INVESTMENT VIEWS

The value of commercially experienced and skilled directors

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THE QUICK TAKE

Establishing and maintaining a diverse, balanced board with the requisite experience and skills have become a challenge, particularly in SA

There are many key qualities that one should look for in a director

When assessing a director, placing too much emphasis on any single criterion can lead to serious unintended consequences

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INTRODUCTION

The fourth iteration of the King Code on Corporate Governance (King IV) was first published in 2016. It strongly emphasised the need for independent non-executive directors on the boards of companies. Independence is, of course, a very important consideration. We continue to advocate strongly for appropriate independent oversight within investee companies (as detailed in our annual Stewardship Report). However, as important as independence may be, we believe that it is only one of the many qualities of a good non-executive director.

Wherever there is complexity in life, there are inevitable trade-offs that need to be made. Since no individual can bring everything to the table, compromises are unavoidable if a company is to appoint a balanced board that can succeed in the very demanding undertaking of exercising ethical and effective leadership (which is how the Code ultimately defines corporate governance).

At the time of King IV's release, we feared an unintended consequence – that in the single-minded pursuit of director independence, companies (and the shareholders who are required to vote for those appointments) would not put sufficient weight on the need for skilled directors with business acumen and decades of business experience. In the cut and thrust of the boardroom, we believe that these are practical necessities if a non-executive director is to succeed in acting as a check and balance over the executive and truly hold management teams to account.

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In the years since King IV's release, we believe that our concerns have been realised. We have seen an obsessive pursuit of independence, to such an extent that many institutional shareholders will automatically vote against directors with more than nine years of service – even if those directors can add tremendous value, have rare skills (in a skill-short environment) and a deep knowledge of the company. As a consequence, the quality of many South African (SA) boards has suffered as they have steadily lost credible directors with the business acumen and experience needed to effectively lead a company.

"One of the most impressive contributions of the new board has been its excellent allocation of capital."

Many high-quality, commercially-minded candidates with a desire to give back to corporate SA have told us that they sadly will not consider board appointments. A myopic focus on narrowly prescribed governance criteria has reduced the crucial role of corporate governance to a by-rote, box-ticking exercise. As a consequence, we hear repeatedly from frustrated directors that too little time is left at board meetings to interrogate the key business issues that will ultimately dictate the success or failure of that business. As a result, many boards fall short of achieving the overriding objective of any board – that of providing the effective leadership that is required for the business to thrive and create value for all stakeholders.

This note bears testimony to the value that a non-executive director with the necessary business acumen and experience can add to a company whose board they serve on. Over the last five years, we have had the privilege of working with one such director, Mr Mike Bosman, in his role as chairperson of two separate, but equally challenged, businesses.

A PRIME EXAMPLE

Our first engagement with Mr Bosman was when he was appointed chairperson of the Spur Group. As we have catalogued in many stewardship reports over the years, Spur was a problematic investment for us. It was plagued by poor governance, pervasive conflicts of interest, and a very flawed remuneration process. Our issues were not addressed by the board, despite multiple engagements and several years of voting against resolutions at their AGMs. After many years of our concerns being ignored, we collaborated with other investors and voted against a number of its directors. This necessitated the appointment of some new directors, the first of whom was Mr Bosman.

It was immediately clear to us that we were dealing with a new paradigm. Mr Bosman was keen to meet with shareholders to discuss their concerns and, once these engagements were held, he immediately set about making many of the changes that were needed for Spur to return to its winning ways.

First, he overhauled the board, spending much time identifying capable directors who could competently cover key areas and at the same time improve the overall diversity of the board. Five years later, the company is fortunate to have a smaller, more skilled, diverse, and engaged board.

As the new board made the necessary changes to its remuneration process and removed the conflicts between the company and its franchisees, it became apparent that the executive team needed to be overhauled. Over time, a new CEO, CFO and COO were appointed. This team has executed very well, initially through the Covid period and very strongly since then.

One of the most impressive contributions of the new board has been its excellent allocation of capital. This is an area that governance codes tend to pay very little attention to. It is a very particular skill set and one in which many professional board members have little experience. In many cases, they end up simply deferring to the executive. Mr Bosman's extensive business acumen enabled him to identify significant flaws in the existing capital allocation framework and to remedy historic mistakes. Under his watch, the company cut loss-making ventures in non-core geographies and initiated a very accretive share buyback programme.

Fortuitously for the Group, Mr Bosman's appointment coincided with the outbreak of the Covid pandemic. We believe that without his substantial experience, strong leadership, and ability

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to take decisive action, the impact of the associated economic lockdown on Spur and its stakeholders would have been far more severe. Since then, the company has moved from strength to strength, outperforming its quick service restaurant peers and delivering superb returns for its shareholders.

TWO FOR TWO

As fate would have it, a company one vowel different, the SPAR Group, would soon be needing Mr Bosman's services. While it is a larger business, with extensive operations abroad, it has a similar organisational structure, but with its stores run by independent retailers (while the Group's focus is building and maintaining the brand, sourcing, and distributing stock for its retailers).

SPAR was also suffering from several governance failures that had compounded and become an existential threat to the business and all its stakeholders. Many of these issues echoed the challenges at Spur, with concerns over conflicts of interest and poor allocation of capital.

Although the SA business had performed reasonably well over the preceding decade, margins had come under increasing pressure. There were also mounting signs that all was not well between the Group and its retailers. Then, in 2020, a serious breakdown between SPAR and one of its largest independent retailers saw the Group head to court in a bid to remove the operator and take over the related stores. In addition, there were allegations of undeclared conflicts of interest between executive management and the company; racism and disputes with black retailers; questionable accounting; and ignored whistleblower reports.

We were very concerned. The company faced many serious allegations of governance failures and its board lacked both the necessary independence and the skill set needed to steer the company through these challenging waters.

At around this time, the Group undertook a material re-platforming of its warehouse system to SAP. Very cognisant of the number of failed (and expensive) SAP implementations in SA, we interrogated the executive robustly over the progress and the plans in place to ensure a low-risk implementation. We were provided with many assurances that they were on top of the issues and that they had appointed the appropriate skills to manage the process.

In late 2022, new allegations surfaced, implying that the newly appointed CEO had been involved in various accounting misstatements relating to fictitious loan agreements in his previous role in the Group. Given the seriousness of these allegations, we felt we could no longer engage with the board constituted in its current form. We scheduled a call with the lead independent non-executive director to inform him of our decision to vote against the current chairperson's re-election at the upcoming AGM. We also recommended Mr Bosman as a good potential candidate for the role. Soon after this, the Group announced that Mr Bosman would be appointed as the new chairperson of SPAR's board (this was subsequently supported by shareholders at the next AGM).

He immediately applied himself to dealing with the many governance issues plaguing the Group. One of these was commissioning a legal and accounting review of the allegations against the then-CEO. The conclusion of this review saw the incumbent step down in early January, with Mr Bosman assuming the role of interim CEO until a new, suitable appointment could be made.

There are very few non-executive directors today with the experience and competence needed to confidently assume the demanding role of interim CEO of a large multinational corporation. That Mr Bosman was not only able to do so but was also willing to do so, speaks highly of his skill set as well as his acknowledgement of his fiduciary responsibilities as a director.

In this period Mr Bosman also set about strengthening the board of SPAR. In so doing, he addressed one of the key concerns we had previously raised with the lead independent director, that of an alarming lack of retailing and IT skills on the board.

Unfortunately, it was not a smooth ride on the operational side of the business. It became evident a few months later that the SAP project had gone completely awry. This resulted in a failed implementation and significantly impaired service levels to stores. Thankfully, Mr Bosman, in his role as acting CEO, was well-equipped to take many far-reaching decisions on how to deal with the situation and how to position the business for recovery.

"Not everything that counts can be measured and not everything that can be measured counts."

By the middle of the year, the board had finalised the recruitment process and selected a new CEO (from within the Group). In recognition of the many operational challenges the company was facing, it also appointed an externally sourced COO to help resolve them. This freed Mr Bosman up to deal with the next shareholder concern, that of its underperforming business in Poland.

Under the watch of the previous board and CEO, the Group had purchased a failing Polish business, with the intent of building out a SPAR solution in Poland. Despite many attempts to boost customer loyalty ratios (the amount of goods franchisees buy from the central company-owned distribution centres), after a number of years they had failed to get to the levels needed for the business to generate a profit. Mr Bosman and a newly appointed non-executive director with deep retail experience spearheaded a review of the Polish business, the net result of which was the decision to exit. This was another good outcome for stakeholders as shareholder capital was protected and the Group could prioritise and focus its resources on more pressing issues.

It is still early days in the turnaround at SPAR, and there is much uncertainty as to the final outcome. However, we believe that the Group is much better placed to face its challenges as a result of the considerable efforts put in by Mr Bosman and the new board to improve governance and the calibre of people in its business.

CONCLUSION

Our view is that our industry needs to rethink the notion of director independence. It is a multi-faceted characteristic that needs to be approached in a more thoughtful and holistic manner, considering that:

- Not everything that counts can be measured and not everything that can be measured counts.
- Independence certainly shouldn't be measured by as blunt a metric as board tenure; nor should it be approached through the lens of a technocratic, box-ticking framework.

We have highlighted the risks of a technocratic approach to independence throughout this article. Further considerations that illustrate the point would be:

- A multitude of directors are drawn from the accounting and legal professions. Although these directors score highly in terms of being technically independent, and many serve valuable roles in important oversight responsibilities, such as on audit committees, they are often ill-equipped to truly serve as a check and balance over the executive. This is because they lack the business experience and the commercial acumen needed to challenge an executive on commercial issues. For this reason, all boards should seek to balance these accounting and legal skills with the appropriate commercial skill sets.
- Many professional independent directors who screen well for independence are technically independent of the business but financially dependent on the incomes they earn as non-executive directors. This can impair independence.

For the reasons articulated above, we believe that considerations such as the person's state of mind; their diligence and conduct at board meetings; and, lastly, their integrity ought to carry far more weight in the independence assessment process.

Finally, we make the impassioned point that independence is but one of many qualities that directors bring to the boards that they serve. The SA economy has performed poorly for a decade. The challenges that both executives and non-executives face in this environment are many and daunting. And it is increasingly difficult to persuade people with the right skills to join boards.

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In the preceding case studies, an independent chairperson was desperately needed to address numerous governance failures. But much more than that was needed for the companies to be stabilised and the foundations built out for a more prosperous future. In both cases, stakeholders were very lucky to get a non-executive with Mr Bosman's skill set and appetite for taking on a challenge.

There are many variables that need to be solved for in the process of identifying and appointing suitable directors. If corporate SA does not place enough weight on directors' skill set, diligence, experience and value-add, then it will lose its hard-won reputation of being a stand-out emerging market in terms of its governance. +

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