle in order because they are the pose grave abuses and have become potential breeding grounds for abuse (Laczniak & Murphy, 2003:2-5; Schermerhorn Jr & Dienhard, 2004:61-64).

South Africa is faced with critical issues, and as for the world, that blocks the possibilities for economic development and shared growth is at an inadequate level of ethical consciousness and ethics management in the business domain (Schermerhorn Jr & Dienhard, 2004:61-64). The State-Owned Enterprises and the private sector do not require overwhelming rules; but they need strong and effective values within their limited scope of corporate governance functions in the world (Schermerhorn Jr & Dienhard, 2004:65-68).

The regulators around the world are carefully considering the limited effectiveness of rules and regulations to address governance matters. In South Africa, the King IV report recognises this. Although the terms of requirement vary only slightly between King III and King IV, the notion of the outcomes when contrasted with the ruled-based application of the code of ethics should significantly improve the efficiency of the increased focus on an ethical culture (Schermerhorn Jr & Dienhard, 2004:61-64).

The strengthening ethical leadership by mainstreaming ethical behaviour throughout the culture of organisations is a task that has become key to good governance, but it is one that few SOEs and corporates have mastered (Naidoo, 2012:25; Agbin, 2018:26). Despite the business being inherently transactional, the shifting the governance paradigm to ethical leadership is contained in the integrity, competence, responsibility, accountability, fairness and transparency drove by virtuosity rather than self-interest is central to good governance (Othman & Rahman, 2014:366; Agbin, 2018:23).

It is designed to anticipate and prevent, or ameliorate, the negative consequences of such activities and outputs on the society, economy, and the environment. A ling between governance and ethical leadership should be practically established (Naidoo, 2012:25). Governing bodies are expected to embed ethical cultures in an organisation, this is despite the difficulty that comes with the implementation of such, as this is hardest to implement due to the absence box to tick to conclude that an end goal has been reached (Schermerhorn Jr & Dienhard, 2004:65-68; Webley & Werner, 2008:408; BR, 2016:7). From literature perspective it is clear that:

- Ethical leadership have an impact on organisational culture because the leaders who are ethical will have the courage to give tone from the top as seen at PRASA, PIC and TRANSNET.
- People follow after the leader, NUGENT COMMISSION, indicated that based on the leader, the organisation was in a state of fear.
- Ethical leaders will ensure that the governing bodies promote and encourage ethical behaviour in the organisation.
- The ethical leadership behaviour has an influence on how the staff operate in an organisation.
- In the case of PIC, it became evident that everyone in the level of operation started to behave in ways that depicted a lack of ethics.
- In an environment where there is no ethical culture, fear is used as a means to coerce obedience from staff.

5. Conclusion and Recommendations

The King IV report on corporate governance has elevated the prominence and importance of ethics to unprecedented heights in South Africa. It is, therefore, up to organisations to turn the words in King IV into practice and ensure that they lead ethically and ensure that they also inculcate the ethical culture in the organisation that they serve. It is evident from this article that South Africa requires governing bodies to act and lead ethically and effectively, and that the organisations with deeply embedded ethical cultures and the organisations with a conscious are responsible citizens of the societies in which they operate they are in all likelihood going to be accepted and respected by the communities in which they operate.

In the absence of effective leadership and good governance at all levels in private, public and civic organisations, it is arguably and virtually impossible to achieve and to sustain effective administration as has been experienced in both the private and public sectors in South Africa. For the organisation to achieve goals, to sustain quality and deliver first-rate services, there is a need lead ethically in the organisation that have embedded with ethical culture, because if not they could be multiple misdemeanours that could be catastrophic for the country. It is evident from this article that due to the increasing complexities in this area and the requirements arising from the constant change in society, coupled with the constant push for higher levels of productivity, there is requirement effective and ethical leadership. It must be acknowledged that King IV is not the panacea for all the ills; however, the good governance and effective-ethical leadership are the essential requirements for an organisation that can be regarded as being successful before all stakeholders in the 21st century.

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