

# Did Steinhoff's board structure contribute to the scandal?

By [Owen Skae](#)

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The global retail group Steinhoff is reeling under allegations of accounting fraud. Since the allegations surfaced last year the CEO of the multi-billion dollar business, Markus Jooste, has [fallen on his sword](#) and the company's stock has been [hammered](#), at one point losing about 90% in market value in a few days.



Image credit: Financial Mail/Jeremy Glyn

Observers are calling for [harsh punishment](#), including jail, for the culprits.

Early reports suggest that Steinhoff was involved in massive [accounting fraud](#), including the overstatement of the company's financial position.

The company is listed on both the Johannesburg Stock Exchange in South Africa as well as the Frankfurt Stock Exchange in Germany. With a primary listing in Frankfurt and an [Amsterdam](#) corporate address, Steinhoff follows the Dutch corporate governance code.

Consistent with this code, Steinhoff has a [two-tier board structure](#). This [is made up of](#) a management board (comprised of four top executives) and a supervisory board (comprised of nine non-executive directors).

The point of the two-tier board structure is to ensure that the supervisory board is independent from the executives who sit on the management board. The management board accounts to the supervisory board, which accounts to the shareholders or to the company.

The two-tier board structure is favoured in western Europe. The US and UK prefer the [one-tier](#) – or unitary board – structure, as does South Africa for historical reasons.

It appears that Steinhoff's decision to opt for the two-tier board structure may have contributed to its undoing. Natural holes in the structure, the biggest one being the fact that the management board doesn't always keep the supervisory board in the loop, combined with Steinhoff's corporate culture which was anchored by a [dominant personality](#), appear to have created accountability holes.

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## Two-tier versus one-tier structure

There are pros and cons to both systems.

One of the good things about the one-tier board system is that executive directors and non-executives directors sit together on a single board. Traditionally there would be two or three executive directors (the CEO, chief financial officer and the chief operating officer) sitting alongside a majority of non-executive directors.

This means that there's a seamless flow of information between executives and non-executives. The executives can be asked questions with the entire board present. This closes any information asymmetry. In addition, it can also facilitate quicker decisions.

On the downside, the unitary board structure has been criticised for its propensity to compromise the independence of the non-executive directors. This dilutes their oversight role.

For its part the two-tier system seems to have more checks and balances built into it given that the management board is subject to oversight by the supervisory board, and the supervisory board has to answer to shareholders.

But the two-tier structure is often [criticised](#) for information asymmetry between the management board and the supervisory board. In other words management knows a great deal more about the business than the supervisory board. This can lead to operational challenges developing without the board noticing until it's too late.

Steinhoff's board structure followed the two-tier system. In 2016 its management board comprised three members, Jooste (CEO), [Ben La Grange](#) (Chief Financial Officer) and [Danie van der Merwe](#) (Chief Operating Officer and now acting CEO). As is normal under the two-tier system, none of the three members of the management board sat on the supervisory board.

Some analysis of the [Volkswagen emissions scandal](#) apportioned blame to the two-tier system combined with a [corporate culture](#) that was anchored by dominant personalities.

A similar case can be made for the Steinhoff saga.



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## Flaws in the Steinhoff structure

Did the two-tier structure give the CEO too much leeway to take decisions that in the end led to the near collapse of the company?

This may indeed have been the case. Take, for example, the fact that some believe the company [grew too quickly](#).

The danger of companies expanding too rapidly was highlighted decades ago by [author and corporate strategy guru](#) John Argenti who came up with [a model](#) that considered factors leading to corporate failure. Two of the higher scored factors were expanding too fast (referred to as overtrading) and high levels of loan borrowing.

Steinhoff seems to have suffered from both. And yet the supervisory board appears to have failed to raise the red flag when it comes to large transactions. An example of it failing to fulfil its oversight role was when it decided to not make public Steinhoff's [USD\\$1 billion](#) transaction with a related company. Even if the supervisory board didn't legally have to make this public knowledge, ethically it should have made the disclosure.

The functioning of the audit and risk committee didn't help the situation either.

## Audit and risk committee

Steinhoff had three standing committees of the supervisory board – audit and risk, human resources and remuneration and the nominations committee. The committee structure had two weaknesses.

The first was that too few of its non-executives actually served on the committees – only 5 of the 11 supervisory board members. And given that the then chairman Wiese and Claas Daun only sat on one, it begs the question how only three members of the supervisory board could have been expected to carry the real responsibility of the standing committees.

The second flaw was that audit and risk were wrapped up in one committee. This is the norm under a two-tier governance structure.

South Africa's corporate governance structures might have helped to address both these problems.

[King IV](#) stipulates that the risk governance committee should be made up of a mixture of non-executives and executives (the majority being non-executives). And the governance guidelines warn against audit and risk being under one committee. Its advice is that a company should only combine them if it's able to devote enough time to dealing with risk related issues.

For a company of Steinhoff's complexity, it seems inconceivable that the audit and risk committee could have devoted the necessary time to undertake its responsibility.

## Conclusion

The Steinhoff case highlights weaknesses in the governance structure the company had chosen to operate under. That said, the rules have worked perfectly well for thousands of other companies. The lesson, therefore, is be alert to the warning signs such as dominant directors who don't heed the rules. They can pose a grave risk to any company.

## ABOUT THE AUTHOR

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