

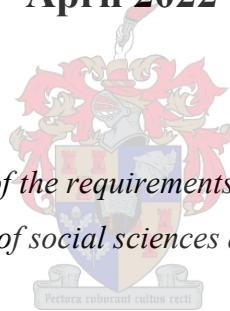
# **An Evaluation of the Readiness of Corporate Governance Frameworks to deal with Crises: A Covid-19 Perspective**

**By**

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## Declaration

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April 2022

## **Abstrak**

Hierdie studie ondersoek die toereikendheid van huidige korporatiewe beheer raamwerke deur hul doeltreffendheid gedurende krisisperiodes te evalueer. Die Covid-19 pandemie is as die ideale gevallestudie geïdentifiseer omrede dat die pandemie grootskaalse implikasies vir beide die teorie en praktyk van korporatiewe beheer inhou. Die vertrekpunt van die studie is dat die huidige krisissituasie 'n deeglike ondersoek van die gereedheid van huidige korporatiewe beheer raamwerke vereis. Die pandemie is nog besig om te ontvou, maar die voorlopige gevolgtrekking is dat die huidige korporatiewe beheer raamwerke nie noodwendig onvoldoende is om die pandemie aan te spreek nie; eerder, die raamwerke ontwikkel om met nuwe uitdagings om te gaan. Die tesis stel dus voor dat sekere areas van korporatiewe beheer (insluitend die doel van die korporasie, die integrasie van digitale tegnologië en kubersekeriteitsstelsels, en verhoogde aandag aan omgewings- en sosiale kwessies) meer aandag in die toekoms behoort te geniet. Die hoof gevolgtrekking van die studie is dus dat korporatiewe praktyke en beleide hersien behoort te word in die lig van nuwe uitdagings. Die studie eindig met riglyne vir korporatiewe beheerpraktyke gedurende tye van krisis.

Sleutelwoorde: Covid-19, korporatiewe beheer, stakeholder-teorie, digitalisering, besigheidsdoelwit

## **Abstract**

This study investigates the adequacy of the current corporate governance frameworks by evaluating their efficiency relative to the context of crises. The Covid-19 pandemic is identified as the ideal case study on the merit that it has significant implications for corporate governance theory and practice. The study work from the premise that the current crisis situation necessitates a thorough evaluation of the readiness of the existing corporate governance regimes. While cognizant to the fact that the pandemic is still unfolding, this thesis concedes that the current corporate governance frameworks are not necessarily inadequate to address the crisis situation, rather, they are still evolving to meet the challenge of the day. The thesis therefore suggests that certain areas of governance (including corporate purpose, the integration of digital technologies and cyber security systems, and heightened attention to environmental and social issues) should receive more attention in the future. The principal conclusion of this study is that there is a need to review corporate governance practices and policies in light of new emerging challenges. The study concludes with guidelines for corporate governance practices during times of crisis.

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# Chapter 1: Introduction

## 1.1 Context

This study investigates the adequacy and readiness of the current corporate governance frameworks by evaluating their efficiency relative to the context of crises. The Covid-19 pandemic crisis is identified as the ideal case study on the merit that it has a far-reaching impact, as well as implications, for corporate governance theory and practice. This thesis evaluates the impact of the pandemic crisis on corporate governance practices, and examine challenges and opportunities that corporate boards may have to address to overcome this crisis. The study also takes insights from corporate governance reforms that ensued from the financial crisis to assess the status quo and provide directives for further reforms in light of new emerging challenges. The pandemic is, however, still unfolding and the lessons emerging from the crisis are ongoing. As such, this study does not pretend to provide an exhaustive analysis of sound corporate governance practices for the current business landscape, but aims to contribute to the emerging body of literature on corporate governance and the Covid-19 pandemic.

The Covid-19 pandemic created a corporate environment characterized by time-constrained decision-making, reducing staff size, remote working, movement restrictions, fragmented supply chain, and exposure to cybercrime. Organizations' governing structures have been required to assess new risks and opportunities for business, and how stakeholders will be affected, while at the same time disclosing necessary "information about the new operating environment and any changes to their business model, strategic objectives and management of sustainability issues" (International Finance Corporation 2020: 2). This thesis suggests that large corporations will need to review their governance practices and policies in order to respond adequately to today's challenging business environment.

The pandemic has also "threatened the survival of corporations and has raised serious concerns for corporate governance practices" (Jebran and Chen 2020: 2). Studies reveal that the Covid-19 pandemic has negatively impacted on firms' supply chains thereby reducing consumer demand for

their products and services (although there are exceptional cases where firms could not meet demand, e.g., the food industry), disrupting the supply of capital inputs and tightening the provision of credit (World Bank 2020: 1). Many businesses were forced into liquidation and bankruptcy. For instance, Statistics South Africa released a report on liquidations and insolvencies wherein 216 companies were liquidated in March 2021, which is a sharp annual increase of 49.0% from 145 companies in March 2020 signaling an 18.9% increase in liquidations in the first quarter of 2021 compared to the first quarter in 2020 (Stats SA 2021: 2). On the flipside, some sectors (e.g., the health sector) and organizations (e.g., those in the chemical industry) have seen a significant increase in the demand for their products and services. Faced with the situation, boards are challenged to assess the feasibility of their risk management strategies, evaluate potential disruptions to their day-to-day business operations and impacts on key stakeholder relationships.

The context of the pandemic is testing and questioning the resilience of corporate governance practices. In all countries and sectors, the business community is facing fundamentally new and more complex and systematic risks and opportunities (Samans and Nelson 2020: 9). With the rapid spread of the pandemic, governments had to impose immediate lockdowns and curfews which, in many cases, caught many executives off guard. Companies had to take swift proactive measures to ensure the health and safety of their human capital. The EY Long-Term and Corporate Governance Survey (2020: 21) indicates that the unprecedented impact of Covid-19 signaled the need for alignment across the key areas of governance, from how boards manage risk to how they revise remuneration strategies, to drive sustainable and inclusive growth.

## **1.2 Literature review**

While it is evident that different organizations have been affected in different ways by the crisis, there are few studies on the impact of Covid-19 on corporate characteristics such as governance, performance and resilience. Of the literature that exists, Ding et al. (2020: 1) examine “the resilience of firms to the pandemic focusing on the differential, cross-firm stock-price reactions to Covid-19 cases.” Their study observes that the pandemic triggered “enormous and heterogeneous stock price movements” which made them ponder “which firm characteristics make some companies more “immune” to the Covid-19 shock than others?” and they discovered that among



other factors, “the structure of corporate governance, managerial entrenchment and executive compensation systems had an influence on market perceptions of a corporation’s resilience to Covid-19” (Ding et al. 2020: 4).

Mathew and Sivaprasad (2020) undertook a non-empirical study on the pandemic’s impact on the corporate governance of firms, specifically focusing on challenges that boards are facing and how they have tackled some of these issues and concerns. Their argument hinges on the premise that during crises such as Covid-19, boards play an important role in crisis management and business continuity (2020: 7). It is evident from their study that the governing body has the primary role of rescuing the business from crisis situations. This is further reinforced by Nasdaq Governance Solutions and Stanton Chase Board Advisory Practice which “surveyed directors, CEOs and other C-suite level executives from 269 companies across 42 countries to gain insight into corporate governance leadership and the critical role boards are – or are not – playing during this extreme period of volatility” (2020: 2).

Besides being a unique crisis, Covid-19 is not the first crisis to have hit the corporate sector. It has been preceded by the global financial crisis of 2008. In line with this observation, Khalil Jebran and Shihua Chen (2020) reviewed leading business journals articles about prior crises to investigate key corporate governance mechanisms that could potentially be effective in the ongoing Covid-19 crisis. Their review based on extant literature highlights several governance features such as risk management committees, board diversity, independent directors, foreign investors, institutional ownership, ownership concentration, dual CEO roles, block ownership and family ownership. Their review also suggests that “firms may be subject to at least one of the identified governance mechanisms and they may learn how these governance attributes can be effective in the Covid-19 crisis.” (2020: 2).

NGS and SC Board Survey Report (2020: 2) highlights that ‘Covid-19 is the first global challenge of its kind for our modern, highly connected world and is testing the foundational elements of corporate governance and the role of boards in a crisis.’ Covid-19 began as a health shock and its

spillover effects unexpectedly threatened the survival of corporations. Boards as the ultimate custodians on corporate governance experienced a unique (unprecedented), intense (continuous cycle of everchanging updates) and time-constrained (immediate need to make critical decisions) challenges created by the pandemic.

Gelter and Puauschunder (2021) explores the possible impact of Covid-19 on comparative governance. They argue that the pandemic is an “exogeneous shock” bearing potential to radically transform numerous aspects of the economy and thus necessitating significant shifts in corporate governance from shareholder-oriented to a more stakeholder inclusive governance which had “already begun in the past ten years” (pg. 559). In particular, they suggest that Covid-19 will benchmark change in three areas: (a) companies will migrate from management strategies that yield efficient results to those that will guarantee resiliency, (b) corporate law will be adjusted to protect local business to eliminate or discourage dependency on “international investors with political motives, such as firms affiliated with the People’s Republic of China” (pg. 561), and (c) firms will embrace “stakeholderism in corporate governance” as a way of addressing two main issues intensified by the pandemic; the health of human capital and economic inequalities among the general public (pg. 561).

Another dimension within the literature focuses on the lessons that can be drawn from Covid-19 in the context of business and governance. Eklund and Stern (2021) argues that boards should see this crisis as an opportunity to acknowledge the vulnerabilities of their organizations and take action for change (2021: 6). In order to achieve this objective, they emphasize that:

BOD should take a holistic approach and change their focus from ‘shareholderism’ to ‘stakeholderism’, develop sustainable value chains and partnerships, restructure their corporate governance mechanism for sustainability, reshape CEO pay structures into fairer and sustainable ones, narrow the pay gap between employees and CEOs, learn to manage new upcoming risk and opportunities, have a succession plan for the critical employees, such as CEO and directors, and develop circular and sustainable strategies, (pg. 6).

From the above, it is evident that there are numerous lessons that corporate boards could learn from the Covid-19 crisis in order to navigate the future. On the same note, Deloitte has added a

few more insights sufficient to weather the crisis. Focusing on the board's role during this crisis, Deloitte (2020) stresses that the corporate governance framework embedded within an organization 'needs to support organizational resilience through effective leadership and oversight, enhanced stakeholder engagement and communications; clear and transparent decision-making; continuous risk management, mitigation and control; and management of organizational performance' (2020: 2).

Analyzing the context of the crisis for organizations, Lynn Paine (2020) also observes that since the onset of Covid-19, corporate boards have had to face a string of difficult decisions. She cites the example of dividend policies, equity, liquidity, and strategic plans among others. These decisions often take place within a constrained timeframe and sometimes with little information at a board's disposal. Apalsan et al. (2009: 41) argues that any delay in addressing the needs of affected stakeholders poses a serious threat to the organization. Her study found that Covid-19 has the potential to "rewrite the rules of corporate governance" thereby endorsing a new model of governance which "does not diminish boards' accountability to shareholders but imply changes in the nature and scope of that accountability" (Paine 2020). This observation brings into the current debate the notion of the changing fiduciary responsibilities of boards which shall be addressed in the chapters to come.

Given the scarcity of literature on the impact of Covid-19 and the fact that the pandemic is still unfolding, little is known about the readiness of corporate governance frameworks in the current context of the pandemic. The scholarly literature on Covid-19, and its impact on corporate governance theory and practice, is gradually unfolding. The available, and yet limited, literature focuses on isolated areas within governance which is indicative that there is a lack of an integrated study which critically engages the extent to which the current corporate governance regimes are adequate to deal with the crisis at hand. To fill this gap in the literature, this study evaluates the readiness of corporate governance frameworks during a time of crisis (Covid-19 pandemic crisis). To advance this cause, the study adopts a non-empirical approach whereby the researcher will use credible data and information obtained from scholarly and non-academic literature to perform conceptual and content analysis.

### **1.3 Problem statement**

A health crisis of such magnitude as the Covid-19 pandemic is unprecedented. Its impact on business has brought an enormous set of challenges and opportunities which are likely to determine and shape the way business will be conducted going forward.

### **1.4 Thesis aims**

This study seeks to interrogate the literature on, and evaluate, the current corporate governance frameworks in order to ascertain whether they are adequate and ready to address this crisis situation. To forward this goal, the study will examine the impact of the pandemic on corporate governance practices, as well as associated challenges and opportunities that corporate boards may have to address in the context of Covid-19. Finally, this thesis shall review the adequacy of the current corporate governance frameworks, and provide governance guidelines for times of crisis.

The three key questions guiding this analysis are: What are the implications of Covid-19 pandemic crisis for corporate governance? Are the current corporate governance regimes suitable or sufficient to address the pandemic crisis? And what can corporations do to adequately address this crisis situation?

### **1.5 Outline of the Chapters**

**Chapter 2** presents the context of the crisis by reviewing early analyses of the causes of the Covid-19 crisis. The first section begins by tracing the origins of Covid-19 pandemic. The second part examines World Health Organization's effort and the international responses. The last section shall explore the impact of the pandemic on business and corporate governance.

**Chapter 3** interrogates corporate governance framework for times of crisis. This chapter traces historical events where corporate governance was directly implicated by crises, although the focus will be on the financial crisis as the immediately preceding crisis. To achieve the intended

objective, the chapter begins by examining the concept of corporate governance and how it has evolved over the years. The chapter highlights that Covid-19 pandemic has been a catalyst to already existing governance “reforms” which were in the pipeline prior the pandemic. Again, the pandemic has thrown new dimensions in corporate governance which calls for further reforms.

**Chapter 4** this chapter builds on the preceding chapters to give an outline of the next corporate governance reforms necessitated by challenges and opportunities brought on by the pandemic crisis. While cognizant of the fact that the pandemic is still unfolding, this chapter concedes that the current governance frameworks may not necessarily be deemed inadequate, rather, they are still evolving to meet the challenges of the day. However, it suggests that certain areas in governance (including corporate purpose, the integration of digital technologies and cyber security systems, and heightened attention to environmental and social issues) needs to be given more attention in the future. The last section provides the summary and the main conclusion of the study.

## **Chapter 2: The Context of the Covid-19 Pandemic**

### **2.1 Introduction**

As stated in the previous chapter, the duration and magnitude of crisis in a company may present both business opportunities and risks. Risk is often the main cause of uncertainty in organizations hence companies increasingly invest more time in identifying and managing risks before they could even affect the business. However, crisis situations differ in scale and impact hence these variables shape organizational response in the midst of uncertainty. The robustness of a company's risk management framework shields the company from being eroded by the adverse impact of the crisis thus the detriment of a shallow risk management approach could result in a compromised business strategy once crisis hits home. Conversely, a crisis situation may present an opportunity for a company to reinvent itself to address new stakeholder needs. It could also help companies reach out to new markets and create job opportunities through innovative solutions and new skills development.

In this chapter, I begin by tracing the origins of Covid-19 pandemic. The second part shall explore on the impact of the pandemic on business and corporate governance, while the last section will consolidate the preceding sections in the context of risks and opportunities. Initially, Covid-19 began as a health shock. However, with its rapid spread at global scale it has almost affected every facet of life. The origins of the virus remain unclear; the scientific research is at odds with conspiracy theories. Consequently, the novel Covid-19 pandemic remain poorly understood. The nature of the virus, that is, its unprecedented scale and impact has made it very difficult for governments and businesses to respond adequately. Throughout the chapter I shall demonstrate that as a result of the Covid-19 pandemic, organizations have been confronted with the challenge of maintaining business operations in an increasingly volatile and complex business environment.

### **2.2 Origins of Covid-19 Pandemic**

On 31<sup>st</sup> December 2019, the World Health Organization (WHO) was alerted of unusual symptoms among pneumonia patients in the city of Wuhan, Hubei Province of China wherefore a week later on 7<sup>th</sup> January 2020 the Chinese authorities confirmed the discovery of a novel coronavirus

believed to be the causative agent of the pneumonia (WHO 2020a). There is currently no conclusive evidence regarding the origins of Covid-19. According to Huang et al. (2020a), “severe acute respiratory syndrome coronavirus (SARS-CoV-2) is a novel Betacoronavirus of lineage B (subgenus Sarbecovirus) and the causative agent of COVID-19, the first detected cases of which were identified in Wuhan in December 2019.” There are various explanations regarding the origins of the virus. Some explanations argue that “its origins are zoonotic”, and the virus was “transmitted “naturally” from bats to humans, possibly from a food market in Wuhan”; whereas others contend that it was “human engineered and leaked deliberately or accidentally from a research laboratory in Wuhan” (Bolsen et al. 2020: 563).

However, Segreto et al. (2021: 1) point out that several characteristics of SARS-CoV-2 taken together do not give conclusive evidence on natural zoonotic hypothesis. These include “a low rate of evolution in the early phase of transmission; the lack of evidence for recombination events; a high pre-existing binding to human angiotensin-converting enzyme 2 (ACE2); a novel furin cleavage site (FCS) insert; and a flat ganglioside-binding domain (GBD) of the spike protein which conflicts with host evasion survival patterns exhibited by other coronaviruses.” On the other hand, those who argue that the virus was deliberately engineered, and might have leaked from the lab, also lack material evidence. According to Morens et al. (2020: 957-958), it is highly unlikely that the virus has other origins besides zoonotic, and they provide three main reasons (a) SARS-CoV-2 does not have genetic fingerprints that could have been engineered before it evolved, its genetic sequence is untraceable from any specimen of previously used coronaviruses, (b) the probability of accidental viral leakage is very low since there is no tangible evidence of any prior laboratory database with the genetic sequence of such a virus, and (c) Chinese laboratories adhere to the international safety practices, policies, training, and engineering systems therefore the likelihood of viral escape cannot be guaranteed.

Despite competing accounts concerning the origins of the virus, the scientific community has largely cohered around the idea that severe acute respiratory syndrome coronavirus (SARS-CoV-2), the causative agent of Covid-19 is zoonotic and natural (Bolsen et al. 2020; Morens et al. 2020; Segreto et al. 2021). The apparent agreement is based on the *belief* that “bats are the reservoir for SARS-related coronaviruses (SARS-r CoV-2) and have been identified as the ancestral source

from which SARS-CoV evolved, but the direct bat to human or intermediate animal to human zoonotic transmission of SARS-CoV-2 has not been established” (Segreto et al. 2021: 1). This agreement or belief is in line with the 2007 warning by scientists studying coronaviruses that: “the presence of large reservoir of SARS-CoV-like viruses in horseshoe bats is a time bomb. The possibility of the reemergence of SARS and other novel viruses should not be ignored” (Cheng et al. 2007: 660-694).

With the looming uncertainty about its precise origins and in the search for blame or responsibility, a number of conspiracy theories emerged. A conspiracy theory is “an effort to explain some event or practice by reference to the machinations of powerful people, who attempt to conceal their role” (Vermeule and Sunstein 2009: 205). Wuhan laboratory is a branch of the Chinese Center for Disease Control and Prevention. The same lab studies animal coronaviruses; based on this fact, conspiracy theorists believe that the virus was engineered with the purpose of producing an offensive biological weapon. Although this claim has no proven evidence, it continued to make news headlines and was supported by the US President Donald Trump who called Covid-19 “the Chinese virus” (Bolsen et al. 2020: 564).

In the midst of the pandemic crisis, media reports and continuous cycle of news updates exacerbated an already existing mode of panic and frustration. The media, whether biased or not, has a considerable degree of influence on people’s perceptions, beliefs, and behavior based on what is discussed, who is interrogated, and who is blamed or thought to be responsible (Chong and Druckman 2007b). In other words, communication frames via the news headlines “provide an interpretative storyline that set(s) a more specific train of thought in motion, communicating why an issue might be a problem, who or what might be responsible for it, and what should be done about it” (Nisbet 2009: 15). Similarly, in the case of Covid-19, the world has been exposed to a wide range of information varying from temporary scientific conclusions to religious beliefs and conspiratorial claims which often drive political propaganda.

Corporations are run by individuals who are not exempt from this vast network of information. It is reasonable therefore to argue that corporate response was in one way or another shaped by the specific set of information they deemed reliable. There was a continuous cycle of changing news



updates that could possibly create confusion and difficulty in modeling data sets to manage risk. Whereas governing bodies in the corporate sector would use discretionary means to manage the pandemic, hourly news headlines would demand a new approach or a supplement to an already existing crisis management plan.

### **2.3 The World Health Organization (WHO) and International Response**

As an international institution responsible for global health and disease control, the WHO, along with its global partners and the Chinese authorities, undertook a quick study to identify the nature of the virus, how it manifests itself, its mode of transmission from one host to another, populations most at risk, and how best it could be detected and prevented (WHO 2020a). Advised by the Emergency Committee, and alarmed by its rapid spread across regions and continents, the Director-General of the WHO declared Covid-19 a public health emergency of international concern on the 30<sup>th</sup> January 2020 (WHO 2020a). Based on the available data in February 2020, the WHO's *Strategic Preparedness and Response Plan* outlined several recommended precautionary measures to limit the transmission rate, save lives, and ultimately to control the virus while the search for a vaccine was underway (WHO 2021a). The urgent need for international cooperation became apparent and the WHO appealed to the international community to enact public health measures in order to contain the virus.

As the situation continued to escalate, the crisis became more risky. At end of 2020, Covid-19 had killed almost 1.8 million people worldwide; as of 7<sup>th</sup> March 2021, over 2.7 million new cases were reported (WHO 2021b). WHO continued to be proactive and called for international cooperation and solidarity in efforts to combat the pandemic and to collaborate in the search for a vaccine. Although the first patients diagnosed with Covid-19 were in the city of Wuhan, there had not been 'severe' infection rates across China when compared to other countries in Europe (such as Italy, Spain, Britain and France), which recorded the highest number of infections and deaths during the first quarter of 2020. At the end of the first quarter of 2020, the United States (US) and India followed with soaring statistics of new infections and deaths. The continent of Africa came last, with South Africa having the highest records. Evidence of this is shown in WHO's epidemiological overview which indicates that Europe and the Americas accounted for "approximately 70% of all

reported cases and deaths during 2020” while Africa and Western Pacific claimed only about 2% and 1% (WHO 2021a).

Covid-19 became a true test for global leadership. Deliberate ignorance by some presidents had bitter health, business and economic repercussions. The presidents of the United States, Brazil and Tanzania openly denounced the WHO’s precautionary recommendations and argued on political grounds to the detriment of their citizens and economy. Consequently, as of 7<sup>th</sup> March 2021 Brazil following the US recorded 413 597 new cases which accounted for an 11% increase in infections. The Bureau of Economic Analysis (2020) reported that “U.S GDP fell by 9.0% in the second quarter of 2020 compared with the previous quarter, or at an annualized rate of -3%, the largest quarterly decline in U.S GDP recorded over the past 70 years.”

However, several vaccines have been developed; the WHO, through its *Strategic Preparedness and Response Plan 2021* along with its *Operational Planning Guidelines*, claims to be ready to address and overcome emerging challenges at the national, regional and global level (WHO 2021c).

## **2.4 Impact of the Covid-19 Crisis**

The pandemic brought the whole world to a standstill and all attention was on Covid-19. The global economy contracted by 4.5% in 2020, which is equivalent to an approximately 3.94 trillion US dollars loss in economic output (Szmigiera 2021). Many businesses performed badly while others had to completely shut down due to a sudden drop in sales and demand for their products or services. The crisis led to heterogeneous cross firm impact on fundamental business drivers such as cash flow, human capital, and finances, with ripple effects on liquidity and solvency because variables such as rent, tax and wages remained constant. One major factor which became a mega trend in business was digitalization. Despite the prevalence of e-commerce prior the pandemic, Covid-19 control measures such as social distancing and lockdown restrictions accelerated digital transformation at an unprecedented speed.

By adopting a systems thinking approach, this section shall examine the gravity of the impact of the pandemic crisis across two dimensions of special interest: business and corporate governance. The aim is to map out the scale of the impact in order to introduce, in the next chapter, corporate governance framework in time of crisis.

### **2.4.1 Impact on Business**

Understood as a Complex Adaptive System (CAS), business has interdependent variables which interact and have potential to reshape the entire business system by creating a new environment or structure – a CAS property known as emergence. The Covid-19 crisis has affected different areas of business which often interrelate to produce certain results or behaviors (i.e sales and employment). The implementation of lockdown restrictions severely affected business through major disruptions in global and local supply chains, with industries such as tourism, hospitality, service providers, culture and entertainment blocked by operational interdictions (Pinzaru et al. 2020: 721). Consequently, demand and supply of goods and services affected businesses' sales thereby generating solvency challenges. On the other hand, to manage the health and safety of the human capital and customers, businesses opted for digitalization of work and e-commerce (although digitalization is not a totally new practice). This section therefore examines the impact of Covid-19 pandemic on such areas of business: sales, solvency, and digitalization. The following assessment of the impact is based on both large-scale businesses (corporations), and Small and Medium-sized Enterprises (SMEs).

#### ***Sales***

Lockdown restrictions and social distancing measures which governments adopted to handle the spread of the virus had negative impact on the operation status of businesses. There was a significant drop in demand for products and services, which in turn led to steep decline in sales. The World Bank Group's (2020) study on the impact of Covid-19 on businesses reveals that there has been a widespread negative impact on sales across countries including South Africa, Bangladesh, Sri Lanka, Tunisia and Nepal with a record of over 60% average drop in sales. China as the first country to be struck by the virus and, as a major exporter in the world, also experienced

a significant drop in sales. Chinese SMEs grappled with the challenge of maintaining their sales margins due to declining market demands and labor shortages with export firms confronted by contract breaching risks because of supply chain disruptions (Dai et al. 2020: 1).

In many countries, businesses were classified into essential and non-essential products or service providers, and only those deemed essential were allowed to operate. The crisis situation led to a high demand for basic goods and services such as food, medication, electricity, fuel, and internet, and a sudden drop in demand for some goods and services. This implies that of all industries designated as *B* in table 2.1 had an advantage. Conversely, companies or businesses whose products or services were classified ‘non-essential’ were the most disadvantaged, i.e., those listed under designation *S*. However, there are some exceptions in the entertainment industry wherein companies such as Netflix and DStv gained massive revenues.

Table 2.1

<b>Industries that benefited most (<i>B</i>)</b>	<b>Industries that suffered (<i>S</i>)</b>
Health	Tourism
E-Learning	Arts and Culture
E-Commerce	Entertainment
Insurance	Construction
Banking	Transport
Logistics	Sports
Telecommunications	Manufacturing
Chemical	
Virtual reality	

### ***Employment***

Covid-19 has had a direct impact on the labor market since firms, which are the major providers of jobs, were also under lockdown. The criterion used to define the operation status for companies during the pandemic was based on the type of business, classified as either essential or non-

essential businesses. Many businesses that were operational during the pandemic had to cut down the number of hours for employees, reduce staff size or give temporary leave. According to the World Bank Group (2020), the probability of larger firms granting leave and laying off workers was much higher than SMEs. This is because large firms which suffered a decline in sales had to cut down labor expenses whereas SMEs resorted to “multiple mechanisms of adjustments of their workforce.”

In the US, Béland et al. (2020) examined the short-term impact of Covid-19 on employment and wages. The results of their study suggests that Covid-19 led to a sharp increase in the unemployment rate and reduced hours of work and staff participation, whereas the impact on wages was insignificant. Consistent with the observation displayed in table 2.1, Fana et al. (2020) affirms that workers in the tourism, entertainment, hospitality industries etc. were the most vulnerable to economic lockdown and confinement measures induced by Covid-19. However, it is also imperative to note that the degree of the Covid-19 impact on employment (in the short, medium and long-term) in each sector, industry or country has been “less determined by the strictness of the confinement than by the structural and institutional differences such as economic specialization, social protection and labor market regulation (Fana et al. (2020: 393).

Whereas many companies opted for remote work, Covid-19 caused job losses for workers who could not work remotely. Using a quantitative survey to study the impact on Covid-19 on remote and non-remote workers in the US, Angelucci et al. (2020) found that the confinement policies, especially social distancing, led to an increase in job losses for non-remote workers more than for remote workers. Job losses as a result of confinement policies is also reported in research on Ghana, where the causal effect of the government’s confinement policies on labor market outcomes has been negative with significant decline in employment in the districts where economic lockdown was imposed (Schotte et al. 2021: 1). Covid-19 therefore poses a serious threat to the human capital in business.

### *Solvency*

One of the key factors that sustains a business is its ability to pay for its monthly and regular bills such as wages, rent, utilities, tax and payment to suppliers. During an economic lockdown, the supply and demand system are interrupted, often with a sudden drop in demand which implies a simultaneous decline in sales and revenue. Therefore, “the direct impact of Covid-19 shock on solvency is through a decrease in profitability from turnover loss” (International Monetary Fund 2020: 20). Evaluating the impact of Covid-19 lockdowns on firm liquidity and solvency among French companies, Guerini et al. (2020) found that these companies experienced an unprecedented 80% increase in insolvencies from 1.8% pre-Covid-19 to 3.2% during lockdown. What does this imply for business? Businesses that experience solvency problems would, in the short-term, fail to make productive investments, be less advantaged to access credit, fail to generate employment, and incur losses to their creditors (Blanco et al. 2020: 17).

### ***Digitalization***

The fear of contagion and the lockdown restrictions could not allow for businesses to conduct their daily operations onsite, therefore, many businesses opted for an online platform in the short-term. Although digitalization varied across sectors and firms, the most common modes of its application included telework, e-commerce and online advertising. While larger firms were likely to invest more in digital solutions, SMEs were less well-positioned to seize the opportunity (WBG 2020: 11).

On the other hand, the move towards the adoption of digital technology created an opportunity for cybercrime. Whereas telework was a viable option for business, it exposed and rendered many companies vulnerable to cyberattacks since employees used unsecured internet connections. The crisis created a platform for cybercriminals to exploit the seeming “vulnerabilities, weaknesses and lapses in controls due to Covid-19 disruptions which provide opportunities that are sought by bad actors with varying degrees of sophistication” (CPA Canada and IESBA 2020: 3).

The World Economic Forum (WEF) (2019) defines cybercrimes as “all unauthorized computer-mediated activities to a company or an individual’s information with malicious intent.” Cybercriminals would illegally harvest information or data with ill-intent to compromise its

integrity or to discredit a company or individual for personal and financial gains. Chigada and Madzina (2021) found that “between February and April 2020, cyberattacks and threats on financial institutions increased by more than 238% globally, at a time when the global economy was working tirelessly to fight the Covid-19 infections.”

The impact of Covid-19 crisis on business implies that corporate governance is also affected. The extent to which management of companies was affected and reacted to the pandemic crisis is worth a detailed analysis. The next section examines how companies’ leadership addressed challenges posed by the crisis.

#### **2.4.2 Impact on Corporate Governance**

Corporations are the major contributors to national economies and development. To fulfill their ultimate purpose – which is the creation of value, companies are directed and controlled by the board of directors and management team. This is known as corporate governance. The overall success of a company is mutually beneficial to both the company and its stakeholders hence the imperative to critically examine the impact of Covid-19 on the governance of companies. Control and preventive measures taken by governments in response to the pandemic had a significant impact on the normal functioning of boards, shareholder meetings, and other corporate governance practices which will be evaluated later in this section. Boards were forced to activate their emergency response plans and adopt these plans to ensure organizational resilience during unprecedented and critical circumstances.

This section reviews the impact of Covid-19 pandemic on corporate governance, and immediate measures that boards took to address the crisis situation. Literature on the impact of Covid-19 on corporate governance practices highlights at least six critical areas on which the disproportionate concentration of challenges and opportunities is observed. These include major implications on corporate strategy (Al-Mansour and Al-Ajmi 2020), suspension and termination of commercial contracts (Twiggs-Flesner 2020), liquidity, solvency and capitalization considerations (Carletti et al. 2020), management of stakeholder relationships (Cheema-Fox et al. 2021), management of

emerging risks (CPA Australia ESG Center of Excellence (2020); Corporate Governance Nigeria (2020), and legal revisions on digitization of Annual General Meetings (Zetzsche et al. 2020).

*Corporate Strategy:* one of the key components of corporate governance is strategic planning. There are three levels of strategy which drive the organization: corporate strategy, which focuses on the scope of the organization, resource allocation and overall management/governance structure; business strategy, which deals with the competitive edge; and, operational strategy, which concerns specific functions and relations across different units of the organization. Covid-19 destabilized these levels of strategy in various ways. For instance, at the time that the Covid-19 pandemic struck, some companies had already set performance targets and metrics for the current performance period regarding short, medium and long-term rewards such as performance equity and annual bonuses for the CEO and management. To address this situation, Al-Mansour and Al-Ajmi (2020: 668) suggest that “in such circumstances, and in order to respond to the associated unexpected global economic recession, businesses must reform their current strategies to effectively respond to the implications of COVID-19.”

However, the sudden change in business climate caused by the pandemic (drop in sales, e-commerce, temporary shutdown, and home-based work) required directors to revise their corporate strategy. Deloitte’s *2020 Chief Strategy Officer Survey* found that the traditional strategic planning process was inadequate to address complex business environments because it is “too infrequent” and “takes too long to complete”, whereas scenario planning has proven to be a most effective technique to help firms to weather and recover from a crisis. Boards therefore have had to identify key areas of focus in their strategy that needed incremental or significant adjustments.

*Commercial Contracts:* Immediate lockdown restrictions, which disrupted the supply chain, and uncertainty regarding the duration and impact of the pandemic severely impacted on companies’ commercial contracts, often forcing boards to either suspend or terminate their contractual obligations. Company specific events and circumstances (e.g., liquidation or insolvency) that emerged as a result of Covid-19 have adversely affected some companies to the extent that it became impossible for them to fulfill their obligations stipulated in commercial contracts (Twigg-Flesner 2020: 2). In their article on the global law firm, Elder and Huiginn (2020) note that, given



the nature of specific contracts and the scales at which these contracts were implemented, some contracts have had to be suspended or terminated prematurely, especially in cases where it became too costly to meet contractual commitments. Here, Covid-19 has been regarded as a force majeure.

*Corporate Finance:* The pandemic has also affected companies' liquidity, solvency and capitalization. According to EY Center for Board Matters (2020):

During times of uncertainty, the board plays a key role by providing strategic insight, oversight and foresight around whether the company's financial scenario planning and stress testing are designed to adequately assess the levels of liquidity, credit and capital needed over relevant ranges, as well as to confirm that appropriate communications are occurring with all stakeholders, (pg. 2).

Although the financial impact varied across sectors and industry, many large companies were severely affected by a significant drop in sales and profits and high operating costs that exhausted cash flow cycle (Ellul et al. 2020: 422). In particular, companies with no e-commerce platforms experienced terrible cash flow strains due to prolonged lockdown restrictions.

In their study, Banerjee et al. (2020: 4) also highlight that at the end of Financial Year 2019 (FY), the financial statements of 50% of companies in 26 advanced and emerging economies reflected insufficient cash to cover foreseeable debt in 2020. Such a financial position could tempt company directors to breach financial covenants such as cover ratio tests, which are contained in the financing documents. Company shareholders have had to be agile to provide additional equity to companies to prevent liquidation and ensure that financial covenants were not breached and that going concerns were maintained (Carletti et al. 2020: 3). The adverse financial positions of many firms also led to hostile and friendly takeovers, immediate voluntary liquidation, or compulsory liquidation.

*Stakeholder Relationships:* company stakeholders are groups or individuals who may affect or be affected by the company's overall business activities, and who have significant role in the company's value creation (King IV 2016: 21). As legitimate constituents of the company, stakeholders need to be engaged in all business activities which may impact on their participation in value creation. The International Finance Corporation (2020) through its *Disclosure and Transparency Framework* also emphasizes the importance of engaging stakeholders, highlighting

that this “can help companies to co-create health and economic solutions for employees and communities and ensure that new risks and impacts are appropriately detected and remediated.” This signals an imperative for the governing body to manage its relationship with stakeholders effectively and efficiently. In principle, stakeholder management involves a careful consideration of business activities that may affect stakeholders through well-established methods of identification, prioritization, planning and implementation with the goal of fostering harmonious relationship and effective engagement (Mints and Kamyshnykova 2019: 2).

During the Covid-19 pandemic crisis, directors had to confront additional challenges to prioritizing stakeholder interests. Since Covid-19 is primarily a health crisis, human capital was at the highest risk. As such, many companies adopted an inside-out approach where internal stakeholders (i.e., the governing body, management, employees and shareholders) took primary priority, followed by other external stakeholders such as customers and suppliers to address the crisis situation. Furthermore, in their study, Cheema-Fox et al. 2020: 34) discovered that “investments in stakeholder relations could be valued as strategic resources especially in a business context where those investments represent a credible and costly commitment to those stakeholders.”

*Risk Management:* on matters pertaining to risk management, Society of Corporate Governance Nigeria (2020: 6) emphasized that “the unprecedented Covid-19 pandemic will require companies to immediately reassess risks, respective processes and controls.” On the same note, CPA Australia ESG Center of Excellence (2020) identified (1) operational risk (2) technology risk (3) financial risk and (4) human risk as key Covid-19 related risks which boards may need to consider. These risks were briefly discussed in the previous section. The risk of Covid-19 infections and government’s subsequent interventions additionally posed a serious threat to the operational human capital of firms.

The governing body had to ensure that the health and wellbeing of its human capital is secured; this also has implications on company’s risk management framework especially with regard to the formulation of an emergency succession plan for when members of the board, the CEO or the management are diagnosed with Covid-19 and must be quarantined for several days. Additionally, due to the volatile business environment, directors and management have had to respond and adjust

to the new organizational climate (e.g., continuous cycle of updates and uncertainty). These circumstances induce stress and anxiety thus rendering directors and management susceptible to decision fatigue.

*Annual General Meetings (AGMs):* conducting annual meetings has been a challenge in the midst of the Covid-19 pandemic. The purpose of AGMs is to update stakeholders (especially financial capital providers) of the company's overall company performance in relation to its financial position, operational status and strategy, ESG targets and risk profile among others. Often, Covid-19 related risks would not allow for boards to convene these meetings at the scheduled time during the first quarter of 2020 hence some companies in other countries resorted to hybrid AGMs (Zetzsche et al. 2020: 12).

The Organization for Economic Cooperation and Development (OECD) through the *National Corporate Governance related initiatives during the Covid-19 crisis (2020)* report surveyed 37 jurisdictions on how Covid-19 affected their corporate governance initiatives. The results indicate that in some jurisdictions (e.g., Italy, Spain and Singapore) AGMs had to be rescheduled, whereas in the United Kingdom, Austria, Czech Republic, and Poland public authorities granted temporary provision for virtual meetings on the basis of the law. The survey results also highlight the fact that Covid-19 provided an opportunity for jurisdictions to revise their regulatory framework for online participation in such meetings (in countries such as Chile, Latvia, Germany and Netherlands).

Reflecting on the UK company law, the Chartered Governance Institute (2020) suggests that companies could adapt, delay, postpone, adjourn, or conduct hybrid AGMs based on specific legal provisions. Because Covid-19 keeps on evolving, the choice to adopt any of these options continues to evolve.

*Corporate Responses:* To remedy the situation and maintain resilience, board composition, functions, and structure has had to be revised. Some boards needed directors with new skills set and experience especially in the areas of data science, digital marketing, occupational health and safety, financial technology, and sustainability. Covid-19 did not only create an opportunity to

rethink or restructure corporate governance but compelled reformation and renewal of corporate governance to ensure that boards were adequate and fit-for-purpose.

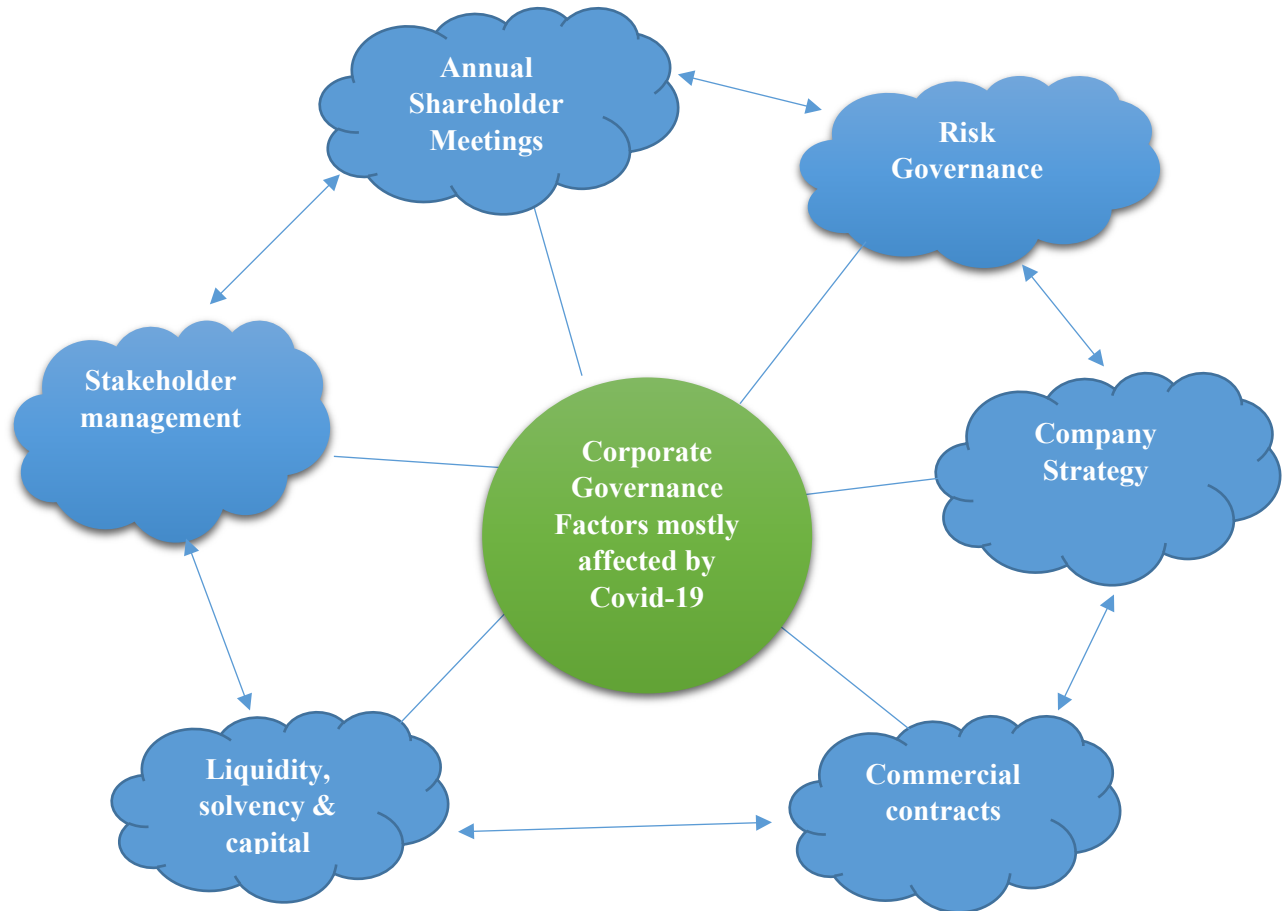


Figure 2.1 Impact of Covid-19 on Corporate Governance Practices

Figure 2.1 illustrates the connection between various areas of corporate governance that have been affected by the Covid-19 pandemic. The main idea is that board composition and structure determine its ability to perform oversight responsibilities. By default, the board has to receive a periodic update from management on various issues including the state of the company in reference to liquidity, solvency and capital(s) and company's risk profile in order to adequately respond to the pandemic crisis. These variables may have implications on company's strategy thus providing opportunities for adjustment, i.e reviewing commercial contracts. Considering the

possibility of their own staff being infected by the virus, companies had to prioritize the needs of their stakeholders accordingly. This also implied that the company's risk governance has to include a well-designed emergency succession plan to address risks. In the end, it became difficult to convene AGMs due to strict regulations.

As stated earlier, the pandemic crisis presented both opportunities and challenges for business and corporate governance. Important lessons have been learnt especially in risk management. Meanwhile, Covid-19 remains the greatest challenge for corporate resilience.

## **2.5 Conclusion**

This chapter has traced the origin and general impact of the Covid-19 pandemic and has specifically focused on how the pandemic has affected business and corporate governance practices. Based on the idea that crisis situations provide both opportunities and challenges, this chapter demonstrated that Covid-19 disrupted business ecosystem and altered corporate governance practices. The overall impact of the pandemic on business was nonlinear with some businesses across different sectors and industries benefiting enormously from the crisis situation, while others were placed in a compromised position. Aside from macro-economic opportunities and constraints, to be sustainable and effective, organizations need(ed) to be governed properly and some of the pandemic challenges to corporate governance practices were investigated. However, the large-scale impact of the pandemic on business as such raises deeper questions concerning the possible need for corporate governance reform.

The next chapter will investigate corporate governance framework in time of crisis. The 2007/8 global financial crisis shall be examined as the immediate crisis preceding Covid-19 pandemic crisis. The aim is to juxtapose the two crises in relation to how challenges pertaining to corporate governance are (could be) addressed.

## CHAPTER 3: Corporate Governance during times of crisis

### 3.1 Introduction

This chapter interrogates the corporate governance framework for times of crisis through means of a deeper theoretical engagement with corporate governance literature. The 2007/8 global financial crisis and the Covid-19 pandemic crisis have shown that crises can stem from within business, and also be external to business (such as Covid-19). Literature suggests that the financial crisis came about as a result of weak corporate governance especially in the banking sector (Kirkpatrick 2009; Sun, Stewart and Pollard 2011; Grove and Victoravich 2012;). The Organization for Economic Co-operation and Development (OECD) released a document on *Strategic Risk Management* (2011) highlighting that the 21<sup>st</sup> century is likely to witness multiple shocks because “our societies are becoming not only more complex and interconnected, but also increasingly vulnerable and exposed, as new or different threats may emerge and spread more quickly through spill-over or amplifier effects.” Both the financial crisis and the Covid-19 pandemic crises exposed these inherent vulnerabilities.

Since the Covid-19 is not the only crisis to have struck the corporate sector, the manner in which corporations are handling crises is worth a detailed analysis. This chapter traces historical events where corporate governance was directly implicated by crises, although much of the focus will be on the financial crisis. To achieve the intended objective, the chapter begins by examining the concept of corporate governance. The first section details a historical background to the concept, momentous developments in the field of corporate governance, as well as the current state of affairs. The central idea is to delineate the focal point of this investigation in order to pave a way for proceeding sections. The second section evaluates how corporate governance functioned during the Global Financial Crisis (GFC) and beyond. The 2007/8 crisis period signifies a crucial moment in the history of corporate governance as it captures both the credit and solvency crises in one (Clarke 2011: 28). Again, prior to the GFC, corporate governance had never been challenged at that magnitude especially after the Enron and WorldCom scandals and regulatory reforms thereafter.

The third section evaluates how reforms after the financial crisis shaped corporate governance. The main goal is to extract important lessons to-date and the extent to which they can be applicable in the current context of Covid-19 crisis. The fourth section highlights that the Covid-19 pandemic crisis has thrown other dimensions of corporate governance (such as those mentioned in the previous chapter) to light and goes a step further to give motivation for why further governance reforms are now necessary. The last section shall provide insights (from the preceding analysis) for managing Covid-related risks and opportunities and offers a conclusion.

### **3.2 Corporate Governance**

Corporate governance, as a way of thinking and doing business, existed prior to the official use of the term in the 1980s (Jovanovic and Grujic 2016: 189-190). More than a century ago (in 1903), Britain had already set up the Institute of Directors (IOD), which promoted free enterprise and corporate governance in the UK. Before the theoretical advancements that occurred in the 1980s, the structure of the corporate system was designed in such a way that a group of investors would provide aggregated financial capital to the corporation, which was actively managed by the company's board of directors on the shareholders' behalf. Shareholders were understood as the owners of the corporation, they had property rights and would delegate powers to management who were merely the agents accountable to their masters (Berle and Means 1933: 135).

The analysis of Berle and Means (1933), which was inspired by the Great Crash of 1929, highlights "separation of ownership" as a concept that invoked the notion of governance. This separation of ownership was such that shareholders had a disciplinary role which was enforced through incentives and supervision systems, while management had a decision-making function on behalf of the shareholders. Realizing the unfairness of this system, Berle and Means concluded that the maximization of shareholder value as the sole objective ignored contributions of other constituents; thus, they recommended an inclusive approach whereby the public corporation would serve the interests of everyone with a stake in it. The idea of "governance" in this case came as a form of "regulation" of managers' behavior (Naciri 2008: 18).

As years went by, concerns about corporate social responsibility emerged during the 1970s. Realizing the detrimental impact of corporate externalities – business activities affecting society and the natural environment (i.e., pollution, deforestation and exploitation of natural resources) during the 1970s – scholars suggested that accounting reports should address this issue (Jovanovic and Grujic 2016: 189). But still, there are scholars who disagreed, Milton Friedman being one of them. In a landmark article, Friedman (1970) wrote that:

In a free-enterprise, private-property system, a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to their basic rules of the society, both those embodied in law and those embodied in ethical custom, (pg.2-3)

Six years later, Jensen and Meckling (1976) came up with a theory concerning the ownership structure of the firm known as agency theory. Their aim was to address the problem of “separation of ownership and control”, which Berle and Means had already highlighted; the “social responsibility” of business (which was among major concerns in the 1970s); define the purpose of the corporation; and, formulate an agency theory of the firm. Agency theory refers to the “ubiquitous agency relationship, in which one party (the principal) delegates work to the other (the agent), who performs that work” (Eisenhardt 1989: 58). According to agency theory, shareholders are the “owners/principal” of the firm, while company directors are the “agents” whose mandate is to pursue the interests of their principal, and this entails maximizing shareholder returns as the primary aim. It was only after Jensen and Meckling’s 1976 paper that debates in the United States focused on such matters as managerial accountability, board structure, and shareholder rights under the collective term “corporate governance” (Cheffins 2011: ix).

Against popular ideology, Edward Freeman (1984) introduced a new approach that would defy profit-making as the ultimate goal of doing business. His stance was that the goal of business is to create value for all its stakeholders. In this way, corporations would cease to generate profit for shareholders at the expense of the natural environment and society. Four years later, in the United Kingdom (UK), the term “corporate governance” was first adopted and widely accepted through Cochran and Wartick’s (1988) publication titled, *Corporate Governance: A Review of the Literature*. During this time, corporate governance still connoted “promotion of shareholder value”



(Cheffins 2015: 5). The subsequent publication of the Cadbury Report in 1992 defined corporate governance as “the system by which companies are directed and controlled”.

This Report came forth as a response to poor business practices that tarnished the image of the British corporate sector at that time. Among these practices were poor accounting standards, lack of a clear regulatory framework for directors’ accountability, and the reluctance of auditors to perform their duties correctly. These concerns inevitably led to “unexpected failures of major companies and criticisms of the lack of effective board accountability” (Cadbury Report 1992: 13). The Cadbury Report came to be known as the first corporate governance code to give directives on good business practice. The Report was intended to provide guidelines of best business conduct to the board of directors in all companies whose shares were listed on the Stock Exchange (Jovanovic and Grujic 2016: 190). Its scope of applicability further accommodated non-listed companies to align themselves with its prescriptions.

### ***Developments in corporate governance***

Ever since the release of Cadbury Report, corporate governance was developed and operationalized through the creation of other national corporate governance reports. In 1993, the Institute of Directors South Africa (IODSA), formed a committee that was tasked with drafting a corporate governance report for South Africa. In 1994, the first report in the series was released, and named after Prof. Mervyn King, who served as the chairman of the committee – the first King Report on Corporate Governance (King I). This Report continued to evolve over the years and the latest version – the King IV Report – was released in 2016. South Africa is the first country in Africa to introduce a corporate governance report and the King Report influenced corporate governance within the wider context of Africa (Armstrong, Segal and Davis 2005: 4). While reflecting on the specific context of the South African business environment, the King Report demonstrates an integrated approach to corporate governance covering the financial, ethical, social and environmental issues.

In 2002, The United States (US) enacted the Sarbanes-Oxley Act which regulates the accounting profession and prescribes standardized financial reporting for corporations. In capital markets

regulation, there are well-established legal structures through which public officials control market actors, obliging them to either comply with the law or face penalties (Anand 2004: 4). The US adopted a statutory, instead of voluntary, approach to corporate governance whereby the former represents a mandatory compliance with the law, and the latter refers to the concerted adoption of corporate governance standards and principles. The Sarbanes-Oxley Act of 2002 is a federal law which came forth as a reaction to a series of major corporate and accounting scandals in the US, which included Enron, WorldCom, and Tyco International (Coates IV 2007: 91-92).

Five years later, the 2007/8 global financial crisis became a major economic challenge of an unprecedented scale. The Financial Crisis Inquiry Commission (2011) concluded that:

While the vulnerabilities that created the potential for crisis were years in the making, it was the collapse of the housing bubble—fueled by low interest rates, easy and available credit, scant regulation, and toxic mortgages—that was the spark that ignited a string of events, which led to a full-blown crisis in the fall of 2008, (pg. xvi).

To supplement the Commission's Report, a large body of research confirmed that the financial crisis was a result of inadequate corporate governance practices in the financial industry (Kirkpatrick 2009; Pirson and Turnbull 2011; Aebi et al. 2011). According to Tarraf (2011), poor corporate governance during the financial crisis resulted from aggressive risk-taking, which was motivated by “incentive systems that rewarded high levels of risk taking”; rationalization of short-term profitability; and “deficient board oversight”, which created opportunities for managers to indulge in rampant risk strategies.

During the financial crisis, the combination of a highly competitive business environment and limited regulation opened up opportunities for big bets and unethical business practice, merely to capture short term profitability. This is evidenced by a lack of disclosure transparency, where banks deliberately provided false financial information (e.g., worth of assets, capital and liquidity sufficiency) in order to justify their eligibility to receive loans and capital (Levitt and Turner 2008). For instance, in the Lehman Brothers case, it was discovered that Richard Fuld (who was then CEO and Chairman of the Board) deliberately misled the board by “filtering out substantial arguments against his strategy when presenting it to the board” (Pirson and Turnbull 2011: 461).

Among other banks which victimized investors and incurred substantial losses were AIG, Fannie Mae, Freddie Mac, Merrill Lynch, and Citigroup.

At a closer look, it was not necessarily the loopholes in corporate governance principles or regulatory frameworks as such that led to the financial crisis. Rather, deficiencies in board oversight, remuneration structure, and lack of transparent and fair reporting (i.e., risk disclosure and financial statements) and the approval of credit rating agencies fueled the financial crisis. The FCIC report (2011) also frankly concluded that the financial crisis was an “avoidable” disaster whose unfolding is attributable to failures in financial regulation, deliberate corporate mismanagement, excessive risk-taking and blind reliance on credit rating agencies. The report is replete with instances of disheartening failures by trusted corporate captains, and conscious ignorance by Wall Street economists and public stewards of the US financial system.

Since corporate governance was implicated as the ultimate causal denominator facilitating the global financial crisis, errors that resulted from poor corporate governance had to be corrected in order to prevent the same or similar crises from repeating. In the aftermath of the crisis, it was clear that corporate governance of financial institutions had to be reformed. The repercussions of a corporate environment characterized by minimum regulation of the banking sector, excessive risk, and credit expansion provided opportunities for the reexamination of corporate governance of financial institutions.

To establish a well-grounded and comprehensive corporate governance framework for financial institutions (and industrial firms), regulators and policy makers had to understand the differences in corporate governance mechanisms for these organizations. A reform project that takes a general approach instead of delineating particularities of each industry could not adequately address problems which arose in, and affected, a specific industry. Since the global financial crisis directly affected financial institutions, the reforms that followed were particularly focused on the corporate governance of banks. The OECD (2008) paper on *Corporate Governance and Financial Crisis* highlighted four main governance areas of concern which regulators and policy makers needed to address in light of the implicated weaknesses: (a) board performance, (b) remuneration/incentive systems, (c) risk management practices, (d) the exercise of shareholder rights.

In the intervening years, corporate governance regimes have continued to evolve. Developments include the *Principles of Corporate Governance* (2019) by the Business Roundtable (BRT), *The New Paradigm* (2019) by the International Business Council of the World Economic Forum, the *Common Sense Principles* (2018) in the US, the *2018 UK Corporate Governance Code*, and the *Mohlomi Code of Corporate Governance* (launched in 2021) in Lesotho. These documents represent efforts to reform business practice in such a way that it can be sustainable and beneficial for all stakeholders.

### *Academic Perspectives*

Some scholars understand corporate governance as representing a value framework (which explains an enterprise-wide approach to the delivery, experience and acquisition of value), a leadership framework (depicting standards for suitable and appropriate leadership style), and an ethical framework (which entails a set of ethical principles and values guiding corporate practice) in which business decisions are handled (Nainawat and Meena 2013: 1085). This implies that for corporate governance to be effective, businesses ought to draw-up and pursue value propositions that do not only attract investment but also take the interests of stakeholders into consideration. In a like manner, the governing body is expected to display the highest form of the internationally recognized corporate governance values of responsibility, accountability, fairness and transparency at all time (Pearse Trust 2014). The King IV report (2016) added values of integrity and competence. The aforementioned three lines of framework are established to manage risk and the possibility of a scandal.

Rossouw (2008: 28-29) argues that corporate governance has three distinctive components: (a) Internal and external corporate governance: the former is comprised of the structure of the board of directors; independent internal audits; oversight of management; and, relationships between internal stakeholders, such as managers, employees, and shareholders. The latter is about controls exercised by those outside the organization who prescribe regulatory guidelines and standards for best practice. The basis for compliance often determines companies' response to such regulations.

(b) Shareholder and stakeholder approaches to corporate governance: these emphasize the interests to be pursued. A shareholder approach pursues the interests of shareholders, whereas the stakeholder approach pursues the interests of all constituents with a stake in the organization.

(c) Descriptive and normative notions of corporate governance: this speaks to the theoretical framework embodying standards and norms guiding corporate decision-making. The descriptive notion reflects the actual behavior in organizations in relation to how it is measured by performance, efficiency and stakeholder treatment. The normative domain prescribes the rules, norms and standards for business ethics and managerial decision-making. A comprehensive definition of corporate governance will therefore encompass these three aspects.

### ***The Corporate Governance Imperative***

From another perspective, corporate governance concerns board of directors who assume the ultimate responsibility within the organization/company. This means that governance is about how boards are constituted and structured, how directors perform their fiduciary duties, framework for directors' accountability to stakeholders, and the remit of the board (Vallabh and Dadhich 2016: 1130). It also concerns the mechanisms used to delegate authority at different levels in the organization. These include powers given to the CEO, executive committees, line managers and employees. This power and authority are intended to aid collective organizational behavior and culture towards the achievement of the company's purpose, mission and strategy. Corporate governance therefore makes up the overall stewardship of the company's total portfolio of assets and resources for the benefit of all stakeholders (Okeahalam and Akinboade 2003: 4).

Sound corporate governance is the imperative for best business practice. When run effectively and ethically, companies earn the trust of investors and lenders. According to Okeahalam and Akinboade (2003: 4), good corporate governance has several benefits: it attracts investment, maintains competitive advantage, enhances accountability and performance, and promotes responsible use of resources. When a company is governed properly, investors become more confident in their valuations and assurance outcomes. Companies often achieve good governance by creating a conducive working and business environment that allows everyone to apply the best

of their skills and knowledge for the good of the company. From good corporate governance practice ensues good corporate culture. It is no coincidence that corporate scandals that occurred were the result of inadequate corporate governance practices.

Corporations continue to have a large impact on society. Debates and concerns about how they are governed has also gained momentum within the public domain. Academics and the wider public are concerned about various governance issues such as the “purpose of the corporation, the role of corporate boards of directors, the rights of shareholders, and the proper way to measure corporate performance” (Paine and Srinivasan 2019). One of the latest debates culminated in the release of *The Statement of the Purpose of a Corporation* by the Business Roundtable in 2019. This report highlights a shift in emphasis from a previously dominant governance principle of shareholder primacy (that corporations are meant to serve the interests of shareholders) to a new principle that requires corporations to integrate the needs of a wider range of stakeholders including customers, employees and communities. The applicability of this report varies according to the model of corporate governance, i.e Anglo-American and Franco-German model (which will be explained in the next section).

In essence, these debates signal a paradigm shift from a shareholder-centered theoretical framework that informed managerial practice for decades to stakeholder-inclusive ways of doing business. To advance this ideology, there is a growing body of research and literature on the role of institutional investors (Ferreira and Matos 2008), the basis for responsible investment (Sparkes 2003), and the Environmental, Societal and Governance (ESG) metrics used to measure corporate financial performance (Friede, Busch and Bassen 2015). Corporations are now more geared towards the creation of a sustainable value for all their stakeholders. This is also heightened by a significant increase in the number of companies voluntarily engaging in corporate social responsibility (CSR) activities to support their local communities (Gigauri 2021: 31).

As noted, the results of poor corporate governance are manifest in corporate scandals which often compromise people and the natural environment. This inquiry, which investigates corporate governance framework for times of crisis, intends to sketch a theoretical basis for resilient corporate practices that will minimize risk and create intergenerational value. The next section

examines the current context of corporate governance reforms. This section shall address issues and events that directly implicated corporate governance in order to pave a way for a clear understanding of how corporate governance reforms post-financial crisis shaped corporate governance.

### **3.3 Corporate Governance Reforms**

Reforms that followed the financial crisis were constructed on the basis of a careful study of the causal determinants of the crisis, especially those that speak directly to corporate governance (Bruner 2011: 310). Indeed, as the term explicitly indicates, the *financial* crisis was a serious challenge within the financial industry rather than in other non-financial sectors/industries. These reforms therefore did not address general corporate governance issues, rather, the focus was on restoring financial regulation and shareholder concerns. Specifically, such reforms dealt with complex principal-agent relationship (agency problems) in the banking industry. Agency problems arises when there is a conflict of interest between shareholders (principal) and directors (agents) regarding the management of a company (Eisenhardt 1989: 58).

The Anglo-American model of corporate governance differs from the Franco-German model of corporate governance. These differences dictate how reforms and agency problems are perceived and understood within specific contexts. The Anglo-American model takes the view that corporate governance is aimed at the maximization of shareholder wealth, irrespective of whether such pursuit is inconsistent with the interests of other constituents, except in the case where managers are legally bound to make provisions (Macey and O'Hara 2003: 91). The Franco-German model, which is dominant in continental Europe, by contrast, views a corporation as made up of industrial relationships where the long-term interests of all stakeholders are considered in the same way as shareholder interests.

Governance reforms were therefore geared towards fixing the relationship between shareholders and board of directors through the principle of 'shareholder empowerment' enshrined in the Dodd-Frank Act of 2010 (Vasudev and Watson 2012: 2). The principle of shareholder empowerment, argues Bebchuk (2003) affords shareholders power to intervene in major corporate decisions,

especially (a) power to make “rule-of-the-game” decisions such as “to amend corporate charter or change the state of incorporation,” (b) power to make “game-ending” decisions including “to merge, sell all assets, or dissolve,” and (c) power to make “scaling-down” decisions whereby they can “contract the company’s size by ordering a cash or in-kind distribution.”

Although the reforms dealt with typical corporate governance structural concerns including remuneration systems, board oversight, risk management and the exercise of shareholder rights, these structural concerns vary on the basis of context, scope and applicability. In the financial sector, they inform board and management’s accountability to the shareholders whereas in the non-financial sector such concerns connote a different approach which is the creation of equitable value between shareholders and other stakeholders (as is typical of the Franco-German governance model). For instance, in matters pertaining to risk management in the banking industry, “the financial literature tends to suggest that increased alignment of bank manager’s interests with those of shareholders through equity-based pay should increase the manager’s risk appetite” (Bruner 2011: 317) a strategy which however led to the financial crisis. In non-financial firms, the scope of risk management covers enterprise-wide risk exposures which might threaten the creation of equitable value for all company stakeholders.

Starting from the release of the Cadbury report in 1992, good corporate practice has been restored via legislation, codes and principles. The US Congress responded through legislation in the form of the *Dodd-Frank Act of 2010*. This law was enacted to extend the regulatory hand of the US government on public corporations. Although some of the content of Dodd-Frank was subsequently repealed, there is a specific provision of the Act which addresses the corporate governance practices of Wall Street banks which were said to be “too big to fail” by setting up limits on engaging in riskier practices, standardizing capital and liquidity requirements, and setting limits on the size of financial institutions (Vasudev and Watson 2012: 2).

Another regulatory response in the US came from the New York Stock Exchange (NYSE) which funded a *Commission on Corporate Governance* (2010) that issued a number of key corporate governance principles. These principles introduced generalizable perspectives on corporate governance concerns in the following areas:



*The role of Board of Directors:* the board is mandated to pursue a long-term sustainable value for shareholders. Therefore, it should formulate policies that are consistent with good corporate practice and in alignment with shareholder expectations. Specifically, the board should approve risk strategies that are long-term oriented, and compensation policies that are congruent with this objective.

*The role of Management:* the management is primarily tasked with the responsibility of “creating a culture of performance with integrity”. Management’s role extends to establishing transparent risk management processes and internal controls. Guided by high ethical standards, management is expected to disclose accurate and honest reports to both board of directors and to shareholders.

*Shareholder Rights:* shareholders are legitimate stakeholders in the corporation. Thus, “shareholders have the right, a responsibility and a long-term interest to vote their shares in a thoughtful manner.” Institutional investors are also encouraged to disclose on their corporate governance guidelines and general voting policies.

*Good Corporate Governance:* corporate governance is the engine of the company. It should be viewed as such, instead of simply being a compliance obligation. The board of directors is directly responsible for quality governance within the organization.

*Transparency:* at the core of corporate governance is transparency. This means that boards and shareholders ought to disclose accurate reports on matters pertaining to diverse issues including ownership of derivatives and securities in order to facilitate quality governance. Transparency is a requisite for continuous dialogue on governance, performance and strategy concerns.

*Board composition and independence:* a well-established board is independent and objective. However, these qualities should not overshadow other essential qualities of the board. The board is subject to the stock exchange requirements, which – in most jurisdictions – recommends that boards should comprise of independent and not-independent directors in order to maintain diversity in expertise and knowledge.

In the United Kingdom (UK), the government was deeply affected by the financial crisis, with the consequence that it also had to bailout a number of prominent financial institutions, including Bradford and Bingley, Lloyds Banking Group, Northern Rock, and Royal Bank of Scotland (Grice 2010: 754). To restore good corporate governance practices in the UK financial system, just like in the US, governance reforms efforts were focused on risk-taking and related incentive structures that would align with shareholder interests – including specific provisions for the empowerment of shareholder participation and intervention in corporate affairs. As Bruner (2010: 318) observes, Sir David Walker, who reviewed corporate governance in UK financial firms, recommended a “Stewardship Code for institutional investors aimed at rendering management more directly responsive and answerable to shareholders.”

One significant observation is that corporate governance reforms in both the UK and the US took a shareholder-oriented approach. This is implicit from the contents of Dodd-Frank Act of 2010 and the UK Stewardship Code in the same year. The Financial Reporting Council (FRC) explicitly states in its preface to the Stewardship Code that “the Code aims to enhance the quality of engagement between institutional investors and companies to help improve long-term returns to shareholders and the efficient exercise of governance responsibilities” (FRC 2010: 1-2).

At the international level, OECD published a paper on *Corporate Governance and the Financial Crisis* (2010) to help guide companies and policy makers in the implementation of the 2004 OECD *Principles of Corporate Governance*. This paper followed the initial report on *Corporate Governance Lessons from the Financial Crisis* (2009) and its successor report on the preliminary findings titled *Corporate Governance and Financial Crisis: Key Findings and Main Messages* (2009). This paper did not introduce anything new to the scene rather it extended clarity on the implicated governance failures during the financial crisis. The main areas it identified as in need of immediate reform were the governance of remuneration and incentives, improving the governance of risk management, improving board practices, and the exercise of shareholder rights.

On the other hand, the International Corporate Governance Network (ICGN) issued a *Statement on the Global Financial Crisis* (2008) emphasizing the role of corporate governance in restoring

trust. While pointing fingers at regulators' failure to respond decisively when they realized significant abnormal market reaction, ICGN highlighted the need for a regulatory response at international level to facilitate coordination of market perspectives that focus on long-term sustainable investments. Nevertheless, ICGN also endorsed a shareholder-oriented reform perspective. It identified the following issues as mostly relevant factors for shareholder consideration in light of corporate governance during financial crises: strengthening shareholder rights, strengthening boards, fair and transparent market, accounting standards, remuneration, and credit rating agencies.

On the whole, and despite an increased recognition of stakeholder interests in other industries, corporate governance reforms that came as a response to the global financial crisis were entrenched in a predominantly shareholder-centric governance perspective. They did not introduce a transition to, or at least some element of, stakeholder consideration except in cases where shareholders remain ultimate beneficiaries. In other words, these reforms only introduced the enlightened shareholder value (ESV) approach to corporate governance in the manner well-articulated by Ho (2010). According to this approach, a wide range of stakeholders are considered in so far as they contribute towards long-term shareholder value maximization. This ESV paradigm has been incorporated in the UK statutory landscape and widely accepted by leading institutional investors in the US (Ho 2010: 60).

Reform efforts to mitigate excessive risk-taking in financial institutions by empowering shareholders may seem to have been counterproductive in some respects; as Bruner (2018: 964) argues, "equity holders – more than any other constituency in a financial firm – prefer greater risk-taking, and that equity holder's risk preference only becomes stronger as a firm approaches insolvency." Again, it is a well-known fact that shareholders are not the only group affected by negative impact of high risk taking on a short-term. Ultimately, such efforts only intensified an already existing tension between shareholder wealth maximization and risk management, especially in financial institutions (Bruner 2018). From the above review and critical engagement of corporate governance reforms after the financial crisis, several governance lessons were derived from the global financial crisis and reforms that came in the aftermath.

### ***General Lessons for Corporate Governance***

The financial crisis provided lessons for the corporate governance of financial institutions and other non-financial organizations. There are at least three key corporate governance lessons which ensued from the financial crisis. These include:

- (1) The recognition that “best practices in corporate governance might vary from sector to sector and that the financial sector at least requires a special review for best practices in corporate governance” (Maxfield, Wang and Sousa 2016: 487). Bank governance is said to differ from that of other firms in two respects: firstly, stakeholders of banks are far more than those of other firms, and secondly, “the business of banks is opaque and complex and can shift rather quickly” (Mehran, Morrison and Shapiro 2011: 3). These differences also need to be analyzed within the context of the governance model that a specific country or region uses.
- (2) As implied in the above point, financial institutions should consider a corporate governance approach informed by principles of stakeholder theory. This is because, beyond structural, technical and operational differences, and market risks to which the banking sector is subjected, the financial sector has both a public and private purpose. In other words, it is my claim that the traditional banking system which profits from aligning manager and shareholder interests needs to change in order to accommodate the interests of all legitimate stakeholders. Pursuit of shareholder primacy at the expense of other constituents creates a chain of externalities affecting the whole network of relationships with the bank. Maxfield, Wang and Sousa (2016: 487) also note that “evaluation of the 2008 financial crisis validates the scholarly effort of trying to extend stakeholder theory more concretely to implications for corporate governance in the case of the financial sector.”
- (3) Advance crisis preparation is imperative, and boards have a special role when confronting the crisis. Boards are mandated to exercise due diligence in fulfilling their fiduciary and oversight responsibilities under normal circumstances and in crisis times. The global financial crisis was not anticipated and neither were risk management teams prepared to

handle it. Whereas the role of risk management is vital to corporate governance, there were ineffective risk management committees during the financial crisis (Pirson and Turnbull 2011: 463). In the events that led to the financial crisis, studies reveal that most of these committees seldom met and were in many cases comprised of few independent directors with no background in finance (Aebi et al. 2011: 3213).

Whereas the current reforms framework is grounded in the enlightened-shareholder model (which, as argued above, is not without criticism), the Covid-19 pandemic crisis introduced a different turn that, in part, further highlighted the need for stakeholder consideration in governance reform. The next section shall provide an analysis of corporate governance challenges and opportunities that came along with the pandemic crisis.

### **3.4 New Dimensions in Corporate Governance**

The crisis of the Covid-19 pandemic has thrown another dimension on corporate governance. It has shown that crises have various origins and can affect corporate governance in different ways. For instance, beyond what has been covered in the reforms following the financial crisis, Covid-19 added unprecedented challenges and opportunities for company directors. These include digital transformation, supply chain disruption, health and safety of human capital, enterprise-wide risk management, and stakeholder communication and disclosure (as addressed in chapter 2). These factors have not only complicated boards' oversight responsibilities but also expanded the scope of such responsibilities (Paine 2020).

The first of the key corporate governance issues induced by the Covid-19 pandemic is the acceleration of the transition from shareholder capitalism to stakeholder capitalism, which was already underway in industries other than the financial industry. Prior to the pandemic, the *World Economic Forum's Davos Manifesto* (2018) and *Business Roundtable's Statement of the Purpose of a Corporation* (2019) laid the groundwork for a new paradigm in corporate governance. They cohered around the idea that corporations should look beyond the single pursuit of shareholder wealth maximization and consider the interests of a wider range of stakeholders such as employees, customers and communities within which they operate. The Covid-19 pandemic presented a

practical test for this newly established framework for stakeholder capitalism by posing health risks to different stakeholder groups.

Secondly, Covid-19 demonstrated the need for corporations to engage actively in Corporate Social Responsibility (CSR) programs. The pandemic exposed and exacerbated socioeconomic issues such as poverty and inequality. Through CSR interventions and philanthropic activities, corporations with well-positioned balance sheets showed a gesture of solidarity with the most vulnerable in society. For instance, in South Africa “at least four out of five companies donated to Covid-19 specific responses, with most supporting interventions in food security (64%), healthcare (60%), and in the form of contributions to the Solidarity Fund (60%). Two-thirds took part in multi-stakeholder responses such as government dialogues and industry initiatives” (Dialogue Business in Society Handbook 2020). What this implies for corporate governance is that corporations can no longer ignore their social responsibility as they are part of a wider social and economic network.

Thirdly, with accelerated digital transformation and disruptions in supply chain, the Covid-19 pandemic pioneered a shift in the risk management agenda. Companies had to recalibrate their priorities to safeguard the health and safety of their employees and communities whom their businesses serve. According to KPMG International (2020), remote work has reoriented the caliber of talent needed in corporations to suit the current context thus creating talent risk. On the other hand, prolonged lockdown restrictions, curfews and banned international travel disturbed the supply chain system thereby creating supply chain risk. Continuous cycle of updates also added challenges in the accuracy of risk data aggregation and reporting. Advance crisis preparation and periodic review of existing risk management programs appear to be a highly significant resilience mechanism for boards during a time of crisis.

Fourthly, the reality of the pandemic crisis illustrated the inextricable connection between public health, environment and the economy. Evidently, Covid-19 and the climate emergency have similar characteristics including “market failure, externalities, international cooperation, complex science, question of system resilience, political leadership, and action that hinges on public support” (Hepburn et al. 2020: 360). Covid-19 triggered an increase in corporate investment in

ESG factors, which was already gathering strength in recent years. Evidence suggests that investment in ESG initiatives sustained considerable growth during the pandemic, triggering major developments in corporate reporting to include non-financial items (Adams and Abhayawansa 2021: 10). Boards' fiduciary responsibilities (especially in the US and Continental Europe) therefore had to include a special disclosure on ESG performance and measurement metrics. The United Nations (UN) sustainable development agenda has never been more pronounced than during the pandemic.

### **3.5 The need for further reforms**

The latest corporate governance reforms are based on the principles of shareholder primacy. The global financial crisis exposed and exacerbated inherent shortcomings underpinning theoretical foundations that inform managerial behavior under shareholder-oriented corporate governance. Even though governance reforms post the financial crisis were helpful in rethinking shareholder duties and responsibilities, as well as protecting shareholders, these reforms – because they were a response to financial loss – did not go far enough in considering other stakeholders. The effects of the pandemic are broader, and hence stakeholders and stakeholder value creation (in addition to shareholder value) is very much at the forefront of governance concerns. This is demonstrated through safeguarding the health and wellbeing of human capital, and active involvement in CSR projects. The impact and influence of business in societies cannot be ignored. As key players within a broader economic context, corporations can, and should, contribute towards solving major socioeconomic problems as diverse as poverty, injustice, inequality and climate change.

The Covid-19 pandemic added a new wave of operational challenges and opportunities for corporate governance, while also intensifying existing social inequalities. Covid-19 makes up a case for stakeholder-oriented reforms in corporate governance. These reforms are necessary to inform a theoretical framework that underpins corporate behavior in the context of heightened socioeconomic and environmental challenges. Corporations are major contributors to economic development, and sustainable development goals cannot be achieved without corporations. The gap between the rich and the poor keeps widening, crises breed other crises – during the Covid-19 pandemic, there has been evidence of a market crisis, supply chain crisis, and energy crisis. The global economy should be underpinned by corporations that contribute towards shared social and

economic prosperity. Reforming corporate governance is the surest way in which this can be achieved.

The challenges of modern-day society are numerous and complex. The Fourth Industrial Revolution and digital transformation have penetrated the corporate world at an unprecedented and unexpected speed, while the necessary expertise in these areas is still a major concern. This implies that there are significant gaps in the labor market to meet the needs of the day since the quality of expertise and talent needed in corporations has shifted radically in recent years (Walwei 2016: 14-15). By increasing the pulse of digital transformation, Covid-19 has demonstrated the need for corporations to consider an investment in technological skills development.

The dynamics of risk management have also changed drastically. The traditional risk management tools and strategies need updating. The current business environment is characterized by a myriad of complex risks exacerbated by the application of digital technologies and automation. For example, the scope of risk management has widened to include health risk, digital risk, skills risk, competition risk, market risk, supply chain risk, climate risk, etc. This means that corporations are bound to have a special budget or investment in risk management.

However, Covid-19 has provided an opportunity for business model innovation. As a result of accelerated digital transformation, corporations were able to reach out to a wider audience, thus opening-up new market possibilities. For instance, the pandemic reoriented the entire economic systems network and communication to facilitate trends such as virtual board and shareholder meetings, e-learning, video conference, e-commerce and online marketing. These trends were driven by “trade closure and mobility restrictions” that ensued from Covid-19 (Almeida, Santos, and Monteiro 2020: 99).

The aforementioned challenges and opportunities provide a case for corporate governance reforms. Stakeholder capitalism should inform the direction and scope of these reforms. The Covid-19 pandemic crisis has raised material issues of concern, and stakeholder engagement is the suggested approach through which these concerns could be addressed.



### **3.6 Conclusion**

This chapter traced the historical background to corporate governance and highlight momentous developments and current state of affairs in the field. The aim was to position corporate governance and examine it under the scope of a crisis. The 2007/8 financial crisis and Covid-19 pandemic crisis provided a crucial reference to evaluate how companies reacted to corporate governance challenges. The financial crisis highlighted industry-specific but also generalizable corporate governance concerns. Whereas a crisis can ensue from poor corporate governance; by the same token, good governance can shield the company from the adverse impact of a crisis. Advance crisis preparation and integration of stakeholder interests have been highlighted among major lessons from the pandemic. The Covid-19 pandemic accelerated trends (and provided firmer basis for their significance) which came later after the financial crisis (i.e digital transformation, the expansion and reinvention of risk management) in corporate governance. The Covid-19 pandemic thus calls for further reforms in corporate governance, and it is suggested that these reforms should be based on a stakeholder orientation, because corporations exist to create value for multiple stakeholders, corporate contribution to society has been widely pronounced, and the link between public health, environment and economy cannot be avoided.

## Chapter 4: Corporate Governance Framework for Times of Crisis

### 4.1 Introduction

A time of crisis needs a well-prepared board of directors and resilient corporate governance. The WorldCom, Enron and Tyco scandals in 2000, the 2007/8 financial crisis, and now the Covid-19 pandemic have clearly demonstrated the absolute importance of good corporate governance. Good corporate governance entails the practical application of the ideals of corporate governance such as sustainable value-creation, effective management and control, transparent disclosure, and ethical decision-making among others (Maier 2005: 2). While crises can differ in complexity, scale, economic impact and duration, the survival and sustenance of corporations is only through good corporate governance. The business case for good corporate governance cannot be overstated. Companies that demonstrate qualities of good corporate governance stand a better chance to weather the crisis, whereas those that possess governance deficiencies may struggle to survive.

Corporate governance frameworks in several jurisdictions including South Africa and Australia have shifted from a shareholder-oriented model to a stakeholder-inclusive model. This shift has been heralded by the release of several regulations, principles, codes, and statements by the international bodies including Business Roundtable (2019), *Global Governance Principles* by the International Corporate Governance Network (2021) etc. Along with this shift came the new wave of the Economic, Social and Governance (ESG) issues which added non-financial factors to the equation of good corporate governance as part of the analysis in the identification of material risks and growth opportunities. The Covid-19 pandemic intensified debates around these issues to the extent that the World Economic Forum's Davos Manifesto for 2020 established a standpoint arguing that stakeholder capitalism is a 'better kind of capitalism'. The message is clear, the economic and financial systems ought to change in order to address sustainability challenges of the day.

Meanwhile, the Covid-19 crisis has also accelerated another shift geared towards a more integrated corporate governance regime that was already gathering momentum in recent years. Prior to the

pandemic, a wide range of stakeholders in the form of customers, employees, suppliers and communities were expectant of companies to deliver on their core purpose and prioritize the interests of stakeholders through corporate social responsibility (CSR) programs and projects. In the same vein, corporations had observed the need to transition from strictly efficient and effective governance structures towards a resilient governance system, capable of weathering the crisis. The uncertain and extremely volatile economic context brought on by the Covid-19 pandemic has highlighted the significance of resilient governance in the form of strong internal control functions, and robust risk aggregation and reporting.

Consequently, a crisis situation of such a magnitude as the Covid-19 pandemic requires an integrated approach and long-term thinking in the manner outlined by the King IV Report (IoD 2016: 24): “integrated thinking ... takes account of the connectivity and interdependencies between the range of factors that affect an organization’s ability to create value over time.” The context of the company is to be addressed in whole in order to adequately cover the needs and interests of all stakeholders accordingly. This holistic approach entails a mindful consideration of the importance of human, social and natural capital drivers that significantly influence the company’s sustainable long-term value creation.

The Fourth Industrial Revolution has deeply penetrated the economy. While benefits that come along with sophisticated technological advances in Artificial Intelligence (AI), robotics, and extreme automation are numerous, there are disadvantages as well. Corporations are benefiting from reduced costs in production, timely delivery and increased profitability. On the other hand, the future of work is under threat and digital technologies have introduced new risks in the market. The business ecosystem is highly connected to the extent that it is vulnerable to spillover effects. Managing a crisis in this business environment is extremely difficult.

The last issue pertains to transparent corporate risk disclosure and reporting. The global financial crisis has clearly shown the negative effects of “false” financial reports and lack of transparency in disclosing direct material risks to the board. Companies with precarious financial conditions, especially those confronted with the challenge of insolvency, will have to apply for loans or call investors for extra capital and this cannot be well processed in the absence of accurate relevant

information. Such information is to encompass not only financial factors, but also include non-financial factors, which can or are affecting the health of society and the environment.

This chapter reviews the readiness of corporate governance regimes to deal with crises. Since the study focuses more on the context of the Covid-19 pandemic crisis, the analysis will be based on the scale of the impact highlighted in chapter 2 and the insights obtained from chapter 3. Consequently, the chapter will contribute to scholarship by outlining the corporate governance framework for times of crisis based on how firms are responding and adapting during Covid-19 and recovering. This framework is grounded in three dominant perspectives found in the literature: crisis preparedness, resilience, and performance assessment and review. The last part shall provide the summary of the whole study and its contribution to the literature, as well as limitations of the study.

## **4.2 Covid-19 Challenges for Corporate Governance Reform**

As stated in the previous chapter, Covid-19 has added new dimensions in corporate governance which necessitate a new thinking in governance. This section takes insights from chapters 2 and 3 to outline the roadmap for the required reforms. Based on the impact the pandemic has had on business and corporate governance, a number of trends which have been well discussed in chapter 3 were accelerated thus laying the groundwork for reforms perspectives addressed in this section.

These reforms have been summarized into three main points: (1) deepening commitment to corporate purpose – which integrates issues relating to strategy, capital allocation, CSR, and stakeholder engagement which are informed by theoretical transition from shareholder to stakeholder capitalism. (2) Integrating digital technologies and cyber security systems – to broaden the scope of risk management and keep companies risk averse especially in the 21<sup>st</sup> century where the fourth industrial revolution is gaining momentum. And (3) incorporating ESG factors into corporate strategy – which encourages effective realization of the triple context and the pursuit of corporate sustainability. It is expected that these reforms will inform the thinking that permeates the next section on corporate governance guidelines for times of crisis.

#### 4.2.1 Deepening Commitment to Corporate Purpose

Business purpose is an evolving and highly debated phenomenon in corporate governance. Critics are now calling for corporations to shift their purpose away from shareholder value maximization to shared value for all stakeholders. Generally, a corporate purpose entails the essence of a company's existence by articulating value propositions it intends to deliver to its stakeholders. In other words, "purpose provides a clear definition of the firm's intent, creates the ability for stakeholders to identify with, and be inspired by, the firm's mission, vision, and values, and establishes actionable pathways and an inspirational outcome for the firm's actions" (George et al. 2021: 7).

The Covid-19 pandemic added a practical dimension to the debate about business purpose by posing real-world dilemmas. These debates date back to the 1960s when Friedman (1970) argued that corporations do not have any obligations towards the society except to make profits for shareholders in so far as this is pursued within boundaries set by business rules and regulations. In the mid-1980s, Freeman (1984) argued for the consideration of the interests of all stakeholders. Freeman's theory attracted a lot of attention from business ethicists and business and management scholars (Vidisson 2021: 1). However, stakeholder theory was largely ignored by management scholars until the first decade of the 21<sup>st</sup> century, which was characterized by corporate scandals and the global financial crisis.

The Business Roundtable (BRT), being one of the most influential players in this debate, released a statement entitled "Statement on Corporate Responsibility" in 1981. The Statement recognizes the interdependency between business and society and thus states that "while each of our individual companies serves its own purpose, we share a fundamental commitment to all of our stakeholders." This was contrary to Friedman's proposition. However, in 1997 BRT turned away from the mutual dependency paradigm which it established and advocated for during the 1980s, and towards a shareholder-centric principle of corporate governance. In its 1997 statement, BRT declared that "the paramount duty of management and of board of directors is to the corporation's stockholders; the interests of other stakeholders are relevant as a derivative of a duty to

stockholders.” It was not until 2019 that BRT took a radical transition in its stance to corporate governance to align business purpose finally and fully with stakeholder interests. In a 2019 statement entitled, “Statement of the Purpose of a Corporation” BRT emphasized a shift away from a shareholder-centric principle to stakeholder inclusive corporate governance highlighting the significance of stakeholder in value creation.

The Covid-19 pandemic, and the accompanying issues of inequality, provided a stress test for corporate purpose and its usefulness in a time of crisis. By the end of 2019, the Covid-19 pandemic had brought about a severe market crisis and forced companies to make decisions which inevitably affected stakeholders. A few months, knee-deep in the pandemic, the death of George Floyd led to massive social unrest and protests against police brutality and racial inequality in the US and other parts of the world. As the Black Lives Matter movement attracted attention across the globe, “hundreds of companies blanketed social media with statements denouncing discrimination and professing their commitment to racial justice” (Kelleher 2020). What this meant for corporations is that corporate purpose extends beyond value propositions to include commitment to social issues as well. Leading by example, JPMorgan Chase spokeswoman Patricia Wexler made a public statement highlighting that their company “invested hundreds of millions of dollars in combined philanthropic and business resources to address some of the most persistent challenges facing the black community” (ref. Kelleher 2020).

Covid-19 also exposed companies that had superficial and meaningless statements of corporate purpose. Soon after the BRT statement in 2019, KKS Advisors and Test of Corporate Purpose (TCP) initiative compiled a report titled: *A Test of Corporate Purpose*, which highlighted that there are companies which prioritized the health and wellbeing of their employees, while others consciously ignored this aspect by leaving their staff exposed to risky working conditions; other companies ‘ramped up’ prices due to higher demand for products like ventilators, sanitizers, face masks, etc. in order to make profits in a short term; and there are those that perpetuated institutional racism while other shifted towards creating “a more diverse and inclusive workplace” (KK Advisors’ report 2020: 20-21).

It cannot be conclusively argued that the current corporate governance frameworks are inadequate relative to their commitment to corporate purpose and ability to resist the pandemic crisis. At best, one can posit that the notion of corporate purpose is evolving within the legal and regulatory frameworks. Purpose has been historically implicated in the debates about whose interests should the corporation pursue – the shareholder value maximization versus stakeholder value creation. However, a radical shift that would later inform Accountable Capitalism Act, S. 3348, 115<sup>th</sup> Cong. § 6 (2018) and perhaps somehow influence BRT's Statement of the Purpose of a Corporation (2019) had been initiated by Senator Warren. These shifts reinforced by Mayer's *Prosperity: Better Business Makes the Greater Good* (2018), challenges the US corporate law and proposes that corporations should be legally required to articulate a purpose. Again, these concerns about corporate purpose have also spread to other parts of the world such the UK and other countries within the European Union which subscribe to the UK's Stewardship Code (2020).

Realizing corporate purpose does not only guide organization's response to a crisis but further enhances its competitive edge through business model innovation and purpose-driven CSR interventions. The Covid-19 pandemic has thus challenged the current corporate governance regimes to reorient their approach to include a deepened commitment to corporate purpose.

### ***Policy Recommendations***

External regulation cannot facilitate sound corporate governance without a definitive commitment of the board of directors. Boards play a critical role in helping companies navigate through the Covid-19 crisis. Policy reforms should therefore focus on the quality of the board of directors and its capacity to deliver on the corporation's purpose. The current situation is evolving and continues to affect corporations' decisions, which in some respects might infringe upon stakeholders' interests. However, evidence from the KK Advisors' report (2020) on TCP suggests that once companies emerge from the crisis, they will recommit themselves to corporate purpose to address overall governance issues.

Firstly, commitment to corporate purpose needs rethinking. The pandemic crisis has shown that corporate purpose is not a simple formal statement with no material meaning; rather, purpose

requires realistic commitment since it informs directives guiding corporate decision-making and action. From a policy perspective, the Institutes of Directors (IoDs) and policy makers should promote a pragmatic approach which necessitates spelling out the functional aspects of corporate purpose to provide concrete guidance for the achievement of a corporation's sustainable long-term goals. Institutional investors may design policies that encourage companies to disclose strategic plans that align corporate performance with purpose. A typical policy framework may focus on the board's oversight responsibilities in as far as concerns how corporate purpose is executed within specific industries and sectors. Stock Exchange Commissions may also enact listing requirements for publicly listed companies to report on corporate purpose performance.

Secondly, as the supreme organizational guiding principle, corporate purpose needs to inform capital allocation and strategic decision-making. Covid-19 provided an opportunity for companies to review the relevance and contribution of their corporate purpose towards solving societal and environmental problems. Ideally, corporate purpose should articulate why a company exists, the problems it intends to solve, and why it is well-placed to do so. This implies that policy makers should be concerned with measuring congruence between the statement of corporate purpose and its execution. This can be done through the establishment of enterprise monitoring systems that will measure and evaluate corporate performance on an annual basis. Corporate purpose could be measured by different variables including, capital allocation, CSR budget or strategy, and the scale of the impact among others.

#### 4.2.2 Integration of Digital Technologies and Cyber Security Systems

Digital transformation is not a new concept in business. Businesses began to focus on digital tools in the 1990s which culminated in the dot.com bubble in 2000. From the year 2000, companies started to manufacture and use smart devices to improve internal operations and marketing strategies by advertising on social media platforms. Today, digital transformation affects different sectors of the economy including media, retail, finance, telecommunications, and manufacturing (Nosova et al. 2021: 659). Although digitalization was already transforming businesses, the Covid-19 crisis accelerated this trend at an unprecedented and unexpected scale within a very short period of time (Kudyba 2020: 284). During the pandemic, digitalization was not a voluntary effort;



instead, companies had to switch to digital technology as a way of maintaining business continuity in the midst of adversity.

Covid-19 has transformed the nature of work through digitalization. Digital transformation is commonly understood as an enterprise-wide integration of digital technologies to revamp business operations and improve ways of delivering value to customers (KPMG 2020: 4). Containment policies to minimize the spread of the Covid-19 virus especially social distancing, curfews and quarantining for a specific period of time compelled companies to respond by switching to digitalization in order to keep operations running. The workforce was the most affected area since some employees had to be furloughed while others worked remotely. While this transformation is likely to last post-Covid, Savic (2020) observes that digital transformation of the workforce has specific requirements which include among others; digital literacy, lifelong micro learning and personal development, continuous engagement, e-work, generation gap, and digital ethic which may be a challenge at the early stages of transformation.

Although digital transformation is a form of innovation in business, it also exposes a business to cyber-attacks. The current economic environment is characterized by business ecosystems that are “shaped by a network of interdependencies specifically generated through digital technologies” (Grewal et al. 2020: 114). Every business strategy based on digital transformation will ultimately need to consider digital risks. Covid-19 and the adoption of digital technologies have changed the dynamics of the risk management framework to include digital risks, defense mechanisms and compliance measures. Digital transformation cuts across three stages of business; operations, customer relationships, and sales and marketing (KPMG 2020: 4). Within these stages are also corresponding risks – operational risks, lack of appropriate skills, and vulnerability of software systems to cyberattacks.

During the Covid-19 crisis, the number of cyberattacks rose due to the sudden acceleration of digital transformation. This is a clear indication that opportunities and risks that come along with digital transformation need to be carefully considered. According to IBM (2018) study, a quick move to achieve digital transformation increases the risk of data breaches by 72% and the risk of cyberattacks or threats to ‘high value assets’ by 65%. Evidence reveals that during the first two

months (between February and April) of the Covid-19 pandemic in 2020, cyberattacks and threats on financial institutions increased by more than 238% globally (Chigada and Madzina 2021). Businesses may have to resort to cyber security as a way of protecting confidential company information and big data sets from malware intrusion.

### ***Policy Recommendations***

Corporate governance practices need to adapt to new changes brought by digital transformation. The primary aim of policy makers in the context of the digital age is the revision of existing policies that are not adequate to serve the digital age. For instance, these may include such policies which mandate annual shareholder meetings and board meetings to be conducted physically. IoDs and policy makers may have to introduce policies that allow for virtual conferences and meetings. This implies that investment policies may encourage companies to have a special budget for, and investment in, digital technology and security.

Since the nature of work has also been affected, new policies may need to ensure that there is a smooth transition from office-based work to remote work. Digital technologies require a special skillset and therefore policy makers are encouraged to promote capacity building through regular workshops and professional development training. The evidence in this thesis suggests that adaptation and improvisation are key factors that will drive new corporate governance practices.

#### 4.2.3 Incorporating ESG factors into Corporate Strategy

The United Nations Environment Programme's Emissions Gap Report (2019) warns that unless global greenhouse emissions fall by 7.6% each year between 2020 and 2030, the global economy will slow down rapidly. With the advent of the Covid-19 pandemic, the investment landscape swiftly changed. Notably, the global pandemic induced volatility in market conditions and in response to such market behavior, Environmental, Social and Governance (ESG) investment strategies grew exponentially (Diaz, Ibrushi, and Zhao 2020: 1). Shareholders are now more than ever concerned about investment strategies that contribute positively towards solving social and environmental issues such as poverty, inequality, injustice, climate change and malnutrition. These concerns and investment decisions demonstrate corporate commitment to stakeholder capitalism.

According to a study conducted by Morningstar (2020), as the pandemic unfolded in 2020, ESG funds grew exponentially with inflows of \$7.1 billion in the second quarter and reaching unprecedented record of \$1 trillion in market capitalization at the end of 2020. The traction that ESG investments has gained during the pandemic crisis signifies the radical investment shift from the usual investment strategy to long-term sustainable investment strategies. Exponential growth in ESG investing is a clear indication that corporations play a vital role in contributing towards the achievement of sustainable development goals.

Backed by the United Nations' Principles for Responsible Investing and the United Nations Global Compact (2020), many investors seem keen to make ESG investments their top priority in the wake of the pandemic crisis and beyond. Health concerns and subsequent social unrests that resulted from the death of George Floyd have put the 'S' in ESG under the spotlight. These concerns influenced the manner in which companies treated their employees, customers and suppliers (Grant 2020: 6). Sustainable investing aligns with corporation's purpose of creating value for multiple stakeholder groups.

Within the current governance regimes, fiduciary duties have also evolved to include disclosure on ESG investment initiatives. To assess risks and opportunities that come along with ESG investing, companies are required to compile sustainability reports on material non-finance performance information which incorporates the ESG concerns (Deloitte 2020). Global standards for sustainability reporting are set by international institutions such as Sustainability Accounting Standards Board (SASB), Global Initiative for Sustainability Ratings (GISR), International Integrated Reporting Council (IIRC), and the Global Reporting Council (GRC).

### ***Policy Recommendations***

Based on the notion that corporate purpose should transcend shareholder value, it is recommended that policy makers establish policies that encourage corporations to contribute towards the Social, Economic and Environmental issues within local communities in which they operate. In emerging and advanced economies, corporations are the major driving forces of economic growth and

production, which means that, in many cases, corporations account for large scale greenhouse gas emissions. Tackling climate change and other environmental issues require the concerted effort of corporations. Consequently, to address the ‘E’ in ESG, Environmental policies should focus on industry-specific issues such as exploitation of natural resources, reducing carbon footprint, reducing greenhouse gas emissions, recycling waste products, reforestation, and investment in renewable energy.

It is also recommended that social policies, i.e. addressing the ‘S’ in ESG, encourage companies to clearly define their approach to inclusion and diversity in order to tackle social inequalities. Broadly, a typical policy may include provisions for protection of employee rights, favorable working conditions, and fair wages. Such efforts amount to explicit recognition that a company holds the interest of its stakeholders at heart.

On matters pertaining to governance, board diversity and inclusion in terms of age, race, gender and experience should be the key priority for policy developers. In this age of digital transformation, young talented board members may be more flexible and innovative. With the rise of gender equality concerns, having women as board members is also important. There should be policies that require companies to publicly declare their commitment to non-discrimination, inclusion, and gender equality. Ultimately, ESG investments and policies will shape and extend the current thinking in corporate governance.

### **4.3 Corporate Governance Guidelines for Times of Crisis**

The need to reform existing corporate governance regimes was motivated in the previous section. As indicated, these reforms build on, and enhance, existing frameworks. Firstly, the following principles: principle 4 (corporate purpose), principle 11 (risk governance), and principle 12 (technology and information), found in King IV, provide clear practical guidelines. However, during the pandemic, these guidelines were sometimes overlooked. Evidence from the 7th edition of PwC’s Global Economic Crime and Fraud Survey (2020) reveals that:

South African organizations have seen an upsurge in instances of senior management perpetrating fraud. Economic crimes perpetrated by senior management are often among the most sinister because of the ability (whether through delegated authority levels, system knowledge, or influence) of top executives to override (or conspire to override) internal controls (pg. 12).

The involvement of senior management in fraud and unethical behavior during the pandemic undermines principle 4 which requires the governing body to “appreciate that the organization’s core purpose, its risks and opportunities, strategy, business model, performance and sustainable development are all inseparable elements of the value creation process” (IoD 2016: 47). Again, this also hinders the governing body from executing its mandate stated in principle 11, which requires that “the governing body should govern risk in a way that supports the organization in setting and achieving its strategic objective” (IoD 2016: 61). These are some of the examples that shows a general lack of a deepened commitment to corporate purpose and values, hence, the need to strengthen board’s oversight and the management of risk to address the current crisis situation.

Secondly, King IV advocates for sustainable creation of value, stating that “governing bodies have the challenge of steering their organizations to create value in a sustainable manner, making more but with less to meet the needs of a growing population and the reality of dwindling natural resources” (IoD 2016: 4). However, a crisis situation such as Covid-19 often create opportunities for corruption and fraud which negatively impact on the creation of sustainable value. To overcome this challenge, internal audit plays a key role in providing quality assurance, monitoring operations, addressing irregularities, risks in financial transactions, and other non-financial matters. Through proper channels of communication, organizations need to prepare and provide accurate and timeous updates to their stakeholders on how they intend to, or are handling, a crisis.

Thirdly, principle 9 of King IV takes cognizance of the need to evaluate on an annual basis, the performance of the governing body to ensure that it is fit-for-purpose and effective. Accordingly, principle 9 states that “the governing body should ensure that the evaluation of its own performance and that of its committees, its chair and individual members, support continued improvement in its performance and effectiveness” (IoD 2016: 58). While this assessment

concerns the overall performance of the governing body in an organization, it does not however, extend to the overall performance of the company. The current frameworks are limited in this regard, and therefore require revisions to include considerations for overall company performance assessment.

Based on the preceding analysis of the current frameworks thus far, this section offers a three-phased corporate governance guideline for times of crisis. The initial phase is where organizations confront the crisis head-on. The focus should be on the role played by boards as the supreme governing body, and how the risk management strategy is executed to mitigate the crisis. The second phase is about the coping mechanisms – this is where organizations’ crisis management structures and strategies are examined to ensure resilience to crisis. Chapter three revealed that Covid-19 has been an accelerator of existing corporate trends. With this in mind, this phase explores the ways in which organizations can better handle or survive crises. The last phase is about performance assessment and review, which encourages reflection on organizational operations during the crisis period.

### **4.3.1 Phase I: Confronting the Crisis**

#### Board of Directors

Board plays a critical role in confronting a crisis. Most importantly, the board of directors is the ultimate stewardship body of the company and thus provides strategic guidance and support to the management team. During a time of crisis, a company’s survival depends on strategic alignment and complementarity between the board chairman and the CEO. Since a crisis situation induces stress and panic due to uncertainty, an adequate crisis response requires board members to act within their lines of responsibility lest they create unnecessary friction between board and management. At best, boards can add value by providing “critical oversight, long-term planning, and strategic support, a much needed outside-in view, and provides oversight as management engages key stakeholders such as government and business partners” (Deloitte 2020: 2).

Advance crisis preparation is imperative for boards. According to a research study by Ball and Seville (2020) of Resilient Organizations, risk identification is not enough, “being prepared means ensuring management have adequately developed and tested risk mitigation and response plans, then trained and practiced using multiple scenarios” (Ball and Seville 2020: 2). Apart from having an emergency succession plan in place, the board also has to exercise an oversight role on management’s crisis response plan/program. This is because a corporate crisis often affects business operations and strategy – both of which can have adverse financial and reputational outcomes.

The Covid-19 pandemic, with its multiple effects on the economy and society, demonstrated that boards have a fiduciary duty to act in the best interest of all stakeholders. Among others, a good crisis response covers the following areas: business continuity, liquidity and capital considerations, and stakeholder communications – all of which are board’s responsibilities. The Institute of Directors South Africa (2020) published a *Guidance for Boards* wherein it defines the primary role of boards as ensuring that they have a clear situational awareness of the bigger picture regarding the effect of the crisis across the six capitals (financial, human, manufactured, social and relational, intellectual and natural) on which the company relies. To properly carry out its roles, a board has to also ensure that it is well structured and fit-for-purpose. High integrity and appropriate competence are the requisite qualities for directors.

### Risk management

Ideally, risk management should integrate expert leadership, excellent communication and effective Information Technology (IT) systems to enable a company to efficiently manage risks and exploit emergent opportunities. Risk management therefore is not a one-time procedure necessary to address a crisis situation; rather, risk management is a well-established process of identification and assessment, mitigation, and control of enterprise-wide risks (Pagach and Wieczorek-Kosmala 2020: 1). During a time of crisis, it crucial for risk officials to deploy a rigorous enterprise risk management strategy.

The Covid-19 pandemic has radically changed the economic and business environment. This new environment can be characterized as “volatile, uncertain, complex, and ambiguous” (Lang, Lee,

and Sang 2016). As businesses and industries evolve, risks also evolve – opening up a window of opportunity for new perspectives in risk management. Through risk data aggregation and scenario planning, the management should be able to gauge a company’s ability to respond, recover and thrive. Ultimately, the board is responsible for ensuring and overseeing that there is an adequate crisis response program, and that stakeholder communications are well facilitated.

Executive compensation system also needs to be fair and sustainable. During a time of crisis, the fairness of a company’s crisis response plan is often put under the spotlight. The Covid-19 pandemic is an example of a crisis situation where companies were forced (by volatile market reactions) to lay off, furlough, or request staff to work with pay cuts. As a matter of critical concern, maintaining or increasing executive pay under such circumstances becomes an insult to the affected groups, especially employees.

#### **4.3.2 Phase II: Navigating through the Crisis**

##### **Internal Audit**

In a time of crisis when business transactions and management processes are under stress, an internal audit is mostly needed. According to the Institute of Internal Auditors (IIA), an internal audit is an “independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes” (IIA 2020). An internal audit is an indispensable component of the internal control functions and plays a pivotal role in monitoring and improving corporate governance. By providing quality assurance and advice to management and the board, internal audits can help address irregularities, risks in financial transactions and other non-financial matters.

Through a meticulous process of confirmation and consultation, internal audits should apply a scientific method and a data-driven approach to add value to the development, implementation and evaluation of company’s business continuity plans and crisis response plans (El-Moneim Serag and Daoud 2021: 8). Notably, internal audits assist and ensure that internal control systems are



well organized to deal with a crisis. Susmanschi (2012) argues that an internal audit has a primary objective of proving board and management with the assurance that “financial and operating information is accurate and reliable; policies, procedures, laws, plans, and regulations are complied with; assets are safeguarded against loss and theft; resources are used economically and efficiently; established program/operating goals and objectives will be met” (Susmanschi 2012: 422).

While maintaining independence and objectivity, internal audits should be flexible enough to respond to the pressing needs of senior management and the governing body when confronting a crisis. An internal audit should support the company’s efforts going forward, and “with the right mindset, safeguards, and oversight by the board or audit committee, an internal audit is positioned to provide its unique value of well-informed, independent, and objective insight, assurance, and advice” (IIA 2020: 7). Corporate governance regimes would do well to stress the importance of internal auditing since it is absolutely necessary in shaping the firm’s response to a crisis.

A crisis situation, such as Covid-19, often creates opportunities for corruption and fraud. In order to stay relevant, internal audits should harness and embrace digital technologies such as data analytics and artificial intelligence to monitor operations, and to detect fraud and patterns of corruption. Ultimately, resilient corporate governance should recognize the importance of the internal audit function throughout a crisis period and beyond.

### Reporting and Disclosure

A crisis situation often presents both challenges and opportunities. Communication helps us understand and make meaning of these opportunities and threats. In a foreword to Sellnow and Seeger’s (2021) book titled, *Theorizing Crisis Communication*, Liu (page xi) highlights that “with a sound understanding of crisis communication theory, leaders are well equipped to navigate troubled waters and steer their organizations and communities towards a stronger tomorrow”. Through the use of appropriate channels of communication, corporations need to proactively communicate their crisis response plan to investors and stakeholders, including employees, customers, suppliers and the communities in which they operate. Communication needs to be accurate and timely.

Stakeholder engagement is crucial for companies in the creation of value in many ways. Emphasizing this point, BSR argues that “stakeholder engagement must evolve from a process too often undertaken for the sake of doing it, into a strategic priority that integrates diverse stakeholder feedback and input deeply into all aspects of a company’s operations” (BSR 2016: 3). As Seeger (2006: 236-237) argues, communication strategies should be “fully integrated into the decision-making process” when confronting a crisis. This enables companies to put possible communication issues into perspective during the planning phase to avoid communication breakdown and false statements. To maintain clear lines of communication, “companies should disclose how they are engaging with different stakeholder groups and should create a dialogue about the most appropriate ways to respond to a crisis” (IFC 2021: 1). This can be facilitated through regular updates and revisions of response plans.

Crises differ in many ways, but they may also have common denominators such as uncertainty and ambiguity. This often complicates decision-making and action. As a result, poorly conducted crisis communication exacerbates and multiplies the effects of a crisis, which may include loss of life, damage to property, environmental harm and financial ruin (Liu 2021: xii). It is important to note that a crisis situation changes the operating environment. For instance, the Covid-19 pandemic disrupted the supply chain network, triggered volatility in market reaction, changed the nature of work, and impacted on sales – changes which meant that companies had to operate in crisis mode.

#### **4.3.3 Phase III: Performance Assessment and Review**

During phase III, corporations should reflect on their overall performance throughout the period of crisis. This is where organizations perform a critical assessment of their ability to respond, resist and thrive through the crisis. Each organization may draw up its own criteria, however this study recommends an assessment based on the three challenges for governance reforms addressed in section 4.2 of this chapter, namely chapter 4. This is because these challenges are a consolidation of material risks and opportunities discussed in chapters two and three, and they have covered a wide range of governance issues brought on by the pandemic. This process needs to be rigorous so as to allow for organizations to capture their potential and overcome their weaknesses. Again, this will also supplement existing practice recommended in King IV’s 9<sup>th</sup> principle which encourages the governing body to “ensure that the evaluation of its performance and that of its

committees, its chair and its individual members, support continued improvement in its performance and effectiveness” (IoD 2016: 58).

#### **4.4 Research Summary**

This thesis has evaluated the readiness of the current corporate governance frameworks in relation to their adequacy to address the crisis situation. To advance this cause, the Covid-19 pandemic crisis was identified as the ideal case study because it has a far-reaching impact on, and therefore implications for, corporate governance theory and practice. In order to lay the groundwork for the analysis, chapter two introduced the context of the study. More importantly, the chapter carefully traced significant impacts of Covid-19 on business as whole. The aim was to introduce some of the main challenges and opportunities brought to light by the crisis. Notably, the Covid-19 pandemic is unprecedented in its scale and impact, complexity and ambiguity – all of which contributes to prolonged period of uncertainty that has radically shaped the way in which business is understood within the wider context of the economy, society, and the environment. In the span of less than 18 months, the Covid-19 pandemic tested the strength of existing corporate governance regimes.

The study recognizes that Covid-19 is not the only crisis to have hit the corporate sector. Chapter 3 thus presented an historical and theoretical overview of corporate governance. The main objective was to identify and review the key tenets of corporate governance in a time of crisis. A snapshot of corporate governance lessons and accompanying reforms after the 2007/8 financial crisis provided a basis for such review. Although these reforms dealt with typical corporate governance structural concerns including remuneration systems, board oversight, risk management, and the exercise of shareholder rights, it was discovered that these reforms did not address general corporate governance issues; rather, they focused on restoring financial regulation and shareholder concerns. However, the Covid-19 crisis introduced new dimensions in corporate governance. These came in the form of challenges and opportunities: supply chain disruption, health and safety of human capital, acceleration of digitalization and ESG investing, and a paradigmatic shift from shareholder capitalism to stakeholder capitalism. It was concluded that all these factors necessitate further governance reforms.

Chapter four, which concludes the study, provided a condensed corporate governance guideline for times of crisis, based on the foundations laid in chapter two and three. This chapter began by highlighting crucial challenges of the Covid-19 pandemic for corporate governance reform and suggested policy recommendations for each challenge. This chapter also argued that the current corporate governance guidelines are not necessarily inadequate to address the crisis situation, rather, they are still evolving – their capacity to withstand the Covid-19 challenge rests on the level of commitment to corporate principles and codes of best practice, and as argued, the different crisis response phases necessitate attention to specific aspects of corporate governance.

The principal conclusion of this study is that there is a need to consider corporate governance practices and policies in light of new emerging challenges. This is because the business ecosystem is radically changed and the operating environment is different – characterized by new risks and opportunities. The Fourth Industrial Revolution has penetrated trade and production systems. Both the financial crisis and Covid-19 pandemic crisis have illustrated how global network systems are vulnerable. Corporate governance regimes need to be updated to address the current context. The Business Roundtable and World Economic Forum have shown interest in shaping the new paradigm for corporate governance. The current times require purposeful organizations which recognize their vital role of contributing towards solving environmental and socioeconomic challenges.

#### **4.5 Limitations of the Study and Contributions to the Literature**

This study provides a theoretical assessments of corporate governance practices under crisis conditions, with specific reference to Covid-19. The pandemic is, however, still unfolding and the lessons emerging from the crisis are ongoing. As such, this study does not pretend to provide an exhaustive analysis of sound corporate governance practices for the current business landscape, but aims to contribute to the emerging body of literature on corporate governance and the Covid-19 pandemic in the following ways: firstly, this study adds to the relatively small amount of corporate governance research examining the impact of Covid-19 pandemic. Secondly, the findings of this study help in providing a better understanding of the important challenges derived from Covid-19. Thirdly, the study highlights key focus areas in corporate governance and

recommends policy reforms that informs new thinking on corporate purpose, ESG investing, and digitalization. Finally, arguments in favor of new reforms in corporate governance may be of interest to Institutes of Directors, the private sector, policy makers, and scholars.

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