Four ways companies can strengthen their boards to make it through tough economic times

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South Africa's economy is struggling. A number of factors are behind the decline. These include severe power cuts which are taking their toll on all spheres of the economy, rising inflation, increases in food prices, the effects of the Ukraine-Russia conflict, which has resulted in higher fuel and energy costs globally, increases in interest rates, prolonged labor strikes and a high unemployment rate.

A further threat to South Africa's economy is the number of companies that have closed in the aftermath of the COVID-19 pandemic. Data from Statistics South Africa show that business liquidations increased by 44.8% in the year to August 2022. The data also shows that in June 2022 there were 145 liquidations (compared to 132 in June 2021) and that the number of bankruptcies in South Africa increased to 165 in July 2022 and to 239 in August 2022.

These difficult operating conditions require strong boards with a diverse range of skills and experiences. Under the Companies Act the ultimate power in a company is with the board of directors, and not with the shareholders.

The COVID-19 pandemic highlighted the need for boards of companies to be able to steer the institutions through testing circumstances. There are four things companies should be doing to shore up the strength of their boards in difficult economic times.

Evaluate whether a refresh is needed

Companies must evaluate whether they need to refresh their boards and their leadership. Bringing on new non-executive independent directors with fresh perspectives and new expertise may strengthen the board and prevent complacency.

Non-executive directors are not involved in the day-to-day management of the company's business and are not full-time salaried employees. They are independent if there is no interest or relationship that is likely to unduly influence or cause bias in their decisions.

The South African King IV Report on Corporate Governance recommends that the majority of board members be non-executive directors and that most of them should be independent. This promotes objectivity and reduces the possibility of conflicts of interest.

In my research I found that the South African Companies Act does not put a cap on how long a director may serve on a board. A director elected by the shareholders may serve on a board indefinitely or for a term set out in the company's constitution, if any.

Corporate governance experts argue that long-serving non-executive directors are so embroiled with the company that they lack independence, leading ultimately to unsatisfactory performance by the company. Shareholder activists in South Africa have shown disapproval of lengthy tenures of directors.

They have exerted pressure on long-serving non-executive directors to resign. Companies must consider whether their non-executive directors have been serving for too long and are still independent.

Directors have a legal duty to act in good faith and in the company's best interests. Boards must therefore have a balance between directors with experience and knowledge of the company and directors with specialist expertise. Companies can even appoint experts on their board committees to advise them.

The Companies Act allows this as long as they are not disqualified to be directors and do not vote.

The board of the power utility Eskom recently went through a major shake up as part of the government's strategy to find solutions to end South Africa's energy crisis. All the directors and the chair were replaced, save for one non-executive director. Five directors now have technical expertise, in engineering, energy policy, electricity delivery and accounting.

The new board has 13 directors compared to the previous board of only six directors, who were criticized for their lack of engineering expertise.

These sweeping changes have strengthened the board by introducing a more diverse range of skills and expertise. It is hoped that the shake up will enable the board to find effective solutions to end South Africa's energy crisis.

Evaluate the board's performance

Boards must evaluate their strengths and weaknesses if they are to govern the company effectively. At least once a year companies must evaluate the performance of the board as a whole, its committees, individual directors and the board chair.

Companies must reflect on the outcome of the evaluations and use it to strengthen the board. For example, if some directors lack governance experience, they should be provided with mentorship or be encouraged to undergo training. To maintain a strong board, all the directors should keep up to date with new laws. They should also commit to ongoing learning and development.

In my research I found that the King IV Report on Corporate Governance leaves much scope for the board's performance evaluation to be conducted internally.

In my view, companies should rather opt to have the evaluation done by external third parties as this increases its objectivity and impartiality.

Pay more attention to risk oversight and risk appetite

The board must take calculated risks. It must balance risks with potential opportunities, in a way that is responsible and not reckless.

In an economic downturn, the board should review its risk appetite. If the risk appetite is too conservative it can limit the company's options in a repressed economy. So companies need to consider accepting a level of risk that they might have considered to be too high when the economy was performing better.

Many companies delegate the governance of risk to the audit committee. Due to the complexity of risk, the King IV Report recommends having a dedicated risk committee. In the current economic downturn this has become more important than ever.

Improve internal processes and procedures

Boards must evaluate whether their internal policies and processes are effective. If not, they must enhance them so that the board can function optimally.

Directors must have access to complete and accurate information that is needed to make effective decisions. The board chair should ensure that the board agenda is comprehensive and well-organized so that board meetings are productive and efficient.

Directors should meet more often in challenging times. This will enable them to engage in more thoughtful deliberations, explore different options and weigh competing considerations.

A company with a weak board is a weak company. A strong board is a key component to a company's success in tough economic times. Companies must urgently take steps to strengthen their boards if they are to survive these uncertain times.

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