Coronanomics

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In this sea of coronanomics we need conscientious corporate leaders who put aside all their present needs and past experiences and the corporate sins of greed, fear, sloth, arrogance and pride. They must approach decision-making with an open mind, individually and collectively, to decide on the long-term best interests of their companies.

Key ideas: Covid-19; coronanomics; ethical corporate leadership; King Report; value creation; sustainability; company stakeholders

A crisis is defined in the Oxford English Dictionary as a turning point, especially during epidemics or at a dangerous time in commerce.

Before the first coronavirus case was reported in South Africa, our economy was on its knees. Many commentators predicted that the rating agencies would downgrade South Africa to junk status. The unemployment rate was the highest ever recorded and there was virtually no growth in the economy. The South African economy was at a turning point. Now, in May 2020, it is in recession.

This critical situation occurred before the country was hit by the coronavirus pandemic. Individuals and companies are now positioned at two turning points: our economy and the coronavirus. To discuss the effect of these two tsunamis on South Africa, I have coined the word ‘coronanomics’. Today, every company, large or small, is an island in this sea of coronanomics.

What can corporate leaders do to ensure the survival of their companies so that they can again prosper when the coronavirus is stemmed? All corporate leaders must remember that the company is an artificial, incapacitated person with no heart, mind, soul or conscience of its own.

The limited liability company was created in the middle of the nineteenth century by society for society. The UK government statutorily created the company with limited liability with the condition that the provider of capital would be at the back of the queue on bankruptcy.

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This mindset change is necessary because, throughout the twentieth century, boards acted in the best interests of shareholders. The result was that, by 1997, researchers realised that the world had over-burdened the environment: companies and, to a lesser extent, individuals were using natural assets faster than nature was regenerating them, which is clearly not a sustainable way of conducting business.
Also, many companies had increased bottom-line profit, but they were not adding value to society because that profit was being subsidised by society or the environment.

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The governance of companies has developed along the lines of curatorship of incapacitated individuals: namely, to act with good faith, care, skill and diligence. These duties of a director are more clearly understood when placed in the context of acting for an incapacitated company. No curator with any conscience would seize an opportunity for him- or herself at the expense of an incapacitated ten-year-old child. No such curator would act other than with care, skill and diligence, applying his or her skills for the child's benefit. The guardian would also make short-, medium- and long-term plans, especially if he or she were told by a physician specialist that the child was healthy and could live well into his nineties.

The governance of companies came to the fore in the late 1980s and early 1990s with the Cadbury Report in the United Kingdom. Sir Adrian Cadbury's mandate was to focus on the financial aspects of the governance of a company. In 1992 I was approached by the Institute of Directors, supported by other well-known institutions such as the South African Institute of Chartered Accountants and the Johannesburg Stock Exchange (JSE), to form a committee to draft guidelines for the majority of my fellow citizens of South Africa on how to manage and direct companies. At the time, the majority of the population had not been in the mainstream of the South African economy because of apartheid legislation.

It became clear to me that my committee could not choose the primacy of the shareholder model that was being practised globally, especially in a society of huge inequality, where capital was seen to be resting in the hands of the white population. These special circumstances drove me and my committee to adopt a model that required a board to learn and understand the needs, interests and expectations of stakeholders before making a business judgment call in the best interests of the company. This company-centric model gives equal weight to the needs, interests and expectations of all stakeholders. This was an entirely new approach to the governance of companies.

The special circumstances drove the King Committee, as it became known, to use the company-centric approach as its premise for the reports that followed. After the first report there was another in 2002, recommending sustainability reporting, following the two Global Reporting Initiative (GRI) guidelines.

I was appointed chairman of the United Nations Eminent Persons Group for the governance and oversight of the UN agencies and became the chairman of the GRI. I was present at a meeting held at the UN headquarters in Geneva when the International Federation of Accountants (IFAC) decided it was no longer sufficient to discharge the duty of accountability by merely issuing annual financial statements. I stated that sustainability reporting was becoming more and more important because sustainability issues were making up 80% of the market capitalisation of companies, but without the numbers they would be meaningless and unhelpful to stakeholders in assessing the value of a company. As a result, companies issued financial and sustainability reports without any explanation as to materiality and the challenges and circumstances faced by the company from an outlook viewpoint in achieving its business model.

This led to the formation of the International Integrated Reporting Council, of which I became chairman. Working together, 105 of the world's iconic companies and many professionals around the world took about two years to issue the Integrated Reporting
Framework in December 2013. The result was that in 2012 the King III Report recommended integrated thinking and publishing an integrated report. This became a listing requirement of the JSE.

King III had an ‘apply or explain’ regime: apply 75 principles or explain why not. On reading many of the explanations it was clear that many senior executives had not applied their minds to these explanations. I concluded that too many executives were complying with King III without thought. As a result, in 2015 the King Committee started discussing from which outcomes stakeholders could draw a reasonable inference that the company had been practising quality governance.

After much input, consultation and discussion, the King Committee concluded that four outcomes, if achieved, would indicate that the company had been practising good governance: ethical and effective leadership; value creation in a sustainable manner; adequate and effective controls with informed oversight; and the trust and confidence of the community in which the company operates with legitimacy of operations.

In consequence, in following what became known as the King IV Report, directors today adopt a mindful outcomes-based approach of applying the 16 principles leading to those four outcomes. Directors apply these 16 principles and explaining the practices followed to achieve those principles.

When making decisions, boards, individually and collectively, need to ask themselves what impact the decision will have on the four outcomes. If the impact appears to be adverse the board should once again apply its mind to its decision.

With the launch of the Integrated Reporting Framework in 2013 there was a shift in the collective mind of a board, because companies were operating in a resource-constrained world with increasing population growth. Clearly a company could no longer conduct business as usual because it had to make more product to meet the growing demands of an increasing population but with fewer natural resources.

This approach was different from that of the nineteenth and twentieth centuries, which was a focus on the primacy of the shareholder: increasing profits even if they were being subsidised by society and the environment. The world moved from profit at a cost to society and the environment to value creation for society in a sustainable manner. The company today must have a purpose that goes beyond making a profit subsidised by society and the environment; that purpose must be how the company is going to add value to society.

**Today boards must make decisions that result in value creation in a sustainable manner.**

The twentieth century was a time of unsustainable development. Today, boards must make decisions that result in value creation in a sustainable manner.
Consequently, investors look at how a company makes its money rather than how much profit it makes. The company could have such an adverse impact on the environment that holistically the company has not added value to society and might even have harmed a natural asset. Individual corporate leaders today no longer make decisions in the best interests of creating wealth for the shareholders but rather make decisions in the best interests of the long-term health of the company. In order to do this, the board must know and understand the legitimate and reasonable needs, interests and expectations of the stakeholders pertinent to the business of the company. Every board meeting should include stakeholder relationships on the agenda. Several companies have appointed a corporate stakeholder relationship officer (CSRO) whose sole job is to learn about the continuing relationship between the company and its stakeholders. The report from the CSRO gives the board more information that will assist it when discussing proposals made by management.

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The board must ensure that it reports in a clear, concise and understandable manner. This is critical because the basic premise of being accountable is that whatever you account for is understandable to the average user. Compared with the board, which is informed approximately six times a year of the company’s activities, the stakeholder is an uninformed person. The board should highlight material, financial and so-called non-financial matters and point out the challenges and circumstances faced by the company in trying to achieve its business goals.

The sustainable development goals (SDGs) of 2015 have shown that there are three critical dimensions to value creation in a sustainable manner, namely, the economy, the environment and society. These must be considered by a board in an integrated way. That is the language in the SDGs as approved by the governments of 193 countries.

In raising capital today, financial institutions not only conduct financial due diligence, but also environmental, social and governance (ESG) due diligence. There are many framework providers for ESG disclosures. In South Africa, the Financial Sector Conduct Authority has issued guidelines for trustees of pension funds and directors of financial institutions to conduct an ESG audit of a company before investing a beneficiary’s money in the equity of that company.

Corporate leaders in South Africa operating during the Covid-19 pandemic must have an integrated, collaborative mindset and be willing to make compromises. This is necessary because of the adverse impact on all the stakeholders linked to a company at this time. Directors must not only know and understand the needs, interests and expectations of their stakeholders, but also the hardships and tribulations they have suffered because of coronanomics. These stakeholders’ concerns must be approached by corporate leaders in a collegial, common-sense manner. This mindset is a manifestation of SDG 17, namely collaboration and cooperation.

Compromises between the company and its stakeholders are necessary in order for the company to survive the adverse effects of coronanomics over the next two years. If a company does not survive
between April 2020 and April 2021 its infrastructure will be sold at bargain prices and its human resources will be dispersed. If the company survives as a result of the collaboration described above, it will be easier of the company. All stakeholders need to approach the situation on the basis of compromise. For example, everyone might agree to a reduction in their salaries, the suppliers might reduce the cost of the supply of

to move from survival mode to a thriving mode and to play a role in the resurrection of South Africa’s economy.

Boards in May 2020 must think in this integrated, collaborative manner in order for their companies to survive; this will be in the long-term best interests of the company and consequently all its stakeholders.

In short, boards must have a very company-centric and knowledgeable approach to their stakeholders’ needs, interests, expectations and hardships in order to make compromises that will result in the survival of goods, or banks might create payment holidays for companies.

The only positive road ahead is an integrated, collaborative, compromising approach between the company and its stakeholders to ensure the long-term health of the company. If this is not achieved, recreating a collapsed business will be much more difficult than maintaining a smaller company, but with its infrastructure and the majority of its human capital intact. The result will be that the resurrection of South Africa’s economy after the pandemic will take much longer.

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