# King Report III

## Chapter 8

## Governing Stakeholder Relationships

**Principle 8.1: The board should appreciate that stakeholders' perceptions affect a company's reputation.**

1. Stakeholders' overall assessments (and therefore aggregate perceptions) of companies, result in the formation of corporate reputations. Reputation is based on how well a company performs compared with the legitimate interests and expectations of stakeholders. There is growing awareness of how important the contribution of reputation is to the economic value of the company.

2. The gap between stakeholder perceptions and the performance of the company should be managed and measured to enhance corporate reputation and to avoid damage or destruction by company actions. What the company does, and not only what it communicates, ultimately shapes the perceptions of stakeholders. However, communication assists in bridging actual and perceived gaps that may occur and it facilitates a balanced assessment of the company.

3. In light of the impact that stakeholder perceptions may have on reputation, companies should realise that stakeholder interests and expectations, even if not considered warranted or legitimate, should be dealt with and cannot be ignored.

4. The board should be the ultimate custodian of the corporate reputation and stakeholder relationships. The company's reputation and its linkage with stakeholder relationships should therefore be a regular board agenda item. The board should take account of and respond to the legitimate interests and expectations of stakeholders linked to the company in its decision-making.

5. An interest or expectation of a stakeholder is considered to be legitimate if a reasonable and informed outsider would conclude it to be valid and justifiable on a legal, moral or ethical basis in the circumstances.

6. A stakeholder-inclusive corporate governance approach recognises that a company has many stakeholders that can affect the company in the achievement of its strategy and long-term sustained growth. Stakeholders can be considered to be any group that can affect the company's operations, or be affected by the company's operations. Stakeholders include shareholders, institutional investors, creditors, lenders, suppliers, customers, regulators, employees, unions, the media, analysts, consumers, society in general, communities, auditors and potential investors. This list is not exhaustive.

7. The board should from time to time identify important stakeholder groupings, as well as their legitimate interests and expectations, relevant to the company's strategic objectives and long-term sustainability.

8. Stakeholders that could materially affect the operations of the company should be identified, assessed and be dealt with as part of the risk management process (refer to Chapter 4). These stakeholders should include not only stakeholders who could negatively impact on a company, but also stakeholders who could add value to the company by enhancing the well-being and sustainability of the company or positively impact on the reputation of the company. For instance, a local community may not affect the operations of the company itself, but the way in which the company impacts the community could affect its reputation.

9. Companies should take account of the fact that stakeholders' interests in the company are dynamic and subject to change. It is therefore necessary to review the process for identification and responding to the legitimate interests and expectations at least once a year.

**Principle 8.2 The board should delegate to management to proactively deal with stakeholder relationships**

10. Management should develop for adoption by the board, a strategy and suitable policies for the management of its relations with all stakeholder groupings.

11. The board should consider from time to time whether it is appropriate to publish its stakeholder policies. If the board decides that it is in its best interests not to publish its stakeholder policies, it should consider whether,

apart from any legal requirements, it would be willing to disclose all or any of these to any stakeholders on request.

12. The board should consider whether it is appropriate to publish a list of its stakeholder groupings (not the names of individual members of any stakeholder grouping) which it intends to deal with on a proactive basis, and the method of engagement.

13. The board should oversee the establishment of mechanisms and processes that support stakeholders in constructive engagement with the company and the board. These mechanisms and processes should be incorporated in the stakeholder policies.

14. Constructive engagement is aimed at ultimately promoting enhanced levels of corporate governance. It enables the company and the stakeholders to share their perspectives on the interests of the company. Constructive engagement should not amount to second-guessing the board or management of the company or permitting interference or undue influence in the running of the company.

15. Constructive engagement with stakeholders could provide companies with valuable information about stakeholders' views, external events, market conditions, technological advances, and trends or issues. This can assist companies [to] anticipate, understand, and respond to external changes more efficiently, thereby enabling the company to deal with challenges more effectively.

16. The board should guard against using legal or other processes to frustrate or block constructive engagement by stakeholders, for instance, by continually compelling stakeholders to resort to courts. This should not prevent the board from resorting to litigation or other dispute resolution mechanisms where appropriate to protect the company's legal interests.

17. A structured process of engagement between a company and its stakeholders, cognisant of uniform disclosure of information and insider trading restraints imposed by law, has many potential benefits. Structured engagement could be partially useful when, for instance, preparing for an annual general meeting. It could reduce the risk of confrontation, could prevent the board having to spend unnecessary time in constant interventions with stakeholders, and could mitigate against mischievous action by competitors.

18. The board should encourage shareholders to attend AGMs and other company meetings, at which all the directors should be present. The chairmen of each of the board committees should be present at the AGM.

19. The board should consider not only formal processes such as the AGM for interaction with its stakeholders. It should also consider informal processes such as direct contact, websites, advertising, or press releases. The formation of stakeholder associations should be encouraged where appropriate.

20. Stakeholders should consider their responsibilities as stakeholders in the company. Stakeholders should, for instance, be circumspect about making public statements that can damage the interests of the company. Stakeholders should clearly and in a constructive manner communicate to the board about the steps they would contemplate if dialogue is considered to have failed. Litigation should be a last resort.

21. If the board is willing to engage directly with any stakeholder groupings, the representatives of the company and stakeholders must be careful how they deal with information that could be share price sensitive. It is incumbent upon both the company and the stakeholders to familiarise themselves with insider trading laws. Even taking this into account, stakeholders should encourage the company to share information with all stakeholders as soon as possible. Use of SENS, the JSE news service, can ensure that instances of unequal disclosure are minimised. A stakeholder liaison forum, electronic or otherwise, that all stakeholders can access with relative ease can prevent or reduce the problem of only certain stakeholders being in possession of inside information.

22. The board should disclose in its integrated report the nature of its dealings with its stakeholders and the outcomes of these dealings.

**Principle 8.3: The board should strive to achieve the appropriate balance between its various stakeholder groupings, in the best interests of the company**

23. The law directs the board to act in the best interests of the company and the board should, within these confines, strive to achieve an appropriate balance between the interests of various stakeholders. In doing so, the board should take into account, as far as possible, of the legitimate interests and expectations of its stakeholders in its decision-making.

24. Board decisions on *how* to balance interests of stakeholders should be guided by the aim of ultimately advancing the best interest of the company. This applies equally to the achievement of the 'triple context' and the notion of good corporate citizenship as described in Chapter 1. This does not mean that a company should and could always treat all stakeholders fairly. Some may be more significant to the company in particular circumstances and it is

not always possible to promote the interests of al stakeholders in all corporate decisions. It is important, however, that stakeholders have confidence that the board will consider their legitimate interests and expectations in an appropriate manner and guided by what is in the best interests of the company.

25. Although the company has the primary governance duty of managing the relationships with its stakeholders, the stakeholders should also, where possible, accommodate the process. The board cannot achieve successful interaction with the company's stakeholders unilaterally. Constructive engagement requires the cooperation of the stakeholders.

26. Engagement is more likely to succeed in achieving a satisfactory result when stakeholders actively support constructive engagement and the principles of good governance (including that of good corporate citizenship), appreciate the legal duties of the board, consider the best interests of the company, take a longer view and are not solely focused on advancing their own interests.

**Principle 8.4: Companies should ensure the equitable treatment of shareholders.**

*This section applies only to companies and state-owned companies.*

27. There must be equitable treatment of all holders of the same class of shares issued by the company as regards those shares, including minorities, and between holders of different classes of shares in the company, except where it is necessary to protect the interests of the shareholders of those classes that have a priority in ranking.

28. Minority shareholders should be protected from abusive actions by or in the interest of the controlling shareholder.

**Principle 8.5: Transparent and effective communication with stakeholders is essential for building and maintaining their trust and confidence**

29. The stakeholder-inclusive approach aims, among other things, to stimulate appropriate dialogue between the company and its stakeholders. Such dialogue can enhance or restore stakeholder confidence, remove tensions, relieve pressure on company reputation, and offer opportunities to align expectations, ideas and opinions on issues.

30. Relationships with stakeholders can only be built and maintained if the company provides complete, timely, relevant, accurate, honest and accessible information.

31. The degree of corporate transparency and communication should, however, be considered with reference to the company's stakeholder policies, any relevant legal requirements and the maintenance of the company's competitive advantage. The decision on the level of disclosure of information and its timing is a strategic one.

32. The company should implement processes to promote appropriate disclosure. However, the board should take account of its duty to protect the long-term sustainability of the company when it considers communications about potentially adverse situations facing the company that may reasonably be corrected in the short term.

33. All communication to stakeholders should use clear and simple language and should set out all relevant facts, both positive and negative. It should be structured to enable its target market to understand the implications of the communication. Companies should use communication channels that are accessible to its stakeholders.

34. The board should, as part of the company's stakeholder policies, adopt communication guidelines that support a responsible communication programme. These guidelines should define the respective responsibilities of the board and management in regard to stakeholder communication.

35. The board should be concerned that the stakeholder communication programme provide that: all who have a right to know are properly informed; that effective feedback systems exist; that the board is alerted in a timely fashion to matters that should be communicated to stakeholders; and that processes exist to deal rapidly and sensitively with any crisis.

36. A company should consider disclosing in its integrated report the number and reasons for refusals of requests for information that were lodged with the company in terms of the Promotion of Access to Information Act, 2000. Disclosure must be considered having regard to whether divulging the information that the disclosure will necessitate will detrimentally affect the company or breach confidentiality or any agreement to which it is a party.

***Dispute resolution***

**Principle 8.6: The board should ensure disputes are resolved as effectively, efficiently and expeditiously as possible**

37. Disputes (or conflict) involving companies are an inevitable part of doing business and provide an opportunity not only to resolve the dispute at hand but also to address and solve business problems and to avoid their recurrence.

38. It is incumbent upon directors and executives, in carrying out their duty of care to a company, to ensure that disputes are resolved effectively, expeditiously and efficiently. This means that the needs, interests and rights of the disputants must be taken into account. Further, dispute resolution should be cost effective and not be a drain on the finances and resources of the company.

39. Alternative dispute resolution (ADR) has been a most effective and efficient methodology to address the costly and time consuming features associated with more formal litigation. Statistics related to success range from a low of 50%, for those situations in which the courts have handed down a case for ADR, to an average of 85% to 90% where both parties are willing participants.

40. ADR has become the intervention of choice in many instances and so it is appropriate for specialists to improve the overall rate of intake and success. Clearly the best outcome would be to increase the overall satisfaction with the process and outcome of successful resolution.

41. Disputes may arise either within a company (internal disputes) or between the company and outside entities or individuals (external disputes). The board should adopt formal dispute resolution processes for internal and external disputes.

42. Internal disputes may be addressed by recourse to the provisions of the Act and by ensuring that internal dispute resolution systems are in place and function effectively.

43. External disputes may be referred to arbitration or a court. However these are not always the appropriate or most effective means of resolving such disputes. Mediation is often more appropriate where interests of the disputing parties need to be addressed and where commercial relationships need to be preserved and even enhanced.

44. A distinction should be drawn between processes of dispute resolution (litigation, arbitration, mediation and others) and the institutions that provide dispute resolution services.

45. In respect of all dispute resolution institutions and regardless of the dispute resolution process or processes adopted by each, an indispensable requirement is its independence and impartiality in relation to the parties in dispute.

46. The courts, independent mediation and arbitration services (not attached to any disputing parties) and formal dispute resolution institutions created by statute are empowered to resolve disputes by mediation or conciliation and by adjudication. Their effective use should be ensured by companies.

47. Successful resolution of disputes entails selecting a dispute resolution method that best serves the interests of the company. This would, in turn, entail giving consideration to such issues as the preservation of business relationships and costs, both in money and time, especially executive time.

48. Mediation is often suggested as an ADR method with the assumption that the parties are willing to engage fully in the process. A process of screening is undertaken by many mediators, which excludes those who fall short of the criteria of will and capacity.

49. It is also important to recognise that the use of mediation allows the parties to create options for resolution that are generally not available to the parties in a court process or in arbitration. Further, the Act makes provision for alternative dispute resolution processes to be conducted in private.

50. Mediation is not defined in the Act. The concept has an accepted meaning in South Africa. Mediation may be defined as a process where parties in dispute involve the services of an acceptable, impartial and neutral third party to assist them in negotiating a resolution to their dispute, by way of a settlement agreement. The mediator has no independent authority and does not render a decision. All decision-making powers in regard to the dispute remain with the parties. Mediation is a voluntary process both in its initiation, its continuation and its conclusion.

51. Similarly conciliation is not defined in the Act. Conciliation is, like mediation, a structured negotiation process involving the services of an impartial third party. The conciliator will, in addition to playing the role of mediator, make a formal recommendation to the parties as to how the dispute can be resolved.

52. Once again, adjudication is not defined in the Act but the process will not differ significantly from arbitration.

53. In selecting a dispute resolution process, there is no universal set of rules that would dictate which is the most appropriate method. Each case should be carefully considered on its merits and, at least, the following factors should be taken into account:

    53.1 Time available for the resolution of the dispute. Formal proceedings, and in particular court proceedings, often entail procedures lasting many years. By contrast, alternative dispute resolution (ADR) methods, and particularly mediation, can be concluded within a limited period of time, sometimes within a day.

    53.2 Principle and precedent. Where the issue in dispute involves a matter of principle and where the company desires a resolution that will be binding in relation to similar disputes in the future, ADR may not be suitable. In such cases court proceedings may be more appropriate.

    53.3 Business relationships. Litigation and processes involving an outcome imposed on both parties can destroy business relationships. By contrast mediation, where the process is designed to produce a solution most satisfactory to both parties (a win-win resolution), relationships may be preserved. Where relationships and particularly continuing business relationships are concerned, therefore, mediation and conciliation may be preferable.

    53.4 Expert recommendation. Where the parties wish to negotiate a settlement to their dispute but lack the technical or other expertise necessary to devise a solution, a recommendation from an expert who has assisted the parties in their negotiations may be appropriate. This process may be termed conciliation.

    53.5 Confidentiality. Private dispute resolution proceedings may be conducted in confidence. Further, the Act makes provision for alternative dispute resolution processes to be conducted in private.

    53.6 Rights and interests. It is important in selecting a dispute resolution process to understand a fundamental difference they have to adjudicative methods of dispute resolution (court proceedings, arbitration and adjudication). The adjudicative process involves the decision-maker imposing a resolution of the dispute on the parties after having considered the past conduct of the parties in relation to the legal principles and rights applicable to the dispute. This inevitably results in a narrow range of possible outcomes based on fundamental considerations of right or wrong. By contrast, mediation and conciliation allow the parties, in fashioning a settlement of their dispute, to consider their respective needs and interests, both current and future. Accordingly, where creative and forward-looking solutions are required in relation to a particular dispute and

particularly where the dispute involves a continuing relationship between the parties, mediation and conciliation are to be preferred. For example, a contract can be amended or materially rewritten.

54. Mediation and conciliation require the participation and presence of persons empowered and mandated to resolve the dispute.

55. The board should select the appropriate individual(s) to represent the company in alternative dispute resolution (ADR) processes.

56. The Courts will enforce an ADR clause to resolve a dispute providing all are subject to an agreed set of rules and practices such as the place and language of the process.

57. Contracting parties who are attuned to the fact that a dispute will be administered and resolved by a third party are naturally inclined to resolve it themselves. If, for example, the ADR processes are made subject to the rules of the Arbitration Foundation of Southern Africa (AFSA), it will be administered by AFSA. If the ADR processes are arbitrary, a recalcitrant party in bad faith may be able to frustrate the process.