BUSINESS PERSPECTIVES ON THE
STEINHOFF SAGA

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The Steinhoff saga, possibly the biggest case of corporate fraud in South African business history, has dominated the news since the company’s share price collapsed on 5 December 2017.

This mini case study, compiled by USB, looks at the rise and fall of Steinhoff, asking questions such as: Were there problems with compliance or the board composition? Were there problems with transparency? Also, can the company’s integrity and reputation be salvaged?

Corporate governance has been defined as the system whereby business organisations are directed and controlled. This definition conveys the inherent dilemma faced by any director, i.e. the need to drive the enterprise forward while keeping it under prudent control.

Steinhoff appeared to comply with all the requirements. Did this create a (false) sense of security for both investors and other stakeholders? Whether there was indeed full compliance will become clearer as the investigations into alleged accounting irregularities start to yield results. Yet it does speak to the risks associated with ‘tick-box’ compliance without an ethical underpinning.

Why did USB write up this case study? We see it as part of our role 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.

As a business school, we understand and value the contribution that entrepreneurs and private corporations make to society. That is why our education is aimed at breeding a new generation of responsible business leaders.
INTRODUCTION

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

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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 become Steinhoff International AG.

"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, reinforced 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 exports). This necessitated a further expansion of its Westerstede warehouse and the start of sourcing operations from China – making Steinhoff one of the first companies to import from China. This perfectly illustrates Bruno’s keen awareness of the drivers of value within his business and his lack of fear or bias when making strategic decisions.

By 1983, furniture deliveries had reached 1,000 wagons per annum and annual turnover was DEM230 million. The number of employees had risen to 320. As can be seen, the company was successful, growing and becoming a global operator. Keeping up the momentum required investment and for the greater part of the 1980s the company made large capital investments to bolster its sourcing, manufacturing and distribution capabilities. 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 DEM70 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 favorable 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.

By 1993, revenue was DEM600 million per annum and the company employed 3,000 people.

2 A NEW ERA: Looking South (1994 – 2013)

“The Steinhoff group is an integrated lifestyle supplier that manufactures, markets, warehouses and distributes household goods and timber-related products.”
Bruno Steinhoff

“We have warehouses, we have distribution centres, we have logistics companies, we have retail stores, we have furniture production companies; we have the entire supply chain built up in all these countries.”
Angela Kräger-Steinhoff

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 a controlling interest in the ailing Victoria Lewis, a JSE-listed furniture manufacturing company. In 1993 the company invested in Gommagomma Holdings, which consisted of Gommagomma, a manufacturer of middle- to upper-market household furniture, and Bakker & Steyger, an Epping-based company specialising in upper-end 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’s fingers two years earlier. This made Steinhoff International one of the largest furniture manufacturers on the JSE and, continuing the Bruno Steinhoff tradition, enabled it to develop a low-cost manufacturing base in Africa.

Steinhoff now consisted of two major businesses, Steinhoff Europe and Steinhoff Africa, each focusing on the manufacturing and sourcing of (predominantly) furniture and with a goal to control the manufacturing, supply and logistics activities of the business. According to Jooste, the following five years saw the company focusing on ‘establishing the base’ and developing Steinhoff into a vertically integrated furniture and household goods business.

Company reports reveal that this was achieved by giving attention to four pillars:

a) Establishing a low-cost manufacturing base: This was largely achieved through the closure of most of the company’s manufacturing activities in Germany and their subsequent relocation to Poland and Hungary.
b) Entering the UK and Australian markets: The company acquired Relyon and Sprung Slumber in the UK and the Cornick and Freedom Groups in Australia.
c) Making inroads into the fields of logistics and raw material supply: The company acquired Unitrans Limited (to bolster its logistics capabilities) and a particle board manufacturer, PG Bison. The company also developed a logistics hub in Leinefelde, Germany;
d) Establishing sourcing operations in Asia:
The company opened a sourcing office in Shenzhen, China.
These investment efforts enabled Steinhoff to reach its goal of achieving a 50/50 split between its own manufactured products and wholesale distribution. The company had 87 factories and 26 distribution and sourcing locations, and operated in 10 countries. It was now a fully vertically integrated furniture and household goods business with activities straddling 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. This, said Jooste, was the era of “consolidation”. It was during this period that the company embarked on a breathtaking acquisition drive.

The consolidation strategy was implemented on three fronts:

- 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, 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.


“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 epitome 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:

- a) Decoration
- b) Furniture
- c) Consumer electronics and cellular
- d) Kitchen, bathroom and quick-fix essentials
- e) Kitchens and appliances
- f) Clothing and footwear
- g) 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. Its integrated retail business is spread across the following regions under brands such as:

- **EU**
  - Conforama, Poco, Abra, Lipo, Emmezeita

- **UK**
  - Harveys, Bensons for Beds, Cargo

- **Asia Pacific**
  - Freedom, Snooze, Poco

- **Africa**
  - JD furniture brands, Poco, Incredible Connection, Hi-Fi Corporation, Pennyprinkers, Timbercity, Hardware Warehouse, The Tile House

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

One of Steinhoff’s most recent and largest acquisitions was that of Pepkor from Christo Wiese for roughly R60 billion (R15 billion in cash and the remainder in the form of R39 million shares), making Wiese one of Steinhoff’s largest shareholders. 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.

In 2015 Steinhoff acquired the kika-Leiner Group and in July 2016 entered into a 50/50 joint venture with Cofel and acquired Poundland. Indirectly, in 2016, Pepkor also acquired GHM and Tekkie Town. 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.

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. 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. 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”.

By 2016, Steinhoff was selling household goods and general merchandise, straddling more than 40 different brands, in more than 32 countries across four continents. Globally it had 26 manufacturing facilities, 2,500 000 m² of warehouse space, 12,000 retail outlets and 150,000 containers annually and employed 130,000 people. That year, the company posted revenue of €6,845 million and a net profit of €1,510 million, representing a year-on-year growth rate of 11.8 per cent. On 23 May 2017 its share price on the JSE was valued at R50.25, equating to a market capitalisation of R240.5 billion.

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. 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 (Scopas). 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

SOURCES
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.
24 NOVEMBER

GERMAN AUTHORITIES RISE STIEFFENHOFF EUROPE GROUP

- 13 -

23 AUGUST

MANAGER RAINS INDICTMENTS ON JOOSTE

- 13 -

19 - 21 SEPTEMBER

JOINT MEETING OF LENDERS AND COMPANIES TO DISCUSS INDEPENDENCE PROBE

- 13 -

15 DECEMBER

CONFIRMATION OF DEPARTURE WITH PACTS REACHED

- 13 -

19 DECEMBER

STEINHOFF DOES CLAIMS MADE

- 13 -

26 NOVEMBER

Wiese attempts to stabilise the company (rumoured to owe creditors) 5

Steinhoff announces that these authorities found no evidence of any possible “accounting irregularities.”

12 DECEMBER

LEGAL RELEASE IN ALL RELEVANT STATEMENTS

Steinhoff announces a delay in the release of audited results due to the company’s priorities to finalise a restructuring plan and the 2017 audit.

15 DECEMBER

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19 DECEMBER

COURT ANNOUNCES ALLEGED OFFENCES AGAINST MARKUS JOOSTE

A lawsuit is filed by TILI in Frankfurt, representing investors.

20 DECEMBER

AGM OF SHAREHOLDERS OF STEINHOFF INTERNATIONAL

Steinhoff appoints German lawyer Steffen Korner to assist.

21 DECEMBER

LAST CALL ON 2018

Shares continue to trade on US$4.50.

31 DECEMBER

STEINHOFF SCRAPS EXTRA PAY FOR DIRECTORS/RETAINS CRO APPOINTED


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31 DECEMBER

STEINHOFF SCRAPS EXTRA PAY FOR DIRECTORS/RETAINS CRO APPOINTED

“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 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 clearer as the investigations into alleged accounting irregularities start to yield results. Yet it does point to 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:

“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 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:

“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 have been ineffectual over the years. For example, in the 2011 integrated report the following comment is made: “Steinhoff has not established a formal process for obtaining assurance on ethical awareness and ethical compliance throughout the group” (Corporate Governance Report, 2011:4). In the same report the chairman states that Steinhoff “keeps its performance and core governance principles under constant review” (Corporate Governance Report 2011:3). One would therefore expect to see some progress in this regard in the 2012 report. However, in the 2012 Integrated Report (p. 89) the following is simply restated: “Steinhoff has not established a formal process for obtaining assurance on ethical awareness and ethical compliance throughout the group” — this despite another expressed commitment to ongoing compliance and a preamble that states that the report presents “progress being made towards compliance”.

Closer inspection has revealed that Steinhoff used the same comment relating to Principle 1.3 in all its company reports between 2011 and 2016. This raises questions about how serious the board was in trying to ensure that the company’s ethical character remained unsullied. From the data it would seem that there was a laissez-faire attitude towards the matter, with a no-change, cut-and-paste approach being routinely applied.

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 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:1

“...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.”

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Table 1: Periods of tenure of non-executive directors, 2002 to 2015

<table>
<thead>
<tr>
<th>Year</th>
<th>Ackerman</th>
<th>Daun</th>
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<th>Mouton</th>
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Table 1 below illustrates the periods of tenure of non-executive directors in the period 2002 to 2015.

King II states (2.18.4) “Every board should consider whether its size, diversity and demographics make it effective.” The King Report (paragraph 71) adds: “Diversity applies to academic qualifications, technical expertise, relevant industry knowledge, experience, nationality, age, race and gender.” Figure 3 above indicates that the Steinhoff board was dominated by white males in the period 1999 to 2015. Many of the board members served on the board for extensive periods of time and the possibility of a group-think culture having taken root cannot be ruled out. Group-think is a phenomenon that emerges when people – owing to their intimate knowledge of one another – lose their willingness to examine critically the decisions taken individually and collectively.
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 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 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 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 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):

“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 alter 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 Sloe 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 standardised 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.
5 WAS THE BOARD SIMPLY HOODWINKED BY A CORRUPT CEO?

“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 PricewaterhouseCoopers 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 of the proceeds of the sale of the Genesis Group to the Steinhoff staff. Unravelling 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 is a strong dose of integrity.

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 now caused 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 Danie [van der Merwe – CEO], Ben [La Grange – COO], Stephan [Grobler – Executive Group Treasury and Financing] and Mariza [Neil – 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. Unravelling 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 is a strong dose of integrity.

6 CAN THE COMPANY’S OPERATIONAL INTEGRITY AND REPUTATION BE SALVAGED?

On 20 April 2018 Steinhoff International Holdings N.V. held a general meeting of shareholders at the Sheraton Amsterdam Airport Hotel in the Schiphol Municipality of Haarlemmermeer, the Netherlands. At this meeting the Supervisory Board of Steinhoff was renewed with the appointment of five new board members – Mr Hugo Khanyisile Kweyama, Ms Mima Mibasa, Dr Dieter Nolin, Mr Peter Wakke and Prof Alexandra Winton – while Dr Stefanos Booyzen, Ms Angela Krüger-Steinhoff and Ms Heather Sorn were retained on the board. Dr Johan van Zyl resigned from the board, indicating “I have thus completed my assignment on the board and fulfilled my commitment to major shareholders of the company.”

At the same meeting the Management Board was renewed with the appointment of Mr Philip Dieperink (Chief Financial Officer), Mr Theodore de Klerk (Operational Director), Mr Alexandre Nodale (Deputy Chief Executive Officer) and Mr Louis du Preez (Commercial Director). Deloitte Accountants B.V was also retained as the company’s external auditor for the 2018 financial year.

Acting Chairperson of Steinhoff Supervisory Board, Heather Sorn, acknowledged at the AGM that “accounting irregularities” did occur and it was a “necessary evil for the purpose to company for finalise and introduce a restructuring plan as well as the 2017 audit.”

“We want to uncover the truth, show the world what has happened, prosecute any wrongdoing and reinstate the company,” Sorn said. It was confirmed that the PricewaterhouseCoopers (PwC) forensic probe into Steinhoff had uncovered a pattern of transactions stretching back over a number of years that had led to the material overstatement of the group’s income and asset values.

Evidently it has taken a crisis for Steinhoff to renew its 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?

The reality is that the crisis at Steinhoff is more than an overstatement of income and asset values which has triggered a liquidity and credit crunch. It is about the collapse in investor confidence. Bringing Steinhoff back from the brink is a possibility, but even the most skilfully executed financial engineering and restructuring plans will not be enough.

LIST OF SOURCES

4 There are many other questions surrounding the complex structure of the company and the various dealings 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.
10 Notice of Annual General Meeting of Shareholders of Steinhoff International Holdings N.V. 8 May 2018.
In this section, we address two intriguing leadership questions as they relate to the Steinhoff case:

1. What are the conditions under which charismatic leadership flourishes and why is this type of leadership sometimes ambiguous?

2. 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 unshakeable self-confidence, while his...
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.

Thirdly, Jooste had loyal followers. The desire and ability to follow are among the manifestations of an ‘charismatic man’.

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 (Vil@cage & Du 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, 2008:83).

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 access and control the economy is just that: a myth, beyond – which put its trust in him and afforded him a ‘legion of disciples’; there was a large group of people who “worshipped him unquestioningly” (Retailers News, 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’ (Tate, 2017) have been a sign of unhealthy, slightly unhinged arrogance?

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 pervasive pride in one’s ability to feed the hungry beast of power, status and a lavish lifestyle (Long, 2008).

B. Pride and Arrogance

This pervasive 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, notwithstanding new and increasingly challenging circumstances (Skue, 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’ (Tate, 2017) have been a sign of unhealthy, slightly unhinged arrogance?

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 entrenched.

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.

### 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" (Thompson, 2017).

Through rationalisation, offenders deny the consequences of their wrongdoings or play down the extent of the damage caused. While Jooste was engaging in "accounting irregularities" (Thompson, 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 & Crotty, 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 cooing 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.

Entitlement, like power and status, is a hungry need, which makes it hard to resist the temptation to engage in various forms of corruption.

Examples of unethical business conduct:

- The absence of identifiable victims further fuels the no-injury argument.
- 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.
- 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.

Entitlement, like power and status, is a hungry need, which makes it hard to resist the temptation to engage in various forms of corruption.
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 controversial way in which the company managed its tax affairs. The line between tax avoidance (technically legal but often ethically questionable) and tax evasion (illegal) is seductively thin.

The company underwent 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 cost of business (Kudin & Ver, 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 temperament. 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.

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**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.1 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.

SECTION FOUR

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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 accountable 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.

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 birming 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 rarefied 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 stirrings 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.