BUSINESS PERSPECTIVES ON THE STEINHOFF SAGA
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We welcome you to this research report on the happenings at Steinhoff International. The Steinhoff saga is possibly the biggest case of corporate fraud in South African business history. Notwithstanding the various formal investigations into what had happened at Steinhoff, we felt that there are too many urgent and important general business lessons to learn from this case to wait for the results from these investigations. Part of our role as the University of Stellenbosch Business School is to reflect on real-life business cases and to extract general lessons to improve business practices and conduct. However, as such investigations are in progress, we had to rely on information in the public domain, which is limited in depth and scope. Nonetheless, we provide readers with key insights into how a supposedly indestructible corporate brand can be practically annihilated as a result of (what appears to be) unethical conduct.

In presenting this research report, we have no intention to partake in the blame-game focused on the questionable behaviour by the Steinhoff Board and executives. Rather, in offering a scientifically based research approach, we attempt to provide a more grounded perspective to what is available in the public media. The aim of this research report is not to discredit Steinhoff or any specific individuals, but rather to distil business lessons that might alert people to other potential Steinhoffs in the making.

We trust that this report will offer insight and make a contribution towards promoting more responsible and ethical business practices to executives.

The authors
BUSINESS PERSPECTIVES ON THE STEINHOFF SAGA

The Steinhoff saga, possibly the biggest case of corporate fraud in South African business history, has dominated financial and general news since the company’s share price collapsed on 5 December 2017. Part of our role as the University of Stellenbosch Business School is to reflect on real-life business cases and to extract general lessons to be learnt. Much can be gleaned from business success stories, but even more revealing sometimes are business failures.

In presenting this mini case study on Steinhoff International, we find no joy in knowing that significant financial losses have been incurred not only by institutional investors and leading business personalities but also by millions of ordinary people. Living and working in close proximity to Stellenbosch, we see the painful effects of the company’s reputational loss on friends, employees, pensioners and families; not to mention the misery caused to people around the world by the swift financial decline and uncertain future of this once-revered global retail giant.

In offering an academic perspective on the Steinhoff case, a certain objective distance is required. However, we are perhaps still too close to events to provide a full interpretation. We have also had to rely on information in the public domain, which is limited in depth and scope. As the financial affairs of Steinhoff were still not clear at the time of writing, we could not, for example, compile a section on the accounting and corporate finance practices or tax structures of Steinhoff in different parts of the world. Nonetheless, we provide readers with important insights into how a supposedly indestructible corporate brand can be practically annihilated in (what appeared to be) unethical conduct.

This mini case study comprises four sections:

In section one, we tell the remarkable story of Steinhoff, from its humble beginnings in Germany to its transformation into a massive global holding company, epitomising the spirit of entrepreneurship and business expansion at its best. To assist readers, we provide two infographics: one with a timeline of the most significant mergers and acquisitions concluded, and one with the list of events leading up to the collapse of the share price in late 2017 and beyond.

In section two, we analyse Steinhoff’s governance structure and practices in the light of relevant rules and guidelines at different times. We also comment on matters like director independence and the impact of a two-tier board on the critical and discriminating mind-set required of directors.

In section three, we reflect on business leadership and two aspects in particular, namely the ambiguity of charismatic leadership and the rationalisation strategy typically adopted by leaders who lose their moral compass.

In section four, we conclude the case study by looking back at earlier sections and extracting the main business lessons to take away. We also leave the discussion open for additional interpretations, particularly as events continue to unfold.

The overall aim of this mini case study is not to further discredit Steinhoff or any specific individuals, but rather to distil business lessons that might alert people to new Steinhoffs in the making. As a business school, we understand and value the enormous contribution that entrepreneurs and private corporations make to society. In this regard one of our passions is providing the type of education and guidance that will help breed a new generation of ethical and socially minded business leaders.

When the Zuma administration dragged whole sectors of the South African economy into a web of corruption and state capture scandals, many people said “This is what politicians and public sector people do”. We know, though, that corruption is not only found in government; it is commonplace in the private sector as well. When lapses in morality are exposed in the private sector, it unfortunately provides useful ammunition to those who are generally suspicious of business “Those guys only look after themselves and will do anything to enrich themselves further”. This distrust erodes the already fragile relationship between government, labour and business without which South Africa – and for that matter any developing country – will not be able to tackle poverty, unemployment and inequality.

It is time for the blame game to end. Alleged and proven cases of unethical business practices involving many reputable international companies should be a shrill wake-up call as to what can go wrong in an organisation. If there is a risk of significant financial loss occurring owing to unsavoury or unethical business practices, how might this risk be averted? What can the Steinhoff story teach us in this regard?

Because no formal legal processes have yet been concluded, all references in the case study to fraud and corruption linked to individuals or Steinhoff as a whole remain allegations at this stage.

No sponsorship was received for this study, which secures the independence of its approach and findings. It should be noted that the views expressed are those of the authors only and should not be attributed to the University of Stellenbosch Business School or the University of Stellenbosch.

Piet Naudé (editor) with Brett Hamilton, Marius Ungerer, Daniel Malan and Mias de Klerk

June 2018
THE STEINHOFF STORY

In this section we look at the remarkable Steinhoff success story, which spans 55 years and is defined by three successive periods of business expansion: (1) the expansion from West Germany to the East (1963 – 1993), (2) the new era of expansion to the South (1994 – 2013), and (3) the last few years signalling Steinhoff’s ascent as a truly global retail company (2014 – 2017).


Steinhoff first became involved in sourcing and selling household goods in 1963 when its founder, an enterprising West German by the name of Bruno Steinhoff, saw an opportunity to procure low-cost furniture from East Germany and sell it to his more well-off countrymen in West Germany. It was a game of arbitrage that helped shape the Steinhoff we know today as well as a core business strategy that the company vigorously pursued, enabling it to become one of the largest retailers in the world.

Bruno clearly had a knack for selling furniture and the business quickly flourished, but it also required hard work, determination and an entrepreneurial spirit. Like so many entrepreneurs, Bruno came from humble beginnings. His first office was in a privately owned home. He then moved the business to a small warehouse near Hanover in Germany which soon filled up with furniture. Bruno spent many nights sleeping in his car, to which he had hitched a trailer, as he travelled all over Europe visiting retailers and showing them his products.

It was not only his selling skills that served him well; he was also able to cross both physical and mental boundaries to source low-cost products from regions and suppliers that his competitors were either unaware of or unwilling to connect with. At the time, Europe was a fractured region comprising a mixture of communist, capitalist and authoritarian regimes. It was Bruno’s innate ability to navigate and adapt to ongoing political, economic and social change that ultimately ensured the success of Steinhoff and to a large extent remains a characteristic of the business today.

In the early days of Steinhoff’s operation, the Cold War was intensifying and the West generally remained sceptical of the East. But this did not seem to deter Bruno. During its first ten years of operation, the company plied its trade almost exclusively in Eastern bloc countries. Naturally, Bruno was aware of the myriad commercial opportunities in these areas and was determined to grow his business. This is a further reflection of the ease with which he was able to transcend national borders, languages and cultures. By the late 1970s the company was sourcing furniture from East Germany, Bulgaria, Denmark, Italy, the Netherlands, Romania, Czechoslovakia and Russia.

The business also took advantage of the economic opportunities presented by strong post-war government spending, various incentives for industrial growth and the general preference for intra-European trade. Within two years of Steinhoff’s establishment, Bruno had managed to secure the exclusive rights to represent suppliers in the Saxony and Hessen regions in Germany. In 1966, he registered the company that would later

― Can you develop factories as well? ― I said, “OK, I will do so.” And so I did.
Bruno Steinhoff

― He had an infrastructure. What came out of there in terms of productivity and what they got right in those days was unbelievable. ―
Danie van der Merwe
become Steinhoff Europe, i.e. Bruno Steinhoff Möbelvertretungen und Vertrieb. Soon after that, a new head office and large factory were built in Westerstede, with the company undergoing further expansion during 1971.

Although the business of importing and trading was going well, Bruno decided to diversify into furniture production. This was in line with his vision to grow, expand and own the supply chain – another characteristic of the business that has survived to this day. By 1973 deliveries to the Westerstede facility had increased to 274 wagons per annum (from 48 wagons in the early years) and turnover had reached DEM40 million. At that point the company employed 105 people.

Strong economic growth in Europe ensured that demand for furniture continued to expand. Keen to take advantage of buoyant market conditions, the company constructed a second factory, Trend Design, for upholstered furniture in Remels, Germany. The company’s brand was clearly growing in stature, underpinned by a reputation for providing high-quality, low-cost furniture. By 1980 the company’s sales network included representatives in Germany, Austria and Switzerland and exhibitions were held in England, the Netherlands, Belgium and Switzerland.

It is often said that fortune favours the brave. Bruno’s preference for sourcing low-cost furniture from the East served the company well during the general global recession in the latter part of the 1980s. The company’s focus on value meant that it was perfectly placed to cater to the needs of cash-strapped consumers. Despite operating under tougher economic conditions, the company continued to grow (specifically through upholstery factories and one bedding factory at very attractive prices. While the factories required significant capital to upgrade, the result was that Steinhoff became one of the largest producers of upholstered furniture destined for the German market. With company-owned factories located in Germany, Poland, Ukraine and Hungary. The company also made strategic investments in numerous import trading companies in the Netherlands and Italy and extended its sales reach to France and Austria.

By 1993, revenue was DEM400 million per annum and the company employed 3,000 people. These investments included a new administration building in Westerstede, an extra 2,000 m² of capacity in the Remels factory and a giant (45 metre-high) warehouse in Westerstede, built at a cost of DEM20 million, which used a state-of-the-art warehouse and management system to control the furniture receiving, packing, storing, retrieving and dispatching processes. This system was paperless and fully automated, a feature that was revolutionary at the time.

The fall of the Iron Curtain in November 1989 presented the company with a massive opportunity for expansion in Europe. ‘New Europe’, as it was often referred to, became for all intents and purposes a continent ‘without borders’, thus allowing the free movement of goods and services across borders and, naturally, a united Germany. The business opportunities linked to this new European configuration were immense. Furthermore, in an effort to develop the region, the new German government began offering incentives for businesses to invest in the former East Germany. Manufacturing facilities in the former East Germany were outdated and no longer received government funding, which meant that businesses either had to adapt or face closure. In addition, the management of these businesses were often ill-equipped to operate in a for-profit business environment.

Consequently, given its knowledge of and experience in this region, Steinhoff was in a very advantageous position and the company soon bought out its East German suppliers. In total, the company purchased seven upholstery factories and one bedding factory at very attractive prices. While the factories required significant amounts of capital to upgrade, the result was that Steinhoff became one of the largest producers of upholstered furniture destined for the German market. With company-owned factories located in Germany, Poland, Ukraine and Hungary. The company also made strategic investments in numerous import trading companies in the Netherlands and Italy and extended its sales reach to France and Austria.

With the collapse of apartheid and the lifting of international sanctions against South Africa in the early 1990s, many international companies saw an opportunity to invest in the country. In doing so they could reach a large and untapped consumer base and use the market as a launching pad for operations in the rest of Africa.

At that time, Class Daun (a tax attorney who was later to become a non-executive director of Steinhoff International) was responsible for monitoring ‘at-risk’ companies for an international bank. From time to time, he also made direct investments into these companies and engineered turnarounds, which is what happened in 1993 when Daun & Cie bought what is now Gommagomma, a manufacturer of mid- to upper-market household furniture, and Bakker & Steyger, an Epping-based company specialising in up-market household furniture. It was then that the paths of Bruno Steinhoff and Markus Jooste would cross. Bruno and Daun had been acquaintances in Germany and Jooste was Daun’s CEO. Not long afterwards, in 1997, Bruno Steinhoff acquired a 35 percent stake in Gommagomma from Daun & Cie. Daun and Jooste formed a friendship and in 1997 made an unsuccessful bid to purchase Afcol, a large
on a breathtaking acquisition drive. It was during this period that the company embarked to fully control every aspect of the supply chain.\(^1\)

Retail activities across all the businesses in the group and sourcing, but the continuation of a vertical manufacturing, sourcing and logistics. However, its retail operations were limited.

What then followed, according to Jooste, was a period of continued development and exponential growth at an international level. The company had developed a secure base of manufacturing and sourcing, but the continuation of a vertical integration strategy required the development of retail activities across all the businesses in the group to fully control every aspect of the supply chain.\(^2\) This, said Jooste, was the era of “consolidation”.\(^3\) It was during this period that the company embarked on a breathtaking acquisition drive.

The consolidation strategy was implemented on three fronts:\(^4\)

a) **UK and Asia Pacific:** The company acquired retail operations in Australia and New Zealand (Freedom Group) and the UK (Homestyle). To bolster its worldwide sourcing operations, it also acquired Unitrans UK.

b) **Europe:** The company continued making investments with a view to expanding its retail footprint and acquired Poco (2008) and Conforama (2011).

c) **Africa:** The company acquired the JD Group of retail companies.

It is through these “bolt-on” investments, as Hendrik Ferreira (executive director) refers to them,\(^5\) that Steinhoff managed to integrate retail into its low-cost supply chain. By 2013, the company had full control over the entire supply chain: sourcing, distribution, logistics and retail.\(^6\)


“This new era means that Steinhoff had developed from a sourcing and manufacturing business to a global retail business – keeping its brands local.”

2016 Steinhoff annual report

For many, Steinhoff International was the epilogue of a successful, global retail business. In its short 50-odd-year history it was able to make the transition from a small-time furniture peddler, which sourced low-cost furniture from eastern Europe and sold it into West Germany, to a truly global retail giant, boasting a fully integrated supply chain covering sourcing, manufacturing, distribution, logistics and retail. This was the result of decades of conscious decisions to expand, diversify and vertically integrate the business.

Steinhoff operates in the following business categories:\(^7\)

- **Decoration**
- **Furniture**
- **Consumer electronics and cellular**
- **Kitchen, bathroom and quick-fix essentials**
- **Kitchens and appliances**
- **Clothing and footwear**
- ** Beds and mattresses**

Its brands have become truly global:

**UK:**
- Harveys (household goods)
- Bensons for Beds (household goods)
- Poundland (general merchandise)
- Pep & Co (general merchandise)
- GHM! (general merchandise)

**Europe:**
- Poco (household goods)
- Conforama (household goods)
- kika-Leiner (household goods)
- Pepco (general merchandise)

**Africa:**
- PEP (general merchandise)
- Ackermans (general merchandise)
- Russels (household goods)
- Incredible Connection (household goods)
- Unitrans (auto)

**Australia and New Zealand:**
- Freedom (household goods)
- Best & Less (general merchandise)
- Harris Scarfe (general merchandise)
- Snooze (household goods)

While Steinhoff has its headquarters in South Africa, it is registered in Amsterdam in the Netherlands with the majority of the company’s operations situated in Europe.\(^8\) Its integrated retail business is spread across the following regions under brands such as:\(^9\)

- **EU**
  - Conforama, Poco, Abra, Lipo, Emmezeta
- **UK**
  - Harveys, Bensons for Beds, Cargo
- **Asia Pacific**
  - Freedom, Snooze, Poco
- **Africa**
  - JD furniture brands, Poco, Incredible Connection, Hi-Fi Corporation, Pennypinchers, Timbercity, Hardware Warehouse, The Tile House

As an integrated manufacturing, sourcing and logistics giant, Steinhoff has a number of companies in its fold, including: QuattroMobil, H&H, Abra, Lipo, Emmezeta, Bensons for Beds, Poco, Harveys, Conforama, Snooze, Xoom, Freedom and kika-Leiner.

One of Steinhoff’s most recent and most significant acquisitions was that of Pepkor\(^8\) from Christo Wiese for roughly €8645 million (€1510 million in cash and the remainder in the form of €839 million shares),\(^5\) making Wiese one of Steinhoff’s largest shareholders.\(^5\) The Pepkor acquisition served not only to accelerate the growth of the company across Europe (in view of the complementary discount retail footprint of the two giants) but also to ensure the profitable transfer of the Pepkor business model into the current Steinhoff network. This has resulted in lower supply chain costs in eastern Europe, Australia and Africa through economies of scale.\(^8\)

In 2015 Steinhoff acquired the kika-Leiner Group and in July 2016 entered into a 50/50 joint venture with Cafel and acquired Poundland. Indirectly, in 2016, Pepkor also acquired GHM and Tekkie Town.\(^1\) Yet the most significant deal concluded by the company has been the merger with Mattress Firm in the US. This merger has created the world’s largest multi-brand mattress retail distribution network and afforded Steinhoff entry into the coveted US market.\(^2\)

At its peak, Steinhoff was part of the JSE Top 40 index, the JSE Top 25 Industrial index and the JSE Socially Responsible Investment (SRI) index.\(^3\) In 2015, the company added to its financial credentials by securing a listing on the Frankfurt Stock Exchange (FSE).

Despite its global acclaim, the business has always remained true to its original goal: To manufacture and source furniture and homeware from low-cost countries and to sell these products to value-conscious consumers, especially in developed economies.\(^7\) It has done this by making use of a decentralised management structure and gaining control of costs throughout the supply chain, including manufacturing, sourcing, logistics and retail. At the height of its success, Steinhoff could proudly reflect on the fact that it provided everyday products at affordable prices, catering to customers’ need for variety and convenience. As a result, the company has often been referred to as the “IKEA of Africa”.\(^4\)

By 2016, Steinhoff was selling household goods and general merchandise, straddling more than 40 different brands, in more than 32 countries across four continents.\(^4\) Globally it had 26 manufacturing facilities, 2 500 000 m² of warehouse space, 12 000 retail outlets and 9 000 000 m² of retail space and a 4 000 000 m² property portfolio.\(^5\) It was also shipping 150 000 containers annually and employed 130 000 people.

That year, the company posted revenue of €68 645 million and a net profit of €1 510 million, representing a year-on-year growth rate of 11.8 per cent.\(^5\) On 23 May 2017 its share price on the JSE was valued at R50.25, equating to a market capitalisation of R246.5 billion.\(^4\)

However, the empire came tumbling down on the evening of 5 December 2017 when the Steinhoff CEO, Markus Jooste, announced that he would step down from his position “with immediate effect” and the Steinhoff board announced that the company had become aware of “accounting irregularities requiring further investigation”. The company appointed PricewaterhouseCoopers to conduct an independent investigation into the alleged irregularities which had originally been identified by Deloitte.\(^1\) These
irregularities related to off balance sheet items and possible misrepresentations of earnings, although the extent and details of exactly what was meant by “irregularities” have yet to be determined.

Over the last few years, suspicions have been aroused by the dizzying pace of Steinhoff’s acquisition drive. What has concerned many observers is the high levels of complexity associated with these acquisitions and the ability of the company to acquire ailing businesses (and nearly instantaneously) show improved results once these businesses have been incorporated into the group.

Sygna Group CEO, Magda Wierzycka, said: “When I looked at the financials … it took me exactly half an hour to figure out that the structure was obfuscated, that financial items made no sense, that the acquisition spree was not underpinned by any logic and was too frenzied to be well thought out, and that debt levels were out of control.”

Currently, the company faces investigations or legal action instituted by numerous bodies and authorities, including the Johannesburg Stock Exchange (JSE), the Financial Sector Conduct Authority (FSCA), the Department of Trade and Industry (DTI), and the Companies and Intellectual Property Commission (CIPC). The company is also facing two different class action lawsuits in Germany and the Netherlands. Furthermore, executives of the company have been brought before Parliament’s oversight committee on finance and its Standing Committee on Public Accounts (Scopa).1

The repercussions of the December 2017 announcements, including the launch of various probes into Steinhoff’s financial affairs, have been catastrophic for the company. In the days that followed the dropping of the initial bombshell, the company’s share price fell by 85 per cent and by 11 May 2018 it was sitting at a measly R1.60. At the time of writing, many new developments – including the instituting of substantial financial claims against the company – were being reported. Whether Steinhoff will survive in its current or an altered form – or at all – remains to be seen.

LIST OF SOURCES

9 The Standing Committee on Public Accounts (Scopa).5
10 The company is also facing two different class action lawsuits in Germany and the Netherlands. Furthermore, executives of the company have been brought before Parliament’s oversight committee on finance and its Standing Committee on Public Accounts (Scopa).1
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12 The timeline of acquisitions was constructed from the information contained in the annual reports of the Steinhoff Group from 1998 to 2016. Please note that the exact dates of the transactions correspond with their listing in the reports and not the actual dates of the transactions.
Wiese attempts to stabilise the company (rumoured to owe creditors Board and Pieter Erasmus in an executive advisory capacity. Possible “accounting irregularities”).

STEINHOFF announces the resignation of Markus Jooste (CEO) and independent governance: The board consists of Dr Johan van Zyl, Clive Thomson, Peter Wakkie and Alexandra Watson. Moody’s downgrades Steinhoff to a CAA1 corporate family rating and MOODY’S DOWNGRADES TO CAA1

Christo Wiese resigns from the board, citing a conflict of interest. DEEPEN CONFORAMA SEEKS FUNDS/STEINHOFF FUNDING CONCERNS

In an attempt to distance itself from its ailing parent company, Steinhoff Asia Pacific appoints its own board (it does not share any income and asset values of the group).

The European Central Bank offloads Steinhoff bonds (estimated at €200 000 to three of its board members for undue time and effort)

Wiese is re-elected as chairman of the board. He steps down and Daniel van der Merwe is appointed acting CEO.

The company announces further board changes: Ben la Grange (CFO) on the board and fulfilled my commitment to major shareholders of the group for accounting fraud.

7 December

Shane continues to trade on ASX and ASX2

To boost liquidity by 25%, Steinhoff renames its core assets and changes its listing to long form.

Wiese agrees to continue to sit on the board for a first tranche of the company’s bonds.

STEINHOFF SELLS ASSETS AT A LOSS 15

15 January

The company’s estimated value to Carrefour.

STEINHOFF DENIES CLAIMS MADE 3

The company announces that the true value of the real estate portfolio is about half its previous estimate.

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“Investors find Steinhoff impossible to analyse from one year to the next, given its frenzied deal-making. I can understand that feeling, but you must always take the facts into account and forget the noise, né? It is now a big business and it’s in lots of countries, so, of course, it will be complicated... With real due respect – I mean this – everyone’s entitled to their opinion. I like to argue with anyone because you learn, but take the last results presentation, then look category by category – now you must really not have to go to Harvard to understand the figures.”

Markus Jooste, 22 September 2017

“I don’t know his business. It’s just a big business – furniture, clothing, whatever you wish. I like businesses like Shoprite and Amazon that stick to their core business.”

Whitey Basson

In his testimony before a parliamentary committee, Christo Wiese, chairman of the Steinhoff Supervisory Board when Jooste resigned, said that the crisis had appeared like a “bolt from the blue.” The Steinhoff board comprised an impressive line-up of individuals, yet they seemed to fail in a collective sense to govern the company. As the story continues to unfold, analysts and commentators will attempt to answer many questions, including:

1. Was there a problem with compliance?
2. Was there a problem with the composition of the board?
3. Was there a problem with the structure of the board?
4. Was there a problem with transparency?
5. Was the board simply hoodwinked by a corrupt CEO?
6. Can the company’s operational integrity and reputation be salvaged?

When the Steinhoff share price collapsed in December 2017 following the resignation of CEO Markus Jooste, it was approximately two years since the first warning lights had flickered when German authorities raided the offices of one of Steinhoff’s subsidiaries ahead of the company’s listing on the Frankfurt Stock Exchange. During the subsequent two-year period the company’s share price remained relatively stable as institutional investors continued to hold the majority of shares in the company. In fact, within five months of the 2015 raids the share price had risen by 17 per cent before it started a slow but steady decline, dropping from R95 in April 2016 to R56 in December 2017.

Since the resignation of Jooste, many questions have been asked about the inability of shareholders and other stakeholders to have anticipated the problem – vaguely referred to as “accounting irregularities” – and to have responded appropriately. From a governance perspective the obvious question asked in cases like this is: Where was the board?
Corporate governance has been defined as the system whereby business organisations are directed and controlled. This definition – originally articulated by Sir Adrian Cadbury in the early 1990s and later adopted by the OECD – neatly conveys the inherent dilemma faced by any director, i.e. the need to drive the enterprise forward while keeping it under prudent control. The tension between performance (driving forward) and conformance (prudent control) provides a useful framework for analysing the corporate governance system of any organisation. At the same time, the degree to which the fundamental governance principles of accountability, honesty and transparency inform board processes is extremely important. It is generally accepted that “independence of thought” and “care, skill and diligence” are among the key capabilities that directors need to bring to the boardroom.

Steinhoff had a primary listing on the Johannesburg Stock Exchange until 2015 when it secured a listing on the Frankfurt Stock Exchange. The company was therefore subject to the King Reports on Corporate Governance Principles for South Africa 2009 (King III) can therefore be viewed as the most important governance standard applicable during the period in which the problems at Steinhoff started to unfold.

1 WAS THERE A PROBLEM WITH COMPLIANCE?

As was the case with Enron and other scandal-ridden corporations over the years, Steinhoff appeared to comply with all legal and listing requirements in its various jurisdictions. This created a (false) sense of security for both investors and other stakeholders. Whether there was indeed full compliance will become apparent once the risks associated with “tick-box” compliance systems that are not underpinned by an ethical commitment to respect and abide by relevant rules and regulations. It also raises the spectre of lip service merely being paid to the importance of compliance. Steinhoff was very clear about its stance on corporate governance. For example, the 2013 Integrated Report (p. 40) states the following:

“All stakeholders and, more specifically, directors and employees are required to observe the Steinhoff Code of Ethics to ensure that business practices are conducted in a manner which is beyond reproach… This requires commitment by management to acknowledge and ensure that our long-term sustainability is based on delivery to all stakeholders.”

Yet the board’s attempts to provide ethical and effective leadership, and more specifically to ensure that the company’s ethical character is subject to close scrutiny (Principle 1.3 of the King III Code), seem to be warranted based on current evidence. The 2006 annual report, Steinhoff states:

“The wording of this extract makes a distinction between practices and structures. There is a difference between action and intent, and the question can be asked whether Steinhoff applied the guidelines of the King Report in any way other than mindlessly ticking the boxes. Even if Steinhoff were to be given the benefit of the doubt in terms of intent (which does not seem to be warranted based on current evidence), the company clearly did not translate this intent into the proactive detection of potential risks. In its 2006 annual report, Steinhoff states:

“Steinhoff’s board of directors and entire management team are committed to sound governance and good corporate citizenship. We accept that good governance practices are fundamental to creating, protecting and sustaining shareholder and stakeholder value, especially within the current volatile economic environment. Our governance structures are in line with King III and the Companies Act 71 of 2008.”

The following graph shows the composition of Steinhoff’s board over the years.

2 WAS THERE A PROBLEM WITH THE COMPOSITION OF THE BOARD?

King III states the following in terms of board composition (2.18): “The board should comprise a balance of power, with a majority of non-executive directors. The majority of non-executive directors should be independent”. Independence is an important characteristic of board directors insofar as it enables them to acknowledge the existence of multiple truths in the same time and space, which should be questioned on an ongoing basis. Independent directors bring to the boardroom new perspectives and views that complement and challenge the status quo.

Other board composition requirements are that the roles of CEO and chairman should be split and that the chairman should be an independent, non-executive director. Again, independence at the chairman level represents an additional safeguard against conflicts of interest at board level.

The relative independence of Steinhoff board members can be discerned from Figure 1.
Figure 1 shows that in the period 1999 to 2007 Steinhoff complied with the independence requirement in only two years (2002 and 2003). However, from 2008 onwards the company was in compliance.

As far as the number of independent non-executive directors is concerned, Steinhoff did not comply with this requirement at all up to 2002. The criterion used by Steinhoff to classify its directors as independent and non-executive is unclear. For example, how is it possible that Len Konar and Claas Daun, who were members of the board from as early as 1999, can be classified as independent and non-executive? The same question can be asked about the actual independence of directors with a significant cross-shareholding, like Jannie Mouton and Christo Wiese.

King III paragraph 2.18.8 states: “Any independent non-executive director serving more than nine years should be subjected to a rigorous review of his independence and performance by the board”. Paragraph 2.18.9, in turn, states: “The board should include a statement in the integrated report regarding the assessment of the independence of the independent non-executive directors.”

Perhaps more importantly, the position of Christo Wiese as chairman of the board should be analysed. There are very good corporate governance reasons for a non-executive and independent director to hold the position of chairman of the board, not least of which being that it ensures a level of objectivity when oversight is exercised over the activities of the executive directors. However, in the case of Steinhoff, the lack of independence seems to have been celebrated. In an interview in October 2017, Markus Jooste stated the following: “I have the highest respect in the world for the guy [Christo Wiese] and to have him today as a chairman and anchor shareholder, together with Bruno and Claas [Daun], it’s a club of friendship and trust.”

Table 1 below illustrates the periods of tenure of non-executive directors in the period 2002 to 2015.
In line with King III, the board of Steinhoff did review the composition of the board on a regular basis. This was clearly done within King guidelines which require that the board make statements regarding the continued board membership of individuals with more than nine years of continued service as independent directors. At this stage, it is very difficult to make a pronouncement on the tenure status of board members. It is interesting to note that when Franklin Sonn resigned as an independent director in 2013, his daughter, Heather Sonn, was appointed. In a similar vein, the appointment in 2016 of the son of Christo Wiese, Jacob Wiese, appears to be questionable in the light of the need to foster independence and diversity. The appointment of family members to the board is reminiscent of a family business and ‘club culture’. As such, the appointment in 2016 of the son of Christo Sonn is reminiscent of a family business and ‘club culture’, as alluded to by Markus Jooste.

In the Steinhoff annual reports of 2011 and 2013, statements are made in terms of the tenure of independent non-executive board members.

In the 2011 report:

“The board has critically assessed and carefully considered the independence of Dr Len Konar, Dr Franklin Sonn, Mr Jannie Mouton and Mr Claas Daun, all of whom have served as independent non-executive directors for more than nine years, and has determined that each of these directors, who serve on other boards and have commitments and interests outside the Steinhoff Group, remains independent in character and judgement and that there are no relationships or circumstances which are likely to affect or which could appear to affect their judgement or independence of character and has determined that the length of service of these directors has not compromised, nor could be held to have compromised, their independence.”

In the 2013 report:

“The board has critically assessed and carefully considered the independence of Dr Len Konar, Jannie Mouton and Claas Daun, all of whom have served as independent non-executive directors for more than nine years, and has determined that each of these directors, who serve on other boards and have commitments and interests outside the Steinhoff Group, remains independent in character and judgement and that there are no relationships or circumstances which are likely to affect or which could appear to affect their judgement or independence of character and has determined that the length of service of these directors has not compromised, nor could be held to have compromised, their independence.”

It is interesting that the company used practically the same wording in these reports, which raises serious questions about the thoroughness of the called-for review process. It would appear that boilerplate reporting was the order of the day.

3 WAS THERE A PROBLEM WITH THE STRUCTURE OF THE BOARD?

When Steinhoff moved its primary listing from South Africa to Germany in 2015, one of the corporate governance implications was that the company had to switch from a unitary to a dual (or two-tier) board structure. The dual structure comprises two separate boards: a Management Board and a Supervisory Board, which are comparable to having executive and non-executive directors in a unitary board. This distinction is explained by Block and Genster (2016:23): “The executive directors in the management board (Vorstand) decide about the company’s objectives and implement the necessary measures. Meanwhile, the non-executive directors in the supervisory board (Aufsichtsrat) monitor these decisions on behalf of other parties.”

The Supervisory Board is appointed by the shareholders at the annual general meeting. Depending on the size of the company and whether co-determination laws must be applied, the employees can elect either one third or one half of the Supervisory Board. This is the main reason why the dual board structure is sometimes described as more stakeholder-based than the unitary board.

Steinhoff’s transition to this new board structure (from non-executive to supervisory) did not have a major impact on the board composition. Nine directors remained, three departed (Mouton, Brink and Van den Bosch) and two joined (Van Zyl and Jacob Wiese). Rather, the major impact of the transition appeared to be that there was less contact between the former executive and non-executive directors (because they were sitting on separate boards). One could therefore argue that the executive directors had more freedom to engage in unethical activities and hide these from the Supervisory Board.

Owen Slake has analysed the relative strengths and weaknesses of the unitary and dual board structures. He asserts that the advantages of a unitary board are that executives can be asked questions while the entire board is present and that decisions are likely to be arrived at more quickly. However, the presence of all the directors around the same table might compromise the independence of non-executive directors. The dual board structure, on the other hand, is often criticised for encouraging information asymmetry since the boards meet separately and management has much more knowledge about the company’s operations. However, the dual board structure has more checks and balances because the Supervisory Board exercises oversight over the Management Board.

With reference to Steinhoff, most of the cases of alleged wrongdoing currently under investigation occurred before the dual board structure was implemented. Therefore, board structure should not be seen as a material factor in the unfolding saga.

4 WAS THERE A PROBLEM WITH TRANSPARENCY?

When evaluating the annual and integrated reports of Steinhoff in the period 1999 to 2015, it is clear that a great deal of care went into producing the reports. From the outside, these reports could be classified as ‘best practice’. The dilemma arises not from the reporting practice per se, but rather from the intent, through the reporting, to create an impression for the reader that everything is in order. This illustrates that there is a disconnect between the reporting practices in the company and the practices that are reported.

When there is a mismatch between the content of a report and the perceived performance that is reported on, the credibility of the report suffers. The board of Steinhoff received well-written documents and even audited statements. What would reasonable persons have done on receipt of such information? They would have accepted it – unless people’s behaviour or the passing of careless or in-jest comments suggested that all was not well. Another alarm bell might have been that only positive things were said about the company. Together with the evidently solid reports was the impressive figure of Markus Jooste, the ‘can-do’ CEO who had built up a track record of prosperous growth and enduring success.

The challenge of achieving authentic transparency is not unique to Steinhoff, but is part of the global corporate reporting landscape. Indeed, the existence of international reporting standards can be both helpful and restrictive. While helping companies to measure performance against relevant indicators, they also push some companies towards standardisation or formulaic reporting.

Furthermore, reporting without a sound ethical foundation will produce information that invariably raises more questions than answers. With the benefit of hindsight, this seems to have been the case with Steinhoff. The bigger question is: can ethical behaviour be legislated? While in principle desirable, it could also create a greater compliance burden and simply lead to more ticking of the boxes. Morality remains a key ingredient in a successfully constituted board and in strong governance. Yet it is a quality that is difficult to pre-check and satisfactorily monitor as time goes by.
In Steinhoff’s 2013 Integrated Report (p. 42) the chairman, Len Konar, states “Markus Jooste ... continues to lead Steinhoff proficiently and I thank him for his continued loyalty and leadership over the past year”. The impact of charismatic leadership should not be downplayed as it can, when not put into context, contribute to the formation of distorted perceptions. The topic is explored in Section 3 of this case study and therefore is not dwelled upon here. We conclude this section with the words of Markus Jooste in an email to staff on the morning after his resignation:

Figure 4: Extract of email from Markus Jooste to Dirk Schreiber, August 2014

“I can only say that cleverer people than this board have been duped before by people committing fraud. I can only refer to many instances around the world of companies of a similar or bigger size where this has happened... To detect fraud in a company is an extremely difficult if not impossible task and it becomes more difficult when as is alleged in this case the CEO is directly involved.”

Christo Wiese, testifying before a parliamentary hearing, 31 January 2018

It should be emphasised that the alleged accounting irregularities at Steinhoff will remain just that – alleged – until the findings of the current investigations are made available. It is a case of just that – alleged – until the findings of the current accounting irregularities at Steinhoff will remain just that – alleged – until the findings of the current investigation are made available and the legal process runs its course. In the meantime the release of leaked emails such as the one in Figure 4 will simply add fuel to the fire of speculation.

I have nominated Genesis Group to receive €130m in commission/fee from BNP because they have facilitated the negotiations on behalf of the whole Steinhoff group and K/L for the exclusivity to provide finance to both Steinhoff and K/L when they pay and execute in October. You would recall 10 years ago PPR received for K/L for the exclusivity to provide finance to both Steinhoff and K/L when they pay and execute in October. You would recall 10 years ago PPR received for K/L for the exclusivity to provide finance to both Steinhoff and K/L when they pay and execute in October.

Hi there,

Firstly I would like to apologise for all the bad publicity I caused the Steinhoff company the last couple of months.

Now I have caused the company further damage by not being able to finalise the year-end audited numbers and I made some big mistakes and have caused new financial loss to many innocent people. It is time for me to move on and take the consequences of my behaviour like a man. Sorry that I have disappointed all of you and I never meant to cause any of you any harm.

Please continue to live the Steinhoff dream and I must make it very clear none of Dane [van der Merwe – CEO], Ben [de Grange – COO], Stephan [Grobler – Executive Group Treasury and Financing] and Marais [Hei – Corporate Services, IT & HR] had anything to do with any of my mistakes.

I enjoyed working with you and wish you all the best for the future.

Best regards

Markus

Figure 5: Email from Markus Jooste to Steinhoff staff, December 2017

The email to Dirk Schreiber (Figure 4) is probably one of the mistakes that Jooste referred to in his email to the Steinhoff staff. Uncovering all the mistakes that were made will take time and will cause a great deal of hardship for many stakeholders, not only professionally but personally. Clearly, one should never take corporate governance for granted. It requires constant vigilance, a critical mind-set and a strong dose of integrity.

**LIST OF SOURCES**

4. There are many other questions surrounding the complex structure of the company and the various deals in shares that involved directors such as Christo Wiese. As more information becomes available as the PricewaterhouseCoopers and other forensic investigations proceed, the focus will shift to these other issues, but at present there is not enough information available to comment in a meaningful way. (Online) Available: https://www.businesslive.co.za/life/main/2017-11-12-inside-the-minds-of-marks-josters Accessed: 8 May 2018.
8. Evidently it has taken a crisis for Steinhoff to more than meet that board. The jury is still out, though, on whether the changes in both the Supervisory Board and the Management Board will significantly influence the organisational culture and future business practices. Are we going to see the moral compass and ethical standards of the organisation being successfully re-calibrated, and management and employees being re-sensitised and subject to greater scrutiny? Or are the changes in the composition of the board actually too late – tantamount to rearranging the deckchairs on the Titanic and in doing so expecting the ship to somehow head off in a different direction?
10. “I can only say that cleverer people than this board have been duped before by people committing fraud. I can only refer to many instances around the world of companies of a similar or bigger size where this has happened... To detect fraud in a company is an extremely difficult if not impossible task and it becomes more difficult when as is alleged in this case the CEO is directly involved.”

Christo Wiese, testifying before a parliamentary hearing, 31 January 2018.
What are the unconscious drivers that steer seemingly ethical leaders down a path of corruption?

1 IN WHAT WAY IS CHARISMATIC LEADERSHIP AMBIGUOUS?

The Greek word ‘charisma’ (plural: ‘charismata’) means to be endowed with a superhuman gift of divine grace. In secular terms, it refers to a special gift that distinguishes certain leaders from others, imbuing them with extraordinary power to sway institutions and the public at large.

Research has shown that for someone to be considered a ‘charismatic’ leader, a combination of three elements is required: extraordinary qualities that are inherent in the person in question; a social situation that provides the ideal setting for the rise of such a leader; and a particularly strong emotional bond between the leader and his or her actual or potential followers.1

To make definitive claims about Markus Jooste as the ‘charismatic’ leader of Steinhoff requires more information than is currently in the public domain. Ideally a traditional research method like conducting structured interviews among a representative sample of people is required to augment and possibly correct what has already emerged from published interviews with Jooste himself and some of his co-workers.

In this section, however, we simply analyse what is already known about Jooste and his leadership style at Steinhoff. Of interest is the fact that the three elements (mentioned above) that are necessary for a charismatic leadership style to take root and thrive were in fact present when Jooste was at the helm of Steinhoff.

In the first place, Markus Jooste was not seen as just another entrepreneur. He was called a “retail star” who was “charismatic” (Retailers News2). He was also hailed as “a gifted business genius” (BizNews.com3) who might even have been viewed by some as South Africa’s top businessman owing to his “extraordinary deal-making talent” (Finweek4). To his credit he led an aggressive international expansion and acquisition drive to build an international giant which was unsurpassed in the history of South African business.

With each step that he took, Jooste was recognised for his charisma and intelligence and for successfully raising significant amounts of capital and engaging in a dazzling array of equity swaps. The relentless stream of expansion projects, the steady growth in off-shore income as a proportion of overall earnings, off-shore listings and a rising share price created and reinforced Jooste’s image as a superhuman businessman. His sometimes unconventional tactics were driven by a seemingly unshakable self-confidence, while his
image as an extremely wealthy individual, replete with race horses, exclusive properties, a weakness for polo and a not-so-secret extramarital relationship with a beautiful woman, completed the picture of this ‘charismatic man’.

Secondly, the social situation in which Jooste rose to prominence had two primary influences.

The first was the rise of a new class of Afrikans entrepreneurs who emerged after 1994. Jooste came from humble beginnings but grew up during a time when professionally minded and educated Afrikaans entrepreneurs were starting to take advantage of the political freedom and economic opportunities of the post-apartheid era to build extraordinary businesses and amass substantial personal wealth.

The second influence was Jooste’s friendship with key business people like Christo Wiese and many others in the public eye. Research has shown that “attributions of charisma will spread more quickly in organisations having well-established social networks” than when a leader attempts to act by himself or herself.

The myth of a Stellenbosch mafia who meet in secret and control the economy is just that: a myth, which is sometimes peddled for political expediency. There is nevertheless no doubt that Markus Jooste’s charisma was in part built on and reinforced by a strong business network – inside Stellenbosch and beyond – which put its trust in him and afforded him extraordinary status in business and social circles. In an interview with biznews.com in 2017, Jooste claimed that ten of the other executives at Steinhoff were his best friends. It is a fact that many investors in Jooste’s network of close allies persisted in holding onto Steinhoff shares, even when a stage had been reached when the tangible net asset value represented only 15% of the actual share price.

As with any sect, there was a strict line drawn between, on the one hand, fiercely loyal insiders who enjoyed social and financial privileges through their close association with Jooste and, on the other hand, circumspect or suspicious outsiders who did not make it into the Steinhoff inner circle or benefit from Jooste’s largesse.

From the narrow perspective of Markus Jooste fitting the description of a charismatic leader, it is perhaps understandable (though still not acceptable) that Steinhoff fund managers and directors failed to remain alert and exercise proper oversight. Charismatic leaders, who are typically intent on promoting self-enrichment and advancing the interests of their network, draw those close to them into a web of loyalty and submission. By surrounding themselves with admirers, such leaders acquire the latitude to act in certain ways and to conceal possible unethical behaviour without any critique or push-back from colleagues.

A universal truth, which is applicable to politics, religion, business and many other disciplines, is that only a small minority of people can foresee the impact of looming danger before disaster strikes. Only afterwards are people’s eyes opened to how risky the situation had been and what could have been done to avert or minimise the damage. In this sense, those who supported Steinhoff up to December 2017 demonstrated once again how easily humans – even very educated ones – can be misled, particularly in a society that is very approving of and denies enormous personal satisfaction from financial wealth.

Society has benefited from charismatic leaders in a great many spheres: Martin Luther King and Nelson Mandela in politics, Mother Theresa and Desmond Tutu in religion, Albert Einstein and Stephen Hawking in physics, and so forth. The same is true for many business leaders who have built prosperity for millions of people in a legal and ethical manner.

However, it is important to remain alert to the possible ambiguity and danger of charismatic leaders. For every Mandela there is also a Hitler, a Vervoordt and a Mugabe. There is a risk that charismatic leaders will become arrogant and believe that they are so extraordinary that ethics and the law do not apply to them. The Steinhoff debacle is a reminder that charismatic leadership can lure people, sometimes unknowingly, in dangerous directions.

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2 WHY ARE GOOD EXECUTIVES LURED INTO CORRUPTION?

The Steinhoff story and the apparent involvement of (previously) highly regarded business leaders such as Markus Jooste and others raise many questions. Why does this kind of thing happen? Why do upstanding people resort to misrepresenting information in ways that are at best ethically questionable and at worst corrupt or fraudulent (Helfage & Do Toit, 2017)? What goes on in the minds of successful executives who do not need the money but still engage in corrupt activities, described as the ‘misuse of an organisational position or authority for personal gain or organisational gain’ (Fleming & Zyglidopoulos, 2008:818).

2.1 Psychological drivers underlying unethical conduct

There are a number of drivers that could potentially push successful executives with apparently good morals and values down the slippery slope of unethical conduct.

A FINANCIAL GREED? OR POWER AND STATUS?

The obvious explanation for executives engaging in acts of corruption is financial greed. However, this is an oversimplification of a much more complex situation. Greed itself is not only a financial matter. Although money might still be the eventual target of corrupt activities, greed is not so much about money as what it represents: money is a symbol of power, status and success.

Thus in the case of a rich and successful executive, corrupt behaviour is driven less by rational cost–benefit calculations than by the symbolic value of power and success. Addiction to the power and status that money provides must be fed continually. The accumulation of ever-increasing wealth is a source of perverse pride in one’s ability to feed the hungry beast of power, status and a lavish lifestyle (Long, 2008).

B PRIDE AND ARROGANCE

This perverse pride is accompanied by a level of arrogance that prompts the executives in question to ignore some of the realities that surround or threaten them. Smart executives who became very successful early on in their careers (such as Jooste when he became the financial director of Gommagomma at the age of 27) easily develop the belief that they are invincible because of their remarkable qualities or accomplishments (Long, 2008).

Jooste apparently believed that his early success could be replicated time after time, not withstanding new and increasingly challenging circumstances (Skæ, 2018). He started to buy shares and companies. When the promised returns failed to materialise, his solution was to acquire an even bigger company in which losses could be absorbed or made to disappear (Rutledge, 2018). This created a vicious cycle of more and more ambition and financial investment being channelled into business deals, with less and less success.

What was being conveniently ignored was that a multinational organisation was being created with an unprecedented level of operational and managerial complexity, little or no focus or integration strategy, and problems in converting earnings into cash flow (Viceroy Research Group, 2017). Yet in amongst these challenges, the desire for more simply grew. Could Jooste’s boast that ‘every competitor of Steinhoff in my 29 years, we either own today or they are bankrupt – all of them’ (Taleri, 2017) have been a sign of unhealthy, slightly unhinged arrogance?

Skæ (2018) notes the rampant managerial ambition, hyperactivity and arrogance that became hallmarks of the Steinhoff operation. Although Jooste was not the founder of the company, he behaved as if Steinhoff and its assets belonged to him personally. This is evident in Jooste once subjecting an MD of one of the Steinhoff companies to a humiliating public trade after which he told the MD to ‘get out of my f***ing factory’ (Rutledge, 2018).

Pride and confidence are not de facto undesirable characteristics. In fact, leaders need a healthy dose of narcissism to be successful as it affords them the psychological energy that drives leadership. However, dysfunctional, narcissistic traits such as entitlement, grandiosity, arrogance, hubris and self-absorption can seriously impede morality. There is a light-hearted saying that the difference
between God and any narcissist is that God does not think that s/he is a narcissist.

Fantasies of transcending an average lifestyle can push talented and charismatic individuals towards greatness, but the frustration of not attaining cherished dreams can lead to acute psychological stress. For some, it may trigger an even greater sense of urgency to accomplish goals, which could fuel opportunistic corruption because of narcissistic illusions of indemnity.

A lack of restraint makes narcissists susceptible to an egocentric sense of entitlement and being above the laws and scrutiny that apply to others. Their authority becomes perverted.

Ken Lay of Enron, who is often touted as the quintessentially dysfunctional narcissist, was found guilty of many of the things that Jooste and other Steinhoff directors are allegedly culpable of, such as misrepresenting and misreporting financial information, restructuring or disguising debts to convey an impression of legislative and regulatory compliance, and engaging in various forms of corruption.

C ENTITLEMENT

Before making hasty judgements, we should acknowledge that CEOs and other executives typically work very hard, putting in exceptionally long hours to build and manage the organisations they were appointed to lead, and dealing with responsibility-induced pressures and stress. They are often required to make sacrifices in their personal lives and relationships. For instance, it has been claimed that Markus Jooste had a punishing business travel schedule, spending more nights on planes between South Africa and Europe than in his own bed.

However, when not rein ed in on the morality front, such commitment might manifest as narcissistic notions of entitlement – “I work so hard and sacrifice so much for the organisation, I deserve more.” Corruption is a crime of entitlement, committed by those who cannot grasp that they should act as responsible members of a wider community. Instead they nurture the belief that they are superior to and more worthy than the rest of society.

Culpable executives may claim, and at a subconscious level believe, that they have earned the right to the proceeds of corrupt activities because they have scored points (relating to effort, ingenuity or largesse) that somehow make them more deserving imbued with a warped sense of entitlement, such executives often put on an elaborate display of self-righteousness, seemingly impervious to the mounting evidence against them.

Entitlement, like power and status, is a hungry beast that needs to be fed, which is why one corrupt act often leads to another. In an atmosphere of rampant self-indulgence, normal risk assessments are often overlooked. When no attempts are made to hide such self-indulgence, the desire (indeed pressure) for power, money and prestige simply grows, sometimes to the point of carelessness.

Although Jooste was notoriously private when it came to engaging with the general public, the trappings of his extravagant lifestyle (from expensive properties to prizewinning horses) were nevertheless in full view of the world (Talel, 2017). Like many others who have landed in the pound seats, Jooste was on a psychological high, luxuriating in people’s admiration of him and his success.

2.2 Rationalisations explain the decline of moral character

One of the general assumptions in psychoanalytic and system psychodynamic theories is that people generally have a desire to be ethical. Except for psychopaths, most people are not inherently unethical; instead they strive to be good and moral. The reality, however, is that people tend to have an inflated view of their morality and they are not as ethical as they would like to think.

More often than not, corrupt activities start on a small scale, with little or no malicious intent. There might be an apparent justification for behaving in a somewhat dubious manner, e.g. to finally close an important deal that will make a difference to the company, to boost profits in order to satisfy shareholders or to accelerate one’s climb up the career ladder in order to be a better provider at home. But if the first transgression goes undetected, it creates space for more unethical acts to follow. Not getting caught can be reassuring and a bit intoxicating and can lay the foundation for a repetitive cycle of unsavoury behaviour (Long, 2008).

As the transgressions multiply, people’s internal moral compass — in other words, conscience — is likely to send warning signals that something is going wrong, triggering feelings of guilt. However, research has shown that often guilt does not stop the corrupt behaviour. Instead, people erect psychological defences, such as rationalisation and denial, to subdue the feelings of guilt and allow the errant behaviour to continue.

Rationalisations are the main reason why ethical people might drift into corruption. They enable transgressors to convince themselves and others that they are not actually corrupt and that their actions are justified and acceptable, e.g. “everybody does it, it is part of doing business”. Rationalisations dull people’s awareness of the nature and impact of their transgressions, which then often gain momentum. Viewed from two different extremes, too little rationalisation does not assuage the feelings of guilt, while excessive rationalisation gives the green light to an escalation in the scope and severity of transgressions.

There are three rationalisations commonly associated with unethical business conduct:

A "THERE WERE GOOD INTENTIONS, WITH NO IDENTIFIABLE VICTIM"

Our unconscious minds have a cunning ability to effectively create self-deceiving delusions of indemnity and redemption which supersede reality.

When still engaging in ‘small’ and ‘less serious’ acts of corruption, offenders tend to rationalise the intention behind the transgression in order to subdue their conscience. They claim that their intentions were “never meant to harm anyone; I was only trying to do good for the company, employees and shareholders.”

Alternatively, they claim that it was always their intention to correct the fraudulent activities later – they were just providing a temporary solution to a problem. But this never happens, until the offender is found out. Sometimes euphemisms are used to make corrupt acts sound more acceptable, e.g. fraud (Haffajee & Du Toit, 2017) is sometimes referred to as “accounting irregularities.” In his note to employees, Jooste attempted to use this tactic when he said that “accounting irregularities” had prevented the finalisation of the “year-end audited numbers” (Thomson, 2017). Through rationalisation, offenders deny the consequences of their wrongdoing or play down the extent of the damage caused. While Jooste was engaging in “accounting irregularities” (Thomson, 2018), no-one apparently suffered directly from it – at least not at the time. Offenders might also attempt to show that their transgressions pale alongside others. Although the Steinhoff saga is being viewed in some quarters as one of the worst cases of business fraud that the world has ever seen, it might be argued by those implicated that the effect on the average man in the street is likely to be very small (Gowan & Croisy, 2017).

The absence of identifiable victims further fuels the no-injury argument. It is very likely that the fantasy of a victimless crime was peddled in the case of Steinhoff. While there have been allegations of ‘cooking of the books’ (Hunter, 2018), no specific individual could be identified as suffering directly. Business corruption on a grand scale occurs more easily when the ‘victims’ are faceless shareholders and pensioners. It facilitates emotional disengagement from the unethical conduct and neutralises guilt and anxiety.

Corruption breeds corruption, a small amount embedded but undiscovered represents the crossing of an important moral boundary (Long, 2008). Once the boundary has been breached, it is easier to cross it again. Corruption can soon spiral out of control, both in frequency and severity, and it is never without victims. Those harmed may just not be aware of it until the rot is exposed.

B “IT IS NOT ILLEGAL”

The link between ethics and the law is complex. As a general rule the law – if not inherently unjust or unfair – is the minimum ethical standard below which one should not go. At the same time being an ethical company or business person requires much more than simply not being found guilty by a court of law.
A powerful type of rationalisation is the justification of unethical or corrupt acts on the basis that the deeds in question are not illegal – at least not according to the strict letter of the law – and are therefore acceptable, notwithstanding the moral implications. Some multinational companies exploit differences in labour laws, environmental requirements and tax regimes, especially across different geographical jurisdictions. This creates ethical grey zones where it is easy to hide behind regulatory discrepancies.

The details still need to emerge, but from what is already known it appears that a major contributing factor in Steinhoff’s ethical and legal problems was the contextual way in which the company managed its tax affairs. The link between tax avoidance (technically legal but often ethically questionable) and tax evasion (illegal) is seductively thin.

The company undertook a series of inspections by a host of regulatory bodies. As early as 2007 there were warning signs and questions raised as to why Steinhoff’s accounts lacked “pivotal information” about where the company was generating revenue and why it appeared to focus on tax breaks rather than on the actual commercial activity (Wild, Kew & David, 2018). Perhaps this could be described as smart management, but when does smart tax avoidance mutate into shrewd and unethical tax evasion? Of course, when paying a bribe to a public official to secure a contract, or hiding losses or inflating profits on paper, the rationalisations might be: “I’m growing the company,” “I’m protecting shareholder value in line with my mandate” and “I’m protecting jobs.”

Those who have a utilitarian mind-set can easily be persuaded that the end justifies the means.

3 FINAL THOUGHTS

Human beings are conflicted – capable of great integrity and kindness, but also prone to envy and temptation. There is no getting away from the fact that everyone embodies a mixture of good and bad. Freud described this relentless internal conflict between good and bad as the “tragic fate of humanity”, with fallibility being a normal part of the human experience (De Klerk, 2017a).

Let us therefore not judge Steinhoff and Jooste from atop a moral pedestal, confident in the belief that this could never happen to us or our organisation. Even the most moral of intentions can be undermined by an unconscious counter-will, which then triggers a moral collapse. We cannot ignore the fact that there are potential Steinhoffs and Joostes in every corner of society.

C “IT WAS DONE FOR THE GREATER GOOD”

Paradoxically, corruption may also be justified on the grounds that it supports higher-order ideals, such as growing the organisation to become more profitable and sustainable and create more jobs. However, organisational ideals and the pursuit of apparently worthy causes can inflate narcissism, offering management a level of protection against reality. As a result managers may start to believe that accepted norms can or should be sacrificed to attain higher-order values. For example, when paying a bribe to a public official to secure a contract, or hiding losses or inflating profits on paper, the rationalisations might be: “I’m growing the company,” “I’m protecting shareholder value in line with my mandate” and “I’m protecting jobs.”

REFERENCES


WHAT BUSINESS LESSONS CAN BE LEARNT FROM THE STEINHOFF CASE?

In this last section we attempt to distil from earlier sections some key learning points from the Steinhoff case. It is too early to give a full interpretation of what has precipitated the recent fall of this corporate giant and we must keep an open mind about how things may eventually play out.

Nevertheless, the various topics covered in the case study – Steinhoff's business vision and fast-expanding operation over the years, and the company's approach to governance and leadership – provide some important business lessons for small entrepreneurial concerns and large corporates alike.

1 LESSON #1: Be true to your strategic vision and 'stick to the knitting'

Strategy theory suggests that strategy development over time is more about making wise choices initially and deepening one's competitive position than going too broad and trying to be all things to everyone.

Although the diversity of the Steinhoff businesses might give some people the impression that the company lacks a core identity and has chased acquisitions in a somewhat random fashion, the company's long-term vision has always been to control its various value chains, thereby moderating costs, keeping competitors at bay and striving for ever-higher levels of efficiency and market share.

This is an important element in its fundamental strategy of sourcing and manufacturing goods in low-cost countries and selling them to value-conscious buyers in more lucrative markets.

Although Steinhoff's operation is today very geographically dispersed and it has progressed from being primarily a furniture supplier to a more holistic supplier of 'lifestyle' products, the company has not deviated too far from its fundamental business strategy and target market. In making the strategic choice to expand its product and service offerings but operate as a vertically integrated business, Steinhoff acknowledges that benefits can be derived from moving almost seamlessly into 'adjacent market space' using its pre-eminent position in related value chains.

Whereas a horizontal integration approach would require a business to operate alongside myriad other businesses in a 'value chain neighbourhood', with a vertical integration approach Steinhoff effectively 'owns the neighbourhood'.

2 LESSON #2: Growth does not equate to profit or success

Organisations that deliver consistently strong performance over extended periods of time invariably practise a controlled growth strategy in which future expansion and investments are carefully planned and executed. The hallmark of truly great companies is that they have the discipline to hold back and moderate their growth plans so as not to experience resource constraints and fatigue, or end up in financial difficulties during lean times when the cash they accumulated during bumper years is all but exhausted.

Steinhoff's extremely rapid acquisition drive, particularly in more recent years, was clearly unsustainable. The nature of its investments (large, new regions and new product lines) signalled a high-risk approach which should have raised more questions from shareholders and the board about the company's ability to sustain all the new acquisitions and ensure their profitability.
Although strong growth always seems impressive, it does not equal cash flow or profits. Such was the case with Steinhoff whose frenetic investment activity concealed highly complex business structures, high levels of debt and less-than-stellar performance within the Steinhoff group. The management team, and Markus Jooste in particular, painted a picture of a fast-growing and practically invincible corporate giant which was too good to be true, and this should have set off alarm bells among different stakeholder groups.

3 LESSON #3: Strong governance is not just about financial and regulatory compliance; it is a mind-set

Most organisations extol the virtues of strong governance, as evidenced in prudent financial management, transparent reporting, and an engaged and account- able executive team and board. However, all too often compliance ends up being a box-ticking exercise, with the goal being to meet minimum standards only – i.e. simply to satisfy the relevant authorities.

Basic compliance may satisfy shareholders on a superficial level but it can lead to operational mediocrity if it is not backed up by enthusiastic and committed management, which is key to sustainable profits and a satisfactory return on investment.

An important dimension of sound management is a commitment to ethical business practices which are based on values, not just rules. Values are deeply entrenched and highly personal belief systems which help people to distinguish between right and wrong and which therefore regulate their behaviour. Rules provide behavioural guidelines but are susceptible to being challenged, manipulated or ignored.

At Steinhoff, weak accountability and a culture of highly creative accounting meant that many dubious investment deals, excessive debt levels and the poor financial performance of several of the businesses went undetected for a long time. Either the truth was hidden, or responsible parties (including the board) were not paying enough attention, or both.

Strong governance in an organisation is heavily dependent on an accountable and capable board to exercise rigorous oversight while also motivating the executive team to follow their vision.

It is a sad indictment of the corporate sector in South Africa that a company like Steinhoff was able to perpetuate the myth of unprecedented financial success for so long. It is difficult to see how the company, given the magnitude of its financial problems and the scale of the deception, will survive in its current form. When stakeholders, and especially investors, are betrayed, trust is rarely recovered.

4 LESSON #4: A charismatic leader can either be very good or very bad for a company

Many people believe that if an organisation is fortunate enough to have a charismatic leader, its chances of success improve dramatically. Charismatic leaders have the ability to engage people at all levels, speak their language, keep their attention and earn their respect, which is no mean feat in an age when authority is regularly questioned.

Yet charismatic leaders are not always brimming with charm and goodwill. They can also be mesmerising in a frightening sort of way, extorting cooperation and loyalty through fear. The world has seen many brutal dictators keep their populations under control by projecting a charisma that is heavily laced with menace. Charismatic leadership is often viewed as ambiguous because the extraordinary power and influence that go with it can be used in either a positive or a destructive way.

Markus Jooste was clearly a charismatic leader who developed a strong and devoted following both within the company and across his many business and social networks. Gregarious and generous to his inner circle, Jooste was afforded almost god-like status by his friends and close associates because to them he was a commercial superstar who had reached the pinnacle of professional and personal success. However, he appeared to operate in the rarified environment of the super-rich and super-successful who often believe themselves to be above the law.

While in one sense Jooste was the architect of Steinhoff’s runaway success in recent decades, from which scores of people benefited in many different countries, he was also the main figure in the company’s recent fall from grace. Driven by his own self-confidence, entrepreneurial talents and adulation from people around him, Jooste became a larger-than-life CEO who took great liberties with Steinhoff’s money and seemingly crossed all sorts of ethical boundaries. Ultimately, this proved to be unsustainable.

Interestingly, many of his colleagues at Steinhoff – perhaps mesmerised by his superstar status – appeared to turn a blind eye to or were complicit in the large-scale “accounting irregularities” that were exposed in 2017, the news of which sent the Steinhoff share price into a tailspin. This is an indication of how easily many people got caught up, knowingly or unknowingly, in Jooste’s seemingly unethical business dealings and ongoing deception about the health of the company. Even when Jooste resigned as CEO, his strangely chirpy email to the staff seemed to suggest that he deserved a slap on the wrist for leading people astray, which was a weak response in the face of such a grave turn of events.

5 LESSON #5: Even ethical business people are corruptible

Human morality is fragile, notwithstanding most people’s good intentions. Deep-seated strings of envy, greed, self-absorption, arrogance or a sense of entitlement could infiltrate people’s moral fibre at any stage – even those who appear to have strong value systems and are the least likely to be swayed. To be human is to have to continually wrestle with one’s conscience when presented with opportunities to win friends, favours or influence without putting in the usual slog.

It is, as Freud described it, a “tragic fate of humanity.”

Of course, this does not mean that wrongdoing should simply be pardoned – particularly when, in an organisational sense, the culpable parties are savvy enough or senior enough to know better. What it does mean is that no organisation can afford to skimp on introducing the appropriate checks and balances, particularly where organisational finances are at stake.

6 A FINAL WORD

Peter Drucker1 reminds us that:

“ ‘Asking What is right for the enterprise?’ does not guarantee that the right decisions will be made. Even the most brilliant executive is human and thus prone to mistakes and prejudices. But failure to ask the question virtually guarantees the wrong decision.”

The Steinhoff story illustrates that business success can be attributed to numerous factors – from well-thought-out marketing and financial strategies and efficient production plants, to clear compliance guidelines and financial reporting standards. While efficient infrastructure and various management and operational tools are naturally important, the human factor stands out as being the most critical of all…and the most difficult to get right. It is largely the human element that has toppled this once-mighty company.

Whether the human element as represented in the new leadership will be able to salvage this business, remains to be seen.

LIST OF SOURCES

Steinhoff International had everything going for it – an enviable growth record, a charismatic and charming CEO in South Africa who had become the doyen of the retail trade, and a steady stream of investors eager to partake of the Steinhoff magic.

Steinhoff represented the quintessential ‘rags to riches’ story, showing how it was possible for a humble furniture retailer in Germany to transform itself into a massive holding company, with multiple brands and vast distribution networks, that catered to the discerning ‘lifestyle’ markets of Europe, Africa, Australia and New Zealand.

It all seemed too good to be true. And it was.

On 5 December 2017, the company’s share price went into freefall amidst claims of widespread “accounting irregularities”. Steinhoff CEO Markus Jooste promptly resigned, admitting to having made “some big mistakes”, and a thick cloud of uncertainty descended on the once-mighty Steinhoff edifice.

Although the details of what went wrong are still the subject of intensive investigation, what is strongly suspected is that the company was engaged in elaborate accounting fraud, with poor returns and escalating debts hidden behind a facade of financial superstardom.

How could this have been allowed to happen? What does it say about the company’s governance standards and the quality of its leadership?

In this mini case study we explore the circumstances surrounding Steinhoff’s dramatic fall from grace, from its business philosophy and runaway acquisition drive to its governance approach and leadership style. We also look at what drives business people to sometimes cross ethical boundaries in their bid to advance their company’s or their own interests.

Finally, we share some important lessons to be learnt from the Steinhoff saga, including the fact that the most rigorous corporate structures and governance standards are always at the mercy of human nature.