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The regulation of executive remuneration (including incentive-linked performance measures) in light of the socioeconomic concerns prevalent in South Africa

Mark Jolliffe

PhD Thesis

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Abstract

This thesis deals with the effectiveness of the regulatory framework pertaining to the remuneration paid or awarded to executive directors and other senior managers (collectively referred to as the 'executive management' team) of companies in South Africa in light of the socioeconomic concerns prevalent in this country. Consideration is also given to the expected effectiveness of the recently enacted amendments to the Companies Act 71 of 2011 which seek to address the level of executive remuneration by enhancing disclosure and providing the shareholders with more opportunity to voice their dissent. It is argued that the inclusion of the remuneration disparity provisions addressing inequality in these amendments may represent a welcome change to the original approach of the Department of Trade, Industry and Competition ('DTIC') to the role of company law in addressing socioeconomic concerns as stated by them in developing the Act. Their original approach advocated methods outside the Act to address socioeconomic concerns in South Africa; these amendments are conceivably a move towards addressing these concerns now also through the Act. In this vein, additional reforms to the Act that address incentive-linked performance measures relating to executive remuneration (being a key area that was not addressed in these amendments) are explored. The focus of this thesis is predominantly on this aspect as it is felt that additional reforms in this area can also contribute significantly to the protection and especially the advancement of stakeholder interests in addressing the socioeconomic concerns in South Africa. The various theories that attempt to explain or legitimise the level and structure (including incentive-linked performance measures) of executive remuneration are briefly discussed before the issues that these levels, structures and measures can create for the stakeholders of the company and the effectiveness of the current regulatory framework pertaining to executive remuneration in South Africa in addressing these issues are analysed. The development of the current approach to stakeholder interests in South African corporate law and the efficacy of the methods suggested by the DTIC in addressing the prevailing socioeconomic concerns are then explored before a new stakeholder approach is proposed as the basis upon which financial and social (or non-financial) performance measures relating to executive remuneration should be incorporated into the Act by way of these additional reforms. The provisions of the corporate governance codes and legislation of several countries with similar executive remuneration practices are then investigated to establish the corporate governance measures contained in these provisions that could be incorporated into the Act to complement this approach. It is submitted that these additional reforms would serve to improve the protection and especially the advancement of the company's stakeholders and thereby contribute substantially to addressing the socioeconomic concerns prevalent in South Africa.

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Chapter 1

Introduction

The remuneration paid to executive directors and other senior executives of listed companies (collectively referred to as 'executive management') in South Africa often makes the headlines for being deemed excessive.[1] Indeed, in a country where more than half of the population is considered to be poor and which is considered to be the most unequal in the World, such exorbitant remuneration is certainly contemptuous towards the majority of the South African society.[2]

While there has been some improvement in the fulfilment of socioeconomic rights since the advent of democracy in 1994, these rights remain unrealised for almost half the population of South Africa.[3] Studies also indicate that the percentage of the population considered poor, whether using the World Bank's poverty lines or South Africa's national poverty lines, has increased since 2011.[4] The South African Multidimensional Poverty Index (SAMPI), which incorporates four dimensions of poverty being health, education, standards of living and economic activity, with the objective of providing an integrated view of poverty, shows a similar trend since 2011.[5]

Similarly, while legal and political equality in South Africa has largely been achieved since 1994, economic inequality remains a challenge with studies indicating that South Africa remains the most unequal society in the World from an income or consumption expenditure point of view.[6] In particular, wage inequality in South Africa is considerable and is compounded by severe polarisation between the highest and lowest groups of wage earners. The top wage earners enjoy wages that are similar to those living in developed economies while at the other end, the lowest wage earners are earning wages that are comparable to those in the poorest countries.[7] South Africa is also the most unequal nation in the world from a household wealth perspective with richer households being more than ten times wealthier than

[1] See for example Moneyweb 'Capitec under fire – again - for its executive pay' *Moneyweb* 31 May 2022 available at https://www. moneyweb. co.za/news/companies-and-deals/capitec-under-fire-again-for-its-executive-pay on 24 July 2022 last accessed on 5 February 2023.

[2] World Bank Group 'Overcoming poverty and inequality in South Africa: An assessment of drivers, constraints and opportunities' (2018) at 6 and 42 available at https://documents.worldbank.org/en/publication/documents-reports last accessed on 24 September 2023.

[3] Ibid at 6.

[4] Ibid at 10-11.

[5] Ibid at 29.

[6] Ibid at 42.

[7] Ibid at 49.

poor households.[8] Recent studies also show that South Africa ranks the highest amongst upper middle income and Sub-Saharan African countries with respect to inequality of opportunities such as access to education, health services and sanitation.[9]

Against this backdrop, it is no surprise that the recently enacted amendments to the South African Companies Act 71 of 2008 ('SA Companies Act'),[10] seek to address the levels of executive remuneration by introducing disclosures of the differential between the highest and lowest paid employees in public and state-owned companies, and providing the shareholders with more opportunity to voice their dissent with respect to inappropriate remuneration packages. Yet the clamour with regard to these levels appears to distract from an equally, and even more, critical issue pertaining to executive remuneration. While reining in these levels may be important in view of the impact that these levels can have on stakeholders both within and outside the company, the consideration of how appropriately their remuneration packages are structured and the nature of their incentive-linked performance measures is also critical to this discourse in light of the impact that the performance of the company can have on these stakeholders. In particular, the manner in which this performance is achieved can be critical to the company's stakeholders and ultimately the long-term sustainability of the company. Unfortunately, however, these latter aspects of executive remuneration are not addressed by these amendments.

Society in general has a significant interest in companies being operated effectively by their executive management teams in order to drive their optimal performance, and thereby, being able to sustain and ultimately grow themselves which in turn contributes to the overall growth of the economy. They are typically significant providers of employment and are large contributors to the tax revenues of the state. Effectively, well-run companies assist the state to discharge its duty to advance various socioeconomic rights such as the access to adequate food, water (and sanitation), housing, healthcare and social grants, by reducing the dependence of society on the state's social spend through employment opportunities and by making more funds available for the state to fulfil these rights. It is imperative, therefore, that companies are managed to achieve their optimal performance while ensuring that this performance is sustainable in the long-term. This may only be achieved where the incentive-linked performance measures pertaining to the executive's remuneration package consider all aspects of the company's financial performance while also ensuring that the interests of the company's stakeholders are adequately considered in driving this performance.

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[8] Ibid at 51-52.

[9] Ibid at 46.

[10] Section 6 of the Companies Amendment Act 16 of 2024 (GN 5082 *GG* 50991 of 30 July 2024). The Act was assented to by the President on 25 July 2024, yet it is not in operation with no date fixed in this regard.

While the recommendations of the King IV Report on Corporate Governance for South Africa ('King IV') incorporate a stakeholder-inclusive approach to the executive management of companies, these recommendations are only mandatory for companies listed on the Johannesburg Stock Exchange through their Listings Requirements which incorporate the application and disclosure regime of King IV.[11] These recommendations remain voluntary for unlisted companies including large private companies that may have a significant public interest from an economic and social perspective. In light of the decline in companies listed on the JSE over the last two decades from around 470 listings in 2003 to 287 currently with some one hundred delistings having occurred in the past five years,[12] it would appear that there is an increasing number of companies that have a significant public interest or stakeholder footprint that are only subject to voluntary measures with regard to the governance of their executive remuneration. The recommendations set out in King IV relating to social and environmental performance measures have also proven to be difficult to apply in practice which may have led to performance measures being weighted more towards financial measures such that the interests of stakeholders may not be adequately protected or especially advanced.[13]

Although incentive-linked performance measures are not dealt with by the enacted amendments to the SA Companies Act, the inclusion of the remuneration disparity provisions addressing inequality may represent a welcome change to the original approach of the Department of Trade, Industry and Competition ('DTIC') to the role of company law in addressing socioeconomic concerns as stated by the DTIC in developing the current Act. Their original approach advocated methods outside the SA Companies Act to address socioeconomic concerns in South Africa;[14] these amendments are conceivably a move towards addressing these concerns now also through the Act. In this vein, the effectiveness of the current regulatory framework relating to executive remuneration (and incentive-linked performance measures in particular) in protecting and especially advancing stakeholder interests is explored with a view to considering additional reforms to the SA Companies Act that are required to address the socioeconomic concerns prevalent in South Africa.

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[11] Section 8.63(a)(i) of the JSE Listings Requirements.

[12] Gouws, J. 'What the shrinking JSE means for Retirement Funds' November 2023 available at https://www.fanews.co.za/article/retirement/1357/general/1358/what-the-shrinking-jse-means-for-retirement-funds last accessed on 11 December 2023.

[13] Van Zyl, M. and Mans-Kemp, N. 'A multi-stakeholder view on director remuneration guidance in South Africa' (2021) *South African Journal of Accounting Research* 1 at 13. MTN Group Ltd Integrated Report for the year ended 31 December 2023 at 116-119 available at https://www.mtn.com/ wp-content/uploads/2024/04/MTN-Group-FY-23-Integrated-Annual-Report-1.pdf last accessed on 18 June 2024.

[14] South African Company Law for the 21st Century: Guidelines for Corporate Law Reform' (GN 1183 in GG 26493 of 23 June 2004) at 27.

In addressing this objective, answers are sought for the following questions:

- who are the members of the executive management team of the company and what are the components of their typical remuneration package including the role each component has in attracting, motivating and retaining these executives?
- what are the theories that attempt to explain how the levels and structures of executive remuneration packages are determined or legitimised, and how do they apply in the South African context?
- what are the issues pertaining to the level and structure (including incentive-linked performance measures) of executive remuneration that can give rise to socioeconomic concerns that need to be addressed by an effective regulatory framework?
- what is the current regulatory framework (and the enacted amendments to the SA Companies Act) in South Africa pertaining to executive remuneration and how effective is this framework in addressing the above issues relating to executive remuneration?
- what was the background to the development of the DTIC's approach to the role of company law in addressing socioeconomic concerns when the current SA Companies Act was drafted, and what was the approach they arrived at and the developments that have occurred over the last two decades since this approach was formed that impact this approach;
- how effective have the methods, suggested by the DTIC under their original approach to addressing socioeconomic concerns, been in addressing these concerns?
- is there a need to consider a new approach as a basis for regulating the performance measures associated with executive remuneration to address socioeconomic concerns and what would such an approach entail?
- how is executive remuneration regulated in comparative jurisdictions and what are the main elements of these frameworks that may be relevant to the corporate governance of executive remuneration?
- what is the continued relevance of King IV with respect to executive remuneration once the enacted amendments to the SA Companies Act are implemented and how should the code relating to executive remuneration otherwise be reformed with reference to the comparative jurisdictions selected?
- how should a new stakeholder approach to executive remuneration be incorporated by way of further reforms to the SA Companies Act, and what associated corporate governance measures should be introduced to the Act and supporting regulations with reference to the comparative jurisdictions selected, that serve to strengthen the protection and especially the advancement of stakeholders interests?

The research methodology applied for this thesis in answering these questions involved a doctrinal study of primary and secondary sources of information derived from the internet and the library of the University of the Witwatersrand. The primary sources of information for the research included current legislation, the enacted amendments to this legislation, listings requirements and corporate governance codes relating to South Africa and appropriate comparative jurisdictions. Further primary sources involved statistical data supplied by Statistics South Africa and the World Bank, and various financial and investigative reports. The secondary sources of information for the research included various academic works and contemporary pieces including books, academic articles, media and other internet-based articles, as well publications of the Institute of Directors of South Africa (IoDSA) and the auditing firms PriceWaterhouseCoopers and Deloitte. Various types of research were applied for this thesis including expository research into the corporate governance codes and legislation (both current and enacted) relating to executive remuneration, as well as reform-orientated research into the appropriateness of these provisions. With regards to the latter, theoretical research was conducted with a view to understanding the conceptual bases for the levels and structure of executive remuneration, and the possibility of exploring a new stakeholder approach upon which these reforms could be based. Comparative research of other legal jurisdictions involving the European Union, the United Kingdom, Germany, the United States, Canada and Australia, where applicable, was also conducted in order to understand the corporate governance measures including disclosures that are applied in these jurisdictions. These measures were then evaluated with a view to their adoption in complementing the stakeholder approach explored above with respect to the reforms that were considered necessary to the regulation of executive remuneration.

This thesis is set out in three main chapters. Chapter 2 mainly deals with the effectiveness of the current regulatory framework in addressing the issues associated with the level and structure (including incentive-linked performance measures) of executive remuneration that can give rise to socioeconomic concerns. Chapter 3 then considers the effectiveness of the methods stated by the DTIC in developing their original approach to the role of the SA Companies Act in addressing these socioeconomic concerns and the consideration of a new stakeholder approach upon which further reforms to the Act that address these concerns could be based. Chapter 4 lastly considers how this new approach could be incorporated into the current regulatory framework as complemented by corporate governance measures garnered from the corporate governance codes and legislation of comparative jurisdictions.

In particular, chapter 2 considers which employees of the company comprise the executive management team and what the components of the typical executive remuneration package consist of in serving to attract, motivate and retain these executives. Consideration is then given to the some of the

more well-known theories that attempt to explain how the level and structure of executive remuneration packages are determined or legitimised, before discussing the main issues relating to these levels and structures (including incentive-linked performance measures) that can give rise to socioeconomic concerns and as such need to be addressed by an effective regulatory framework. The current regulatory framework including the enacted amendments in South Africa pertaining to executive remuneration is then analysed with a view to establishing how effective this framework is in addressing these issues.

Chapter 3 considers the background to the development of the DTIC's original approach to the role of company law in addressing the socioeconomic concerns in South Africa during the drafting of the current SA Companies Act, including the recognised approaches to stakeholder interests, the experience of the United Kingdom and the influence of the Constitution of the Republic of South Africa 1996, and the developments in these areas that have occurred in the last two decades since this process was undertaken. The effectiveness of the methods suggested by the DTIC under their original approach, including both legislative and facilitative means, in advancing stakeholder interests and thereby addressing these socioeconomic concerns is then explored. Consideration is then given to a new approach to advancing stakeholder interests and addressing these concerns as a basis for regulating the incentive-linked performance measures associated with executive remuneration.

Chapter 4 considers how this new approach to the advancement of stakeholder interests, as complemented by certain corporate governance measures that serve to protect stakeholders, could be incorporated by way of reforms into a revised corporate governance code and the SA Companies Act (including the supporting regulations to the Act). To this end, the principles and corporate governance measures contained in the corporate governance codes and legislation of comparative jurisdictions are considered in addition to those contained in King IV and the recently enacted amendments to the SA Companies Act. In light of the enacted amendments to the SA Companies Act having adopted certain recommendations of King IV, the continued relevance of King IV with respect to executive remuneration is discussed before the principles that inform the setting, approval and disclosure of executive remuneration are considered. Consideration is then given to how this new approach to stakeholder interests, as complemented by certain corporate governance measures adopted from comparative jurisdictions, should be adopted by way of further reform measures to the SA Companies Act and supporting regulations that contribute substantially to addressing the socioeconomic concerns prevalent in South Africa.

Chapter 2

Theories, issues and regulation of executive remuneration

2.1 Background

Companies in South Africa are typically governed by either a board of directors or in larger companies, both by a board of directors and an executive management team (the 'executive') consisting of executive directors and certain senior managers of the company. In order to attract suitably talented individuals to the executive, and to motivate and retain these individuals as members of the executive, their remuneration needs to be set at a competitive level and should be structured in such a way that a sufficient portion of the remuneration is contingent upon achieving certain performance targets. Yet, there are concerns that executive remuneration in South Africa is unacceptably high in proportion to other employees in the company and that the company is driven for the benefit of the shareholders with adverse impacts on other stakeholders, such that these levels and structures exacerbate the poverty and inequality in South Africa.

In this chapter, the components of the typical executive remuneration package and some of the more well-known theories as to how the levels of their remuneration and the structure (including incentive-linked performance measures) thereof are determined or legitimised in order to achieve these objectives are first discussed. In addition, the other factors that play a role in tempering the levels and structures of their remuneration such as the personal attributes of the executive, the organisational context of their company and the institutional context within which the company operates are discussed. The application in South Africa of these theories and other factors, especially its institutional context, that influence the levels and structures of executive remuneration are then explored with a view to understanding the current environment relating to executive remuneration in South Africa.

Consideration is then given to the adverse issues that arise for companies and consequently, the interests of their stakeholders including the socioeconomic concerns of indigent communities, from inappropriate levels and structures of executive remuneration despite their determination or legitimisation in terms of the various theories relating to executive remuneration. Attention is also given to how these issues may be exacerbated where the executive remuneration package and/or the nature of performance measures relating to incentive-linked performance measures are poorly designed or do not properly consider the interests of stakeholders other than its shareholders, or

where there are ineffective corporate governance measures to properly protect and advance these stakeholder interests.

Consideration is lastly given to the effectiveness of the current regulation in South Africa in addressing the issues associated with inappropriately high levels of executive remuneration and poorly designed remuneration structures (and incentive-linked performance measures). To this end, the provisions of the Companies Act 71 of 2008 ('SA Companies Act'), the recommended practices of the King IV Report on Corporate Governance for South Africa ('King IV'), as incorporated in the Johannesburg Stock Exchange Listings Requirements ('JSE Listings Requirements'), and certain disclosures under the Employment Equity Act 55 of 1998 ('Employment Equity Act') are set out before their effectiveness in addressing these issues is discussed. The possible effectiveness of the recently enacted amendments to the SA Companies Act (Companies Amendment Act 16 of 2024[15] or the 'SA Companies Amendment Act'), which incorporate certain parts of King IV and the Employment Equity Act, in addressing these concerns in the future are also discussed.

2.2 Executive management, and the components and theoretical determination of executive remuneration

2.2.1 Executive management

King IV sets out the roles and responsibilities of the governing bodies of organisations including companies, retirement funds, non-profit organisations, state-owned entities and municipalities. It defines the board of directors as the governing body of the company that has 'primary accountability for the governance and performance of the organisation'.[16] The board is responsible for the management of the 'business and affairs' of the company and has the 'authority to exercise all of the powers and perform any of the functions of the company' as provided for by the SA Companies Act or the company's Memorandum of Incorporation.[17] A 'director' is defined in the SA Companies Act as being 'a member of the board of a company, as contemplated in Section 66 of the Act, or an alternate director of a company and includes any person occupying the position of a director or alternate director, by whatever name designated'.[18]

[15] GN 5082 *GG* 50991 of 30 July 2024.

[16] Glossary of Terms ('Governing body') of King IV (at 12).

[17] Section 66(1) of the SA Companies Act.

[18] Section 1 of the SA Companies Act.

King IV makes a further distinction between executive and non-executive directors (including independent non-executive directors).[19] Executive directors and non-executive directors are not defined in King IV. However, its predecessor, the King Report on Governance for South Africa 2009 ('King III'), defines executive directors as being involved in the day-to-day management of the company or being in the full-time salaried employment of the company or both.[20] Non-executive directors, on the other hand, would therefore be neither involved in the day-to-day management of the company nor in the full-time salaried employment of the company, while an independent non-executive director would be a non-executive director that has no interest, position, association or relationship with the company concerned beyond his or her directorship.[21]

Beneath the board of directors, is what King IV terms the 'executive management' of the company which is defined as being the 'highest decision-making authority in the organisation' after the board of directors.[22] The term includes executive directors (whether officially appointed as directors in terms of the SA Companies Act or meet the requirements of the Act to be *de facto* directors), and prescribed officers of the company (other than the executive directors) as defined in the Companies Regulations 2011 ('SA Companies Regulations'),[23] which together typically form the executive management team or committee of the company.[24] The focus of this thesis is on this group of employees.

Although prescribed officers are not formally appointed as such in terms of the SA Companies Act, their appointment to the executive management team would more than likely result in them being designated as prescribed officers of the company due to their functions falling within the scope of the definition. An important consequence of accepting such an appointment is that many of the onerous provisions in the SA Companies Act pertaining to directors apply in the same

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[19] See for example Part 5.2 par 7(b) of King IV (at 50).

[20] Annex 2.2 of King III (at 53).

[21] Annex 2.3 of King III (at 53) and Chapter 2 par 67 (at 38).

[22] Glossary of Terms ('Management') of King IV (at 14).

[23] Per Regulation 38 of the SA Companies Regulations:

. (1) Despite not being a director of a particular company, a person is a "prescribed officer" of the company for all purposes of the Act if that person- (a) exercises general executive control over and management of the whole, or a significant portion, of the business and activities of the company; or (b) regularly participates to a material degree in the exercise of general executive control over and management of the whole, or a significant portion, of the business and activities of the company.

(2) This regulation applies to a person contemplated in sub-regulation (1) irrespective of any particular title given by the company to- (a) an office held by the person in the company; or (b) a function performed by the person for the company.

[24] Glossary of Terms ('Management') of King IV (at 14).

way to prescribed officers such that there is no difference in their legal position in this regard.[25] These include the provisions setting out the fiduciary duties of directors and the liability for the breach thereof, as well as the disclosure of the remuneration paid to directors.[26]

2.2.2 Components of executive remuneration and their purpose

The remuneration paid to members of the executive management team usually consists of fixed and variable components.[27] The fixed components typically consist of the basic salary, health and retirement benefits, and various perquisites or 'perks' such as company cars and club memberships.[28] These form part of the guaranteed package and are paid or provided to them irrespective of the performance of the company or the individual concerned.[29] The variable components typically consist of short-term and long-term incentives that are subject to various performance criteria of the company or the individual concerned being met, although the performance criteria are usually linked to the performance of the company.[30] Short-term incentives typically consist of cash payments which are paid shortly after the end of the company's financial year to which the related performance pertained,[31] while long-term incentives typically consist of share-based awards which may vest after a period of several years (usually between three and five years) and are usually subject to certain performance conditions being met during the vesting period.[32]

Share-based awards include share options, share appreciation rights, restricted shares, performance shares and share plans. Share options are awarded with a set exercise price with the executive choosing to exercise the option where the exercise price is lower than the market price of the share concerned at the exercise date (i.e. when the plan is 'in the money') and may be settled in the company's shares (with the executive paying the exercise price) or in cash (being the difference between the market price and the exercise price). Share appreciation rights are incentives

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[25] Cassim, F.H.I., Cassim, M.F., Cassim, R., Jooste, R., Shev, J. and Yeats, J. *Contemporary Company Law* 2 ed (2012) 415.

[26] Sections 30(4)-(6) and 76 of the SA Companies Act.

[27] Bussin, M. 'CEO pay-performance sensitivity in the South African context' (2015) 18.2 *South African Journal of Economic and Management Sciences* 232 at 234.

[28] Ibid at 234-235.

[29] Massie, K., Collier D. and Crotty A. *Executive Salaries in South Africa: Who Should Get a Say on Pay?* (2014) 2.

[30] Ibid at 3.

[31] Bussin, M ibid at 235.

[32] Ditto, G. 'A Comprehensive Guide to Long-term Incentive Plans' March 2024 available at https://hrsoft.com/a-comprehensive-guide-to-long-term-incentive-plans last accessed on 15 June 2024.

that are based on a formula linked to the appreciation in the share price (and as such do not involve the issuing of the company's shares) and vest after the set vesting period has elapsed. Restricted shares involve the award of shares to executives with the ownership of the shares vesting after the vesting period has elapsed. Performance shares are similar to restricted shares, yet their vesting is also subject to certain performance conditions being met during the vesting period. Share plans usually involve the deferral and replacement of part of the executive's annual cash incentive as shares and the award of a matching number of shares by the company at no cost to the executive after the vesting period has elapsed.[33]

In addition to these components, the employment contracts of executive management may provide for various types of other remuneration including front-end (or sign-on) bonuses, retention payments, and termination payments. Front-end or sign-on bonuses (or 'golden hello's') are typically awarded to an executive who has been identified by the board of directors as having special skills that are critical for the firm's success and to induce the executive to move from another company.[34] They may also be used to buy-out, even partially, any forfeited or deferred remuneration that the executive was entitled to at the other company or remuneration that has been forfeited as a consequence of the move to the new company.[35] Retention payments, commonly known as 'golden handcuffs', is a benefit, payment or incentive which is provided to induce the recipients' to remain with the company. Termination payments, commonly known as 'golden handshakes', are payments made to the directors and senior executives of companies upon termination of their service contracts or retirement from office.[36]

The various components of the executive remuneration package are intended to attract, motivate and retain high calibre individuals with these components having different impacts on

[33] Mavrodinov, N. S. 'The changing landscape of long-term share-based compensation in South Africa: an investigation into recent developments in employee incentive used by companies listed on the Johannesburg Stock Exchange' (2012) unpublished Master's thesis, University of Cape Town at 21-25. Mavrodinov distinguishes between 'appreciation schemes' consisting of share options and share appreciation rights, and 'full quantum schemes' consisting of restricted and performance shares, and share plans. The latter is preferable as it involves the executive being subject to exposure in both the appreciation and depreciation of the company's share price thereby placing the executive in a similar position to that of the shareholder (i.e. these schemes ensures that the executive has 'skin in the game').

[34] Xu, J. and Yang, J. 'Golden hellos: Signing bonuses for new top executives' (2016) 122.1 *Journal of Financial Economics* 175 at 175.

[35] Ellig, Bruce R. 'Attracting, motivating and retaining executives: lessons from years as an HR executive.' (2013) 45.2 *Compensation & Benefits Review* 75 at 76.

[36] Madlela, V. 'Legislative Controls on Director and Executive Termination Payments in the UK and Australia – Lessons for South Africa' (2016) 37(3) *Obiter* 617 at 617.

achieving these objectives.[37] Ellig indicates that the basic salary is considered to be very important in attracting and retaining executives yet does not have much value in motivating them as salary increases are usually modest.[38] Xu and Yang indicate that sign-on bonuses play a role in attracting and motivating the executive in that the bonus signifies the board's confidence in the hiring and its commitment to help the executive succeed.[39] Ellig also indicates that employee benefits and perquisites have some worth in retaining executives but are not very effective in attracting or motivating executives. Short-term incentives are very effective in both attracting and motivating executives, especially if the award is contingent on individual rather than group performance, yet only has a moderate retention effect. Long-term incentives, on the other hand, are very effective in retaining executives, especially where the vesting period is longer, yet only has a moderate effect on attracting and motivating executives.[40]

2.2.3 Theoretical determinants of the level and structure of executive remuneration

Consistent with the functions of the various components of executive remuneration to attract suitably talented individuals to the executive, and to motivate and retain these individuals as members of the executive, their remuneration needs to be set at a competitive level and should be structured in such a way that a sufficient portion of the remuneration is contingent upon achieving certain performance targets. The structure of executive remuneration relates to the composition of the executive package consisting of both fixed and variable remuneration components, and also involves a consideration of the nature of performance measures set for the award of the variable remuneration components. As Otten indicates, theories explaining or legitimising the level of executive remuneration deal with *how much* to pay executives, while theories explaining or legitimising the structure of executive remuneration deal with *how* to pay them.[41]

a) Theoretical determination (or legitimisation) of the level of executive remuneration

Ellig states that studies have shown that the level of the basic salary and short-term incentive components have the highest impact on attracting executive management talent while the level of the long-term incentives (as well as the basic salary) have the highest impact on retaining

[37] Part 5.4 par 28 of King IV (at 65).

[38] Ellig, Bruce R. op cit note 35 at 75.

[39] Xu, J. and Yang, J. op cit note 34 at 176.

[40] Ellig, Bruce R. ibid at 75.

[41] Otten, J.A. 'Theories on executive pay. A literature overview and critical assessment' (2008) *Munich Personal RePEc Archive (MPRA*) 1 at 6.

individuals.[42] He also indicates that the level of short-term incentives has the highest impact on motivating executive management.[43] As to determining what the appropriate level of the remuneration components should be in order to achieve these objectives and thereby attempting to legitimise these levels, Otten states that theories dealing with the level of remuneration or how much to pay executives are either based on the market value of the executive's services as determined by the economic laws of supply and demand, and/or on the symbolic value of what executives should be paid.[44]

i. Market value

The theories that are based on market influences include the marginal productivity theory and the superstar theory.

The *marginal productivity theory* is considered to be the most fundamental theory under the value approach and suggests that the services that the executives provide to the company should be treated in a similar manner to other employees as with any other input into the production process.[45] The value of an employee's input into the production process of a company is, as with other production inputs, equal to the marginal revenue product derived from that input.[46] In other words, the cost of employing the person concerned would be equal to the additional revenue that the employment of the person would generate. Roberts indicates, however, that there is some difficulty in treating the executive as an employee when determining the theoretical amount of his or her remuneration due to the level of innovation that the executive is expected to bring to the production process.[47] Therefore, he indicates that the employed executive's marginal revenue product is rather 'the excess of the firm's total profit under his direction over what it would be under the direction of the best alternative executive plus the amount which would have to be paid in order to secure the latter's services' assuming that the demand for executives and the supply of executives in the executive labour market is perfect.[48]

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[42] Ellig, Bruce R. op cit note 35 at 76.

[43] Ibid.

[44] Otten, J.A. op cit note 41 at 8.

[45] Otten, J.A. ibid. Roberts, D. R. 'A general theory of executive compensation based on statistically tested propositions' (1956) 70.2 *The Quarterly Journal of Economics* 270 at 288-289.

[46] Roberts, D.R. ibid at 289.

[47] Ibid at 289-290. The alternative executive's remuneration would be equal to his full marginal revenue product, while the remuneration of the employed executive, calculated in this manner, would therefore be higher.

[48] Ibid at 290-291.

The *superstar theory* suggests that the disproportionately higher remuneration packages paid to executives are due to imperfect substitution in the labour market for talented individuals.[49] Rosen argues that less talent is often a poor substitute for great talent and that small differences in talent can become magnified in larger differences in earnings. He uses the example of people being more willing to pay for a good quality artist than several mediocre artists. Similarly, where a surgeon is considered to be ten percent more successful in saving lives than his peers, most people would be willing to pay more than ten percent for the surgeon's services.[50] The remuneration packages of executives may be further skewed where, as a consequence of being able to command higher levels of remuneration (by virtue of their superior talent), they are motivated to increase their productivity and thereby create a multiplicative effect on their level of remuneration.[51]

ii. Symbolic value

Theories that suggest that executive pay should be set at levels that reflect socially constructed beliefs with respect to their status, dignity and expectation include the tournament theory and the figurehead theory.

The *tournament theory* suggests that remuneration levels of the company are similar to the prize money in a sports tournament where the first prize is generally disproportionately higher than the other contestants.[52] Lazear indicates that this first prize in the context of the company is the promotion to the ranks of executive management.[53] Lazear and Rosen indicate that the level of remuneration at the executive ranks relative to that of the senior employees from whom the individual concerned was promoted is not necessarily reflective of the individual's superior skills.[54] It reflects rather the an incentive for other employees to perform appropriately throughout their career with the company thereby increasing their productivity.[55] Although the raise that is associated with a promotion is designed to motivate

[49] Otten, J.A. op cit note 41 at bid at 9.

[50] Rosen, S. 'The Economics of Superstars' (1981) 71.5 *The American Economic Review* 845 at 846.

[51] Ibid at 852. The increase in their remuneration in these circumstances would be related to the variable components of their package.

[52] Lazear, E.P. 'Compensation and incentives in the workplace' (2018) 32.3 *Journal of Economic Perspectives* 195 at 201.

[53] Ibid.

[54] Lazear, E.P. and Rosen, S. 'Rank-order tournaments as optimum labour contracts' (1981) 89.5 *Journal of political Economy* 841 at 847.

[55] Ibid.

junior employees to exert higher levels of effort in order to 'win' the promotion ultimately to the executive ranks, the difference between the remuneration level of the promoted and the unpromoted should be just large enough to induce the efficient level of effort, but not so high as to result in the competition for the promotion being overcompetitive (win at all costs) and hence result in the efforts exerted being counterproductive.[56] Similarly, where the remuneration levels between the promoted and unpromoted are insufficiently high, employees would not be incentivised to compete thereby resulting in their efforts being unproductive.[57]

The *figurehead* theory suggests that executives adopt several roles in communicating and managing relationships within and outside the company. In this regard, Ungson and Steers identify three perspectives of these roles. First, the executive plays the role of the political figurehead in that as the legal authority of the company they act as a symbol of their company or 'boundary-spanners' in dealing with the various stakeholders of the company including shareholders, the government, employee groups and the general public. Secondly, the executive plays the role of a political strategist in that he or she needs to manage political coalitions within the company and with external constituencies which may include bringing the latter within the boundaries of the company (such as facilitating their appointment to the company's board) to 'win' these persons over to the company's position. Thirdly, the executive has to play the role of facilitating succession by managing the relationship with the board with respect to the appointment of new executives and the setting of executive remuneration.[58] Executive remuneration is seen as a reflection of the ability of the executive to manage the complexity of these different roles and as part of the status that the executive has within and outside the company.[59]

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[56] Lazear op cit note 52 at 202. Lazear compares the Wimbledon tennis tournament to the extremes of a gladiator tournament. Wimbledon's prize money is designed optimally between the winner and runner-up to produce the efficient level of effort but not the maximum level of effort that is possible. The contestants in the gladiator tournament would, however, exert maximum effort and risk death in trying to kill the other player to win the tournament!

[57] Connelly, B.L., Tihanyi, L., Crook, T.R. and Gangloff, K.A. 'Tournament theory: Thirty years of contests and competitions' (2014) 40.1 *Journal of management* 16 at 18.

[58] Ungson, G. R. and Steers, R. M. 'Motivation and politics in executive compensation' (1984) 9.2 *Academy of Management Review* 313 at 316-317.

[59] Ibid at 318.

b) Theoretical determination (or legitimisation) of the structure of executive remuneration

The relationship between the shareholders and the executive of a company is considered to be an agency relationship as a consequence of the separation between the ownership (shareholders) and control (executive) of the company.[60] Jensen and Meckling indicate that an agency relationship can be defined 'as a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision-making authority to the agent'.[61] Problems with the agency relationship arise where the executive (as the agent) does not always act in the best interests of the shareholder (the principal). The determination, and thereby the legitimisation, of the structure of executive remuneration or how to pay executives traditionally arises out of this perceived conflict between the interests of the executive and the shareholders. The level of the various remuneration components for this determination is mainly assumed to be based on the market value of the executives' services.[62]

The agency theories can be differentiated into two groups: the first group deals with theories that consider the structure of executive remuneration to be a solution to agency problems and include the complete (or optimal) contract theory and the behavioural agency theory, while the second group considers the structure of executive remuneration to be a consequence of agency problems and includes the managerial power theory and the class hegemony theory.[63]

i. Executive remuneration as a solution to overcoming agency problems

In terms of the *complete (or optimal contract) theory,* Gomez -Mjia and Wiseman indicate that the agency model is premised off the assumptions that executives are risk averse, that they behave according to their self-interest and that these interests differ from those of the shareholder. They indicate that, in the typical relationship between the executive and the shareholder, the shareholder may not be aware that the executive has diverged from acting in their interests as a consequence of shareholder having incomplete information about the

[60] Otten, J.A op cit note 41 at 3.

[61] Jensen, M.C. and Meckling, W.H. 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure.' (1976) 3.4 *Journal of Financial Economics* 305 at 308.

[62] Otten, J.A ibid at 10. Although Otten does not refer to the level also being impacted by the symbolic value to executives, there is no reason not to assume that the levels of incentive-linked remuneration would also be impacted by the socially constructed beliefs as to what these levels should be.

[63] Ibid.

behaviour of the executive. This divergence may be caused by executive avoiding or neglecting their duties, or misrepresenting their abilities to perform their duties.[64]

Jensen and Meckling indicate that in order to address the executive's divergence from acting in their interests, the shareholder may obtain more information about the agent's efforts and behaviour by incurring monitoring costs and providing the executives with incentives that align the interests of the shareholders with that of the executive (thereby transferring the risk of non-alignment between the interests of the shareholder and the executive back to the executive). Monitoring costs are costs that are incurred by the shareholder in measuring, observing and otherwise controlling the behaviour of the executive, and include such costs as auditing, budget restrictions and operating rules. In some cases, the shareholder may even incur bonding costs which consist of costs incurred to ensure that the executive will not take actions that may harm the interests of the shareholders or to compensate them where this occurs, and include costs such as contractual guarantees to have the financial statements audited and contractual limitations on the executive's decision-making powers. Despite the incurrence of these costs, there may still be some divergence between the decisions of the executive and those that would maximise the wealth of shareholders. This reduction in shareholder wealth caused by this divergence is termed the 'residual loss'. Agency costs, therefore, represent the sum of monitoring costs, bonding costs and the residual loss.[65]

Gomez -Mjia and Wiseman conclude by indicating that, as the executive is assumed to be risk adverse and motivated by self-interest, it is expected that he will conform his behaviour to pursuing incentive performance targets that support the shareholders' interests. The central issue in the design of the complete or optimal contract, therefore, involves choosing between the options of incurring more agency costs to obtain information or control the behaviour of the executive, or provide the agent with appropriate incentives that aim to align the interests of the shareholders with the executive. The complete or optimal contract is therefore one that represents a 'trade-off between the cost of measuring agent behaviour

[64] Gomez-Mejia, L. and Wiseman, R.M. 'Reframing executive compensation: An assessment and outlook.' (1997) 3.23 *Journal of Management* 291 at 296. Executives are considered to be risk averse in that they are averse to uncertainty and would prefer a higher portion of their remuneration package to be fixed or certain as opposed to variable or uncertain (and contingent upon meeting certain performance criteria or targets).

[65] Jensen, M.C. and Meckling, W.H. op cit note 61 at 308.

and the cost of transferring risk to the agent, that is, balancing the insurance and incentive properties of compensation design'.[66]

The *behavioural agency model*, introduced by Wiseman and Gomez-Mejia, integrates prospect theory with traditional agency theory and specifically addresses the formulation of risk under the traditional agency theories which they claim is too restrictive and naive.[67] In contrast to the complete contract theory, which is based on risk aversion assumptions, the prospect theory deals with loss aversion assumptions. Prospect theory, introduced by Kahneman and Tversky, deals with individual decision-making under risk where an individual is required to make a decision between several prospects (or options) with monetary outcomes.[68] Loss aversion behaviour involves preferring those options that avoid losses altogether even if more risk is required to avoid that loss.[69]

While traditional agency models assume that executives are risk adverse in that they prefer lower risk options in pursuing wealth maximisation and would therefore prefer their remuneration to be more fixed or certain, the behavioural agency model suggests that executives tend to only be risk averse in certain situations. First, where executives bear risk with respect to their anticipated increase in wealth achieved in gain conditions (in the sense of possibly achieving less of the anticipated increase to that wealth), executives may become more risk averse as opposed to loss conditions where the executive feels he or she has nothing to lose.[70] Secondly, where executives bear more risk to their current or personal wealth (or their current employment), executives may tend to be more risk averse. This current personal wealth consists of their base salary (as well as future adjustments to this base salary) and is tied to his or her standard of living, as opposed to the variable remuneration that is contingent upon meeting certain performance criteria or targets which he or she sees as being uncertain and, therefore, not a reliable source of income. Where the base salary is insulated from the threat of loss, the executive bears less risk and the executive may therefore be more willing

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[66] Gomez-Mejia, L. and Wiseman, R.M. op cit note 64 at 296.

[67] Wiseman, R.M. and Gomez-Mejia, L.R. 'A behavioural agency model of managerial risk taking' (1998) 23.1 *Academy of management Review* 133 at 133.

[68] Kahneman, D. and Tversky, A. 'Prospect theory: An analysis of decision under risk.' (1979) 47.2 E*conometrica* 263 at 274.

[69] Ibid.

[70] Wiseman, R.M. and Gomez-Mejia, L.R. ibid at 136-137. Otten J.A. op cit note 41 at 12 indicates that in these circumstances the executive would be unwilling to take risks once he has met his performance targets as the benefit of increasing his performance is more than offset by the possibility of falling below his or her targets.

to pursue contingent remuneration through riskier strategic actions. Only where part of the base remuneration is restructured or converted to variable remuneration, would the executive's risk-bearing increase and they would be more inclined towards avoiding loss (in other words, they are loss averse) to their current personal wealth as opposed to generating more wealth i.e. wealth maximisation.[71] Finally, targets and performance measures set for variable remuneration can increase or decrease risk-taking by the executive. The degree of risk taking may increase with higher targets due to the increased possibility of a loss condition for the executive, and whether the performance measures are market-based (as opposed to financial information produced by the company) due to market-based measures being more volatile.[72]

ii. Executive remuneration as a consequence of agency problems

In contrast to the optimal contract approach in agency theory where executive compensation is seen as a way of aligning the interests of executives with the interests of the shareholders, the *managerial power* theory is seen as part of the agency problem in itself.[73]

In terms of this approach, Bebchuk, Fried and Walker indicate that executives use their power to garner more value from their remuneration packages than they would otherwise attain under the optimal contract approach. This power is derived from the relationship that executives may have with the board through common interests, collegiality or affinity.[74] The incremental value extracted is termed 'rent'. They also indicate that remuneration consultants can be used to camouflage rent extraction by executives in the way they are used and retained in that they may be used to justify executive remuneration instead of optimising it. Typically, the executive influences the appointment of the consultant such that it is in the interests of the consultant to design a package that is to the executive's liking. Consultants may also be providing other services to the company which the executive has influence over and this may also impair their objectivity. They may also seek to please executives by generating a large volume of remuneration data which serves to justify the level and structures of the package

[71] Ibid at 139-141.

[72] Ibid at 142-143.

[73] Otten, J.A. op cit note 41 at 13.

[74] Bebchuk, L. A., Fried, J. M. and Walker, D. I. 'Managerial Power and Rent Extraction in the Design of Executive Compensation' (2002) 69 *The University of Chicago Law Review* 751 at 784.

design as proposed by the consultants. The comparative data used may in turn lead to the ratcheting of compensation packages each time the data is compared.[75]

Related to the managerial power theory is the *class hegemony* theory. While the managerial power theory deals with the influence that the executive has over the board through their shared interests, collegiality and affinity within the company, Otten indicates that this theory suggests that executives have a commonality of interests with executives of other companies. These bonds typically form relationships which create a class across these different companies and by using their shared power the executives they can extract privilege and wealth of their class.[76]

c) Qualification of the theories

The theories discussed above attempt to provide an understanding of the determination or legitimisation of the level and structure of executive remuneration. The level of executive remuneration is impacted both by market forces as well as social constructs as to what executives should earn. The structure of executive remuneration, on the other hand, is impacted by the problematic relationship between the executive and the shareholders and the need for appropriately aligned incentives while limiting agency costs, as well as being impacted by the influence of assertive executives within the company and from outside the company.

Despite the insights provided by these theories, the underlying assumptions of each theory may be tempered by several factors which must also be considered in the remuneration setting process. These include the personal characteristics of the executive, particular attributes of the company and the specific features of the institutional environment in which the company operates.

i. Personal characteristics of executives

Ellig indicates that research has shown that not all executives are motivated by significant financial incentives and that the degree to which they are motivated is strongly influenced by factors such as their background and current economic status.[77] Pepper also indicates that most executives would prefer remuneration that can be guaranteed and is at a level that is fair in relation to their peers. He submits that many executives are also motivated by non-financial factors and would rather accept less remuneration for jobs that are more intrinsically

[75] Ibid at 790-791.

[76] Otten, J.A. op cit note 41 at 14.

[77] Ellig, Bruce R. op cit note 35 at 81.

satisfying.[78] In particular, Davis, Schoorman and Donaldson indicate that these factors include the intrinsic rewards associated with his position such as opportunities for growth, achievement, affiliation and self-actualisation, as opposed to extrinsic rewards that have a measurable market value, such as monetary incentives, which typically represent control mechanisms under agency theory.[79]

Davis et al argue, in terms of their stewardship theory, that the assumptions under agency theory of the executive being individualistic and self-serving may not hold for all members of the executive and therefore exclusive reliance on these theories is undesirable as the complexities of companies are not taken into account.[80] As such, the stewardship theory paints a different picture of the executive and considers the executive as a steward who displays pro-organisational and collective behaviour as he or she sees such behaviour as having more value than individualistic, self-serving behaviour. In these cases, the agency costs that would otherwise be incurred to guarantee pro-organisational behaviour from the executive are reduced. Instead of focussing on methods to monitor and control the executive (such as the use of exorbitant incentive-linked remuneration), the company can focus more on structures that facilitate and empower the executive.[81] However, in order for a stewardship style of governance to be effective, the shareholder would need to assume a level of risk (that the executive will be self-serving to the detriment of the shareholder) that is acceptable to him or her and be willing to trust the executive. This may only be achieved where there is a long-term relationship between the shareholder and the executive.[82]

ii. Particular attributes of the company

Filatotchev and Allcock indicate that the company's specific circumstances or organisational context can play a significant role in the determination of the structure of remuneration and the related corporate governance measures required to ensure accountability and incentive alignment.[83] In particular, factors such as the company's size or age, its development phase

[78] Ibid. Pepper, A. 'The behavioural economics of executive incentives' (2021) 14.2 *NHRD Network Journal* 186 at 188.

[79] Davis, J.H., Schoorman, F.D. and Donaldson, L. 'Towards a Stewardship Theory of Management' (1997) 22.1 *Academy of Management Review* 20 at 28.

[80] Ibid at 20.

[81] Ibid at 24-26.

[82] Ibid at 40-41.

[83] Filatotchev, I. and Allcock, D. 'Corporate governance and executive remuneration: A contingency framework' (2010) 24.1 *Academy of Management Perspectives* 20 at 24.

of growth or decline, the degree and nature of external finance on which it is dependent and the extent of innovation in the different markets within which it operates, are all important determinants in this regard.[84] Bussin also indicates that other company-specific factors such as the company's performance, the structure of the company and the complexity of the executive positions are also important determinants of executive remuneration.[85]

Filatotchev and Allcock indicate that the different phases of the development or organisational life cycle of the company are particularly relevant in the determination of the structure of executive remuneration, and each phase can result in changes to the extent and nature of principal-agency conflicts which in turn brings into play different corporate governance measures such as monitoring and incentive alignment. For example, as the company grows, it requires external funding to support this growth and this funding comes coupled with increased corporate governance requirements including greater transparency and monitoring by the providers of these funds. This move to a more developed corporate governance system enables the company to access further funding from the stock market. At this stage, executive incentives may increasingly become a mechanism intended to align the interests of the executives with the shareholders. As the company matures, it may ultimately reach a stage where it has exhausted its growth opportunities. Governance systems may become less transparent as executives attempt to push for expansion and diversification leading to decreased performance of the company and shareholder value. The executive may derive more power in the process to design their own pay packages such that the incentives become more about self-enrichment or skimming than trying to align their incentives with shareholder interests. These actions in turn will demand more stringent corporate governance measures to ensure incentives are aligned with shareholder interests.[86]

iii. Specific features of the company's institutional environment

Filatotchev and Allcock also suggest that the institutional environment within which the company operates can have a significant impact on the corporate governance systems relating to the levels and structure of executive remuneration. These institutions can either be formal or informal. Formal institutions consist of explicit constraints on behaviour such as laws and

[84] Ibid.

[85] Bussin, M. op cit note 27 at 235.

[86] Filatotchev, I. and Allcock, D. op cit note 83 at 24-25.

regulations, as well as political and economic rules and procedures. Informal institutions, on the other hand, consist of unwritten influential societal norms, conventions and values.[87]

Bottenberg, Tuschke and Flickinger indicate that corporate governance systems can differ from country to country in the way that they regulate the rights, obligations and relations of the company's various stakeholders. In particular, these systems differ in the way that they empower or constrain the influence that the stakeholders have over the governance and management of the company. In shareholder-orientated societies, such as the Anglo-Saxon countries which include the United States and the United Kingdom, these systems are characterised by the robust protection of shareholder rights and specifically those of minority shareholders. Other stakeholders in these countries have fewer rights with respect to the governance and management of the company. Stakeholder-orientated societies, such as Germany and Japan on the other hand, are characterised by more involvement of the different stakeholder groups in the governance and management of the company due the rights of these stakeholders being more equally distributed.[88]

Salazar and Raggiunti indicate that differences in corporate governance systems between shareholder-orientated and stakeholder-orientated countries arise from differences in business practices and culture in these countries. The United States and Canada, as with most other Western countries, are liberal market economies where co-ordination issues between companies, their lenders, employees and other participants are largely handled with market incentives or free market mechanisms. In contrast, the economy of Japan follows a more coordinated market approach which depends on non-market relationships within formal institutions. Where in the United States and Canada, the dominant short-term culture has historically encouraged the drive for short-term profits with little concern about the impact of corporate decisions several years down the line, the Japanese culture tends to depend on long-term objectives and are particularly committed to long-term sustainability. The short-term view embraced by Anglo-Saxon countries leads to companies being run in the interest of shareholders and creating wealth for them, and accordingly short-term incentives for executives are particularly aimed at achieving these objectives. Japan, on the other hand, by virtue of its non-market relationships, including its central bank, crossholdings and insider

[87] Ibid at 29.

[88] Bottenberg, K., Tuschke, A., and Flickinger, M. 'Corporate governance between shareholder and stakeholder orientation: Lessons from Germany' (2017) 26.2 *Journal of Management Inquiry* 165 at 167.

board of directors, discourages shareholder primacy in order to maintain social harmony. As a consequence of this approach, Japanese executives have traditionally received remuneration of which a large portion is fixed.[89] The level of executive remuneration in Japan is also much lower than that in Angola-Saxon countries and that this is due to Japan's long-standing tradition of not tolerating excess or greed.[90] Similarly, the remuneration disparity or wage gap between the Chief Executive Officer and the lowest paid workers of companies in Japan is not as pronounced as the United States and Canada.[91]

d) Application in South Africa

The level of executive remuneration in South Africa appears to be influenced both by market forces and social constructs as to what executives should earn. Viviers, for example, indicates that evidence suggests that the high levels of executive remuneration are justified by companies on the basis that they are concerned about losing talented executives that possess specialised knowledge and skills, and who are also very mobile. Some executives also believe that they are simply entitled to their high levels of remuneration.[92]

Similarly, the structure of executive remuneration in South appears to largely be determined by the agency approach. Bussin indicates that within this approach, research suggests that the optimal contract theory appears to be dominant during periods of strong economic performance, while the managerial power theory and other behavioural theories appear to be stronger during periods of weak economic performance. This trend emphasises the need to ensure that executive remuneration packages are designed to properly to align the interests of executives with those of the shareholders especially during downturns in the economy.[93] While stewardship theory offers an alternative view to agency theory, the possibility of adopting this approach does not appear to be supported by current research and its reliance on the executive as being pro-organisational is perhaps too aspirational in South Africa's current economic environment.

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[89] Salazar, A.R. and Raggiunti, J. 'Why does executive greed prevail in the United States and Canada but not in Japan? The pattern of low CEO pay and high worker welfare in Japanese corporations' (2016) 64.3 *The American Journal of Comparative Law* 721 at 730. See also Waldenberger, F. 'Company heroes versus superstars: executive pay in Japan in comparative perspective' (2013) 25.2 *Contemporary Japan* 189 at 196: studies show that the incentive share in Japan's remuneration structure for executives appears very low compared to the United States and Europe.

[90] Salazar, A.R. and Raggiunti, J. ibid at 735.

[91] Ibid at 733-734.

[92] Viviers, S. 'Executive Remuneration in South Africa: Key Issues Highlighted by Shareholder Activists' (2015) 9.1 *African Journal of Business Ethics* 1 at 2.

[93] Bussin, M. op cit note 27 at 240.

The high levels of executive remuneration and the agency approach in support of the company's shareholders suggest that South Africa's institutional environment with respect to the executive remuneration is strongly influenced by the Anglo-Saxon culture. Its corporate governance system with respect to stakeholders and their requirements, however, appears to be somewhat confusing. Despite the provisions of a progressive constitution which influenced the early policy behind the current SA Companies Act, the common law pertaining to the fiduciary duties of directors leans towards a shareholder-orientated approach. King IV (as with its predecessor), on the other hand, explicably supports a stakeholder-orientated approach.[94] Yet it is clear from the explanatory memorandum behind the Companies Amendment Bill of 2021, that more credence needs to be given to the demands of the informal institutional environment of South Africa that considers executive remuneration levels to be unacceptably high in a country where much of the population are beset by poverty and inequality.[95] While company specific factors must also come into play in the determination of appropriate corporate governance measures, the personal characteristics of the executive may well be a factor in the recruitment or retention of executives in driving these changes.

2.3 Issues associated with ineffectively regulated executive remuneration

While the high levels of executive remuneration in South Africa appear to be largely driven by market forces and social constructs as to what executives should earn, these levels may give rise to various issues for companies. The absence of effective corporate governance measures that reflect the demands of the company's specific circumstances and, in particular, its informal institutional environment in curbing these levels and thereby addressing these issues may ultimately impact the company's sustainability in the long-term.

Similarly, the structure of executive remuneration (including incentive-linked performance measures) in South Africa plays an important role in motivating executives to drive the performance of their companies especially in the weak economic environment being experienced currently. Yet these structures (and/or the related incentive-linked performance measures) can also give rise to various issues for companies where these structures and/or incentive-linked

[94] This dichotomy is discussed in detail in chapter 3 with a view to establishing an approach that reconciles the demands of the company and its stakeholders in the context of South Africa's formal and informal institutional environment.

[95] Background Note and Explanatory Memorandum on the Companies Amendment Bill of 2021 (introduced by GN 586 of *GG* 45250 of 1 October 2021) at 342-350. See also the World Bank Group 'Overcoming poverty and inequality in South Africa: An assessment of drivers, constraints and opportunities' op cit note 2.

performance measures are inappropriate for the company's specific circumstances and its informal institutional environment. In particular, the absence of an effective approach to recognising the interests of all the company's key stakeholders as supported by effective corporate governance measures that addresses these issues may also ultimately impact their sustainability in the long-term.

2.3.1 Issues arising from the inappropriate level of executive remuneration

The issues that excessive or disproportionate levels of remuneration may give rise to relate to the adverse impact of these levels on the corporate reputation of the company, the morale of its employees and the stability of society within which the company operates.

a) Corporate reputation

Excessive executive remuneration levels may adversely impact the reputation of companies in the eyes of its current and potential stakeholders, including investors, employees, customers, suppliers and society in general.

The corporate reputation of a company has been defined as the 'observers' collective judgment of a corporation based on assessments of the financial, social, and environmental impacts attributed to the corporation over time'.[96] Seow, Goh and Pan suggest that the company's corporate reputation influences the trust that stakeholders place in the company and relates to their perceptions of the reliability, honesty, and benevolence of the company. Studies in this area have found that people inherently trust companies that have a good reputation compared to those that do not.[97] According to Gomez-Trujillo, Velez-Ocampo and Gonzalez-Perez, theoretical and empirical research also supports the idea of a direct and positive relationship between the company's reputation and its sustainability. Where this trust is compromised, the sustainability of the company may be adversely impacted.[98]

Core, Guay and Larcker indicate that the media tends to sensationalise the levels of executive remuneration and often select poor performing companies (and possibly those that have recently retrenched a portion of their workforce) for their negative coverage. Often, the

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[96] Barnett, M. L., J. M. Jermier, and B. A. Lafferty 'Corporate reputation: The definitional landscape' (2006) 9.1 *Corporate Reputation Review* 26 at 34.

[97] Seow, P. S., Goh, C. and Pan, G. 'The effects of corporate reputation and compensation disclosure on investor judgments' (2019) Conference Paper - American Accounting Association Annual Meeting at 4.

[98] Gomez-Trujillo, A. M., Velez-Ocampo, J. and Gonzalez-Perez, M. A. 'A literature review on the causality between sustainability and corporate reputation: What goes first?' (2020) 31.2 *Management of Environmental Quality: An International Journal* 406 at 408.

negative sentiment relates to the level of remuneration as reflected by the proceeds of options that have been exercised as opposed to the more correct measure being the grant date value of these options.[99] Be that as it may, a survey conducted by the Institute of Directors in the United Kingdom found that excessive executive remuneration is the biggest threat to public trust in business and a real strategic concern to the economy of the United Kingdom.[100] Miles and Miles suggest that the reason for this is that the general public consider excessive levels of executive remuneration to be unfair. This is especially where employees of the company at the various levels below the executive have been retrenched.[101]

Kelly and Seow also show that investors have a negative perception of companies that pay executive remuneration which appears to be excessive in relation to other employees of the company concerned due to the perceived unfairness of these levels. The results of their research support one of the main contentions of equity theory that suggests that the public would respond negatively to violations of fairness norms and punish perpetrators of unfairness even where the inequitable treatment is not experienced by them personally but by others. As such, investors may be reluctant to invest in these companies.[102] Paredes indicates that excessive executive remuneration may also suggest that there are structural weaknesses in the corporate governance of the company and thereby can also erode investor confidence and the company's access to capital markets. He indicates that investors and analysts focus on managerial oversight and effective corporate governance more today now than ever and that recent studies suggest that there is a link between the quality of governance and corporate performance. Weak corporate governance is often seen as contributing to the company's poor performance.[103]

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[99] Core, J. E., Guay, W. and Larcker, D. F. 'The power of the pen and executive compensation' (2008) 88.1 *Journal of Financial Economics* 1 at 2.

[100] High Pay Centre 'Performance-related pay – what does business think' 2015 at 11 available at https://highpaycentre.org/wp-content/uploads/2020/09/FINAL_IOD_report.pdf last accessed on 15 June 2024.

[101] Collett Miles, P. and Miles, G. 'Corporate social responsibility and executive compensation: Exploring the link' (2013) 9.1 *Social Responsibility Journal* 76 at 79. The authors refer to research conducted in 2010 where it was established that of the 50 companies that retrenched the most employees in 2009, the average CEO remuneration was significantly higher than in the Fortune 500 companies as a whole.

[102] Kelly, K. and Seow, J. L. 'Investor reactions to company disclosure of high CEO pay and high CEO-to-employee pay ratio: An experimental investigation' (2016) 28.1 *Journal of Management Accounting Research* 107 at 125.

[103] Paredes, Troy A. 'Too Much Pay, Too Much Deference: Behavioural Corporate Finance, CEOs, and Corporate Governance' (2005) 32.2 *Florida State University Law Review* 673 at 713.

b) Employee morale

Executive remuneration that is excessive or disproportionately high relative to the remuneration of the average employee of the same company may negatively impact the morale and consequently the productivity of employees. This disparity can also lead to an increase in strikes amongst the lowest paid employees in the company. These issues may in turn adversely impact the profitability and/or the sustainability of the company.

Arsalidou and Labi refer to recent research indicating that employees are not as productive where there is a significant disparity between the remuneration of executives and those of the wider workforce. This adverse impact on their productivity appears to flow from the perceived unfairness of the decisions made with respect to remuneration. As a consequence, these employees tend to feel detached from their jobs and their potential for developing mental health issues is acute. They also indicate that various studies suggest that there is a strong link between the extent of the disparity in remuneration levels and the performance of the company. A narrow remuneration gap tends to lead to the improved performance of the company, while wider remuneration gaps tend to have an adverse impact on this performance.[104]

Murwirapachena and Sibanda indicate that the perceived inequality in current remuneration structures in companies generally is also a contributing factor to the frequency of strikes in South Africa. These actions can adversely impact the company's operations through the loss of production flowing from picketing, sit-ins and negotiations. The longer the strike persists, the more productive hours that are lost. Prolonged strikes can also lead to disruptions in the relationships that the company has with its customers and suppliers which can adversely impact its operations and those of these customers and suppliers with further adverse consequences for the employees of these operations. These strikes can also lead to violence which can cause significant loss of life, injury and destruction of company property and surrounding infrastructure. These effects can in turn even lead to a loss of perceived economic stability of the country and consequently potential investment opportunities.[105]

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[104] Arsalidou, D. and Labi, C. 'The controversy of executive remuneration: pay ratios and other approaches.' (2021) 42.6 *Business Law Review* 291 at 297. See also Van Zyl, G. 'The impact of employee remuneration inequalities on employee productivity in the South African workplace' (2021) 14.1 *Journal of Economic and Financial Sciences* 1 at 2: empirical research in the South African environment suggests that a disproportionate disparity between the highest and lowest paid employees in the company can contribute to decreases in productivity amongst the lowest paid employees.

[105] Murwirapachena, G. and Sibanda, K. 'Exploring the incidents of strikes in post-apartheid South Africa' (2014) 13.3 *International Business & Economics Research Journal (IBER)* 553 at 553 and 556.

Power and Gwanyanya relate how the 2012 strike at the Marikana platinum mine of Lonmin plc ('Lonmin'), in which 44 people lost their lives, serves as a classic example of the consequences that can flow from the disproportionate disparity between the remuneration of the executive and that of the lowest paid employees of the company. The mine workers of Lonmin's Marikana operations had been protesting against Lonmin for a 'living wage' of R150 000 per year (R12 500 per month). This was against the backdrop of the living conditions that the mineworkers were enduring. At this stage, the Chief Executive Officer of Lonmin earned R24 million per year.[106] In addition to the deadly strike at Lonmin, there were also significant illegal strikes at Gold Fields and Angola Platinum after Lonmin where political and labour analysts blamed excessive executive remuneration for the increasing remuneration disparity in companies and was cited as one of the key reasons for the wave of illegal strike action on the mines.[107] Even in the United States recently, strike action amongst Hollywood's copywriters and Detroit autoworkers has been blamed on the disproportionate remuneration disparity between executives and other employees.[108]

c) Societal stability

Executive remuneration that is excessive or disproportionately high may be insensitive to the levels of poverty and inequality in the communities within which the company operates and may indirectly contribute to these levels where their remuneration increases at a faster rate than the average worker in these communities.

While there has been some improvement in the fulfilment of socioeconomic rights since the advent of democracy in 1994, these rights largely remain unrealised for a significant portion of the South African population who remain chronically poor.[109] Studies also indicate that the percentage of the population considered poor, whether using the World Bank's poverty lines or South Africa's national poverty lines, has increased since 2011. The South Africa Multidimensional Poverty Index (SAMPI), which incorporates four dimensions of poverty

[106] Power, M. and Gwanyanya, M. 'Massacre at Marikana' (2017) 14.25 *Sur International Journal on Human Rights* 61 at 62.

[107] Matuma, L. and Molele, C. 'Pay disparity blamed for mine unrest' 14 September 2012 *Mail and Guardian* last accessed at https://mg.co.za/article/2012-09-14-00-pay-disparity-blamed-for-unrest on 24 September 2023.

[108] Morrow, A. 'A core frustration unites striking workers: exorbitant CEO pay' 19 September 2023 *CNN* last accessed at https://edition.cnn.com/2023/09/18/business/ceo-pay-unions-strike on 24 September 2023.

[109] World Bank Group 'Overcoming poverty and inequality in South Africa: An assessment of drivers, constraints and opportunities' (2018) op cit note 2 at xiv and xviii of the Executive Summary.

being health, education, standards of living and economic activity, with the objective of providing an integrated view of poverty, shows a similar trend since 2011.[110]

South Africa is also considered the most unequal country in the world with an income distribution that is highly polarised.[111] The Gini co-efficient, usually based on income or consumption expenditure, is typically used to measure the level of inequality in societies relative to each other. An index of 0 would represent a perfectly equal distribution of income between the lowest and highest paid members of society, while an index of 1 would represent and perfect inequality between these members.[112] Based on income, South Africa had a Gini co-efficient of 0.63 in 2014 being the last date of measurement. This is significantly higher than the United Kingdom (0.33), the United States (0.40) and Australia (0.34), while also being higher than other African countries such as Nigeria (0.35), Angola (0.51) and Zambia (0.56).[113] Similarly, based on the wage income component of income alone, South Africa had a Gini co-efficient of 0.69 in 2014. Using either measure, South Africa's Gini-coefficient is the highest in the World and both measures have increased since the advent of democracy in 1994.[114]

The main drivers impacting poverty and inequality in South Africa is the dual structure of the labour market which is characterised by the increasing demand for skilled labour in largely the services sector and decreasing demand for semi-skilled and unskilled labour due to the contracting primary sector. This structural mismatch between the demand and the supply of unskilled workers, coupled with the inequality of opportunity to acquire skills, contributes to low wages for these jobs (where a job in this sector can be acquired) and the high unemployment rate.[115] For the first quarter of 2022, the unemployment rate was measured at 34.5 percent and 51.0 percent using the broad definition (which includes discouraged work-seekers).[116] While South Africa has well-established means-tested social assistance schemes covering children, working age people and the elderly that have had a significant impact on reducing poverty and

[110] Ibid at 10-11 and 29.

[111] Ibid at 42.

[112] World Bank Group 'GINI index definition' last accessed at https://databank.worldbank.org/metadataglossary on 24 September 2023.

[113] World Bank Group 'Gini Index' last accessed at https://data.worldbank.org/indicator on 24 September 2023.

[114] World Bank Group 'Overcoming poverty and inequality in South Africa: An assessment of drivers, constraints and opportunities' op cit note 2 at xv of the 'Executive Summary' and 50-51.

[115] Ibid at 79, 84-85 and 94-95.

[116] Statistics South Africa *Quarterly Labour Force Survey Quarter 1: 2022* at 2 available at https://www. statssa.gov.za/ publications/P0211/P02111stQuarter2022.pdf last accessed on 2 August 2024.

inequality, further expansion of these programs is limited as they depend on tax revenues which are being curtailed by the lack of growth in the economy.[117]

Although the level of executive remuneration may not be the direct cause of poverty and inequality, Collier, Idensohn and Adkins indicate that the increasing disparity in the level of remuneration can contribute to these issues and result in economic and social instability in the communities which they form part of.[118] For example, in the aftermath of the July 2021 looting, which was ignited by the arrest of Jacob Zuma for contempt of court and resulted in 354 people losing their lives, R50 billion in damages and 150 000 jobs lost,[119] Vhumbunu suggested that:

> 'the enabling factors, which may qualify as the root causes of the July 2021 protests and looting, centre around the challenges faced by the state to address the problems of poverty, unemployment, and inequality as these often create portions of communities that are economically disenfranchised, desperate and marginalised. Therefore, they identify common grievances and shared bonds as they engage in survivalist-motivated violence and frustration instigated social unrest or are prone to manipulation by elites to fight political battles on their behalf.[120]

2.3.2 Issues arising from the inappropriate structure of executive remuneration

The issues that inappropriate remuneration structures (including incentive-linked performance measures) may give rise to relate to the adverse impact that these structures (and performance measures) can have on the company's management of risk, its financial performance and the interests of its stakeholders.

a) Risk management

The design of executive remuneration packages, or the specific components of the package, can encourage executives to pursue strategies which involve taking excessive risks to the company's profitability and liquidity, and consequently the welfare of its stakeholders due to there being

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[117] World Bank Group 'Overcoming poverty and inequality in South Africa: An assessment of drivers, constraints and opportunities' op cit note 2 at 75.

[118] Collier, D., Idensohn, K. and Adkins, J. 'Income inequality and executive remuneration: assessing the role of law and policy in the pursuit of equality' (2010) 34.2 *South African Journal of Labour Relations* 84 at 88.

[119] Nqunyana, A. 'July unrest: One year on, SA still doesn't know who masterminded the chaos' *News24* 8 July 2022 available at https://www.news24.com/news24/investigations/july-unrest-one-year-later-sa-still-doesnt-know-who-masterminded-the-chaos last accessed on 23 April 2023.

[120] Vhumbunu, C. H. 'The July 2021 Protests and socio-political unrest in South Africa' (2021) available at https://www.accord.org.za/conflict-trends/the-july-2021-protests-and-socio-political-unrest-in-south-africa/ last accessed on 2 August 2024.

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little or no downside risk to the executive personally in respect of his or her remuneration. These concerns relate to the proportion of the fixed and variable components of their remuneration packages, guaranteed incentive payments, severance payments, awards of share options and similar appreciation schemes, and awards of shares without prescribed holding conditions.

i. Predominance of fixed remuneration components

Gomez-Mejia and Wiseman indicate that the premise of the agency models is that the base (or fixed) remuneration component is less at risk than the variable components for the executive as the base remuneration is assured while the variable component carries some uncertainty as to whether it will be awarded. Many executives see fixed remuneration as part of their current and anticipated wealth as it is tied to their standard of living while variable remuneration is not seen in this light as it is considered an unreliable source of income. As the executive is considered to be risk averse, a threat to his or her base remuneration (or anticipated wealth) by making more of these components variable will lead him or her to rather pursue more risk averse strategies.[121] Therefore, where the fixed component is too high relative to the variable components in the executive's package such that it sufficiently meets his or her standard of living, the executive may take excessive risks in pursuing the variable remuneration components.[122]

This disconnect can be even more pronounced where executives receive increases on this fixed component in terms of their employment contract. Bussin indicates that much criticism has been levelled at companies and their remuneration committees for executives receiving increases in remuneration despite the disappointing financial performance of their companies.[123]

ii. Guaranteed incentives

Ferrarini and Ungureanu suggest that guaranteed incentive payments can encourage excessive risk-taking as the guarantee of receiving the incentive payment is not dependent

[121] Gomez-Mejia, L. and Wiseman, R. M. op cit note 64 at 343.

[122] Research by Bussin and Modau indicates that there have been some structural changes to the total remuneration of CEOs since 2008. They found that the main change was an increase in the fixed pay portion and a decrease in the short-term incentive portions of their remuneration packages. (Bussin, M. and Modau, M. F. 'The relationship between chief executive officer remuneration and financial performance in South Africa between 2006 and 2012' (2015) 13.1 *SA Journal of Human Resource Management* 1 at 15). This leaning towards a higher proportion of their remuneration being fixed may contribute to them being less risk averse.

[123] Bussin, M. op cit note 27 at 233.

on poor performance by the company or the executive.[124] This practice was widespread in the United Kingdom ('UK') banking sector with banks such as Lloyds and RBS that continued to pay guaranteed incentive payments even after receiving relief from the UK government following the fallout from the 2008 financial crisis. Although this practice was stopped in the United States with banks such as Goldman Sachs and JPMorgan Chase when the crisis broke, the practice appeared to have resumed by the end of 2009 as banks rebounded. The payment of guaranteed incentive payments effectively impacts the balance between fixed and variable pay and the ability of the company to operate a fully flexible incentive policy which ensures bonuses are withheld either fully or partly when the relevant performance criteria are not met.[125]

iii. 'Golden parachutes'

Ferrarini and Ungureanu also suggest that severance pay (termination payments or so-called 'golden parachutes') can enhance risk-taking by the executives where these payments are not based on the performance of the company or the executive. Although the original intention behind these incentives was to ensure that an executive of a company that is subjected to a hostile bid will not resist the takeover through concerns of losing his or her position at the company, these have been extended to other situations based on the argument that executives should be compensated for the risks inherent in their positions.[126]

iv. Appreciation incentives

Bebchuk and Spamann indicate that share options granted to executives as part of their remuneration package can encourage excessive risk-taking due to there being only upside potential for the executive of the options he or she has been awarded. Where ventures pursued by executives are not successful and cause the share price to decrease, the executive is not exposed to this decrease in value before the exercise date of these options.[127] The accounting scandals at companies such as Enron and WorldCom have been linked to the use of share

[124] Ferrarini, G. and Ungureanu, M. C. 'Executive pay at ailing banks and beyond: a European perspective' (2010) 5.2 *Capital Markets Law Journal* 197 at 204.

[125] Ibid at 205.

[126] Ibid at 205-206.

[127] Bebchuk, L. and Spamann, H. 'Regulating bankers' pay' (2010) Discussion paper 641 *The Harvard John M. Olin Discussion Paper Series at* 16-17.

options and the executives' excessive focus on the share price related to the options concerned.[128]

v. Minimum shareholding requirements

Bhagat and Romano indicate that shares awarded to executives in terms of long-term incentive awards are preferable to share options in that, unlike share options above, the ownership of shares places the executive in the same position of other shareholders with respect to the potential returns on the shares and their downside risks. However, where there is no minimum shareholding requirement during the executive's employment or for a certain period thereafter, those executives may consider various means to inflate these share prices in the short-term, including taking on unnecessary levels of risk, with the intention of cashing out the shares on leaving the company's employment before the adverse consequences of the executive's actions are revealed.[129]

b) Financial performance

Executive remuneration may not be properly correlated or linked to the financial performance of the company concerned. The Institute of Directors South Africa ('IoDSA') refers to this concern as 'performance risk' which is the risk for the company and its shareholders that the remuneration is not appropriate in light of the financial performance achieved by the company.[130]

The financial performance of a company can generally be assessed from how certain financial measures relating to the company's profitability, cash flows, asset efficiency, liquidity and solvency compare year-on-year (particularly if this comparison is set out over several years) and relative to its peers. Measures of the company's financial performance (or financial measures) are typically based on elements of the company's financial statements that have been prepared in terms of a recognised accounting framework or alternative financial information which may involve elements of the company's financial statements that have been adjusted for

[128] Scholtz, H. E. 'Share options as part of executive remuneration: aligning the interests of stakeholders' (2009) 13.2 *Southern African Business Review* 58 at 61-62

[129] Bhagat, S. and Romano, R. 'Reforming executive compensation: Focusing and committing to the long-term. (2009) 26 *Yale Journal on Regulation* 359 at 363. Effectively, the award of shares ensures that executives have 'skin in the game' in that it is in their personal interest to think and act like long-term shareholders of the company.

[130] IoDSA 'Linking Pay with Performance – Remuneration Committee Guidance' August 2020 at 13 available at https://cdn.ymaws.com/www.iodsa.co.za/resource/collection/57F28684-0FFA-4C46-9AD9-EBE3A3DFB101 last accessed on 1 March 2024.

certain items.[131] These measures are generally expressed as financial measures in themselves or as financial ratios.[132]

Performance risk can arise where the executive's remuneration package is structured in such a manner that the greater component of the package is fixed as discussed above. Apart from inducing executives to take excessive risks, this structure results in a natural disconnect between the executive's remuneration and the performance of the company.[133] Performance risk, however, especially arises where incentive-linked performance measures are based on financial measures that are inappropriate or incomplete, or where there are no effective corporate governance measures to prevent executives engaging in short-term behaviour at the expense of value creation, receiving 'windfalls' or unearned remuneration, or falsifying or manipulating financial information upon which financial measures and related financial performance measures are based.

i. Inappropriate or incomplete financial performance measures

Correia indicates that traditional financial management is associated with maximising the financial value of the company which in turn translates to maximising shareholder value and, as a consequence, the share price.[134] To achieve this, the executive often resorts to focussing on profit maximisation alone.

As Million states:

> 'Failure to meet earnings targets usually results in an immediate fall in the stock price, often of substantial magnitude. Companies falling short by even a penny per share can see an immediate plunge of 25 percent or more. A single-minded focus on boosting stock prices through short-term earnings performance has become standard operating procedure at most of our publicly traded corporations.'[135]

However, as Correia indicates, the focus on profitability including the growth thereof are incomplete actions with respect to the financial management of a business and may lead to

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[131] These measures are discussed in detail in chapter 3.4.

[132] Bussin, M. op cit note 27 at 239. Bussin distinguishes between absolute financial performance measures (based on audited financial information such as revenue, EBITDA and earnings per share), financial ratio performance measures (based on ratios derived from audited financial information such as return on assets and return on equity) and market or relative performance measures (based on market fluctuation or share price movement).

[133] Bussin ibid at 240.

[134] Correia, C. *Financial Management* 9 ed (2019) 1.10.

[135] Millon, D. 'Why is corporate management obsessed with quarterly earnings and what should be done about it' (2002) 70 *George Washington Law Review* 890 at 892.

poor decision-making. The other measures of the company's financial health, being its cashflows, operating efficiency, liquidity and solvency, must always also be managed. Where the executive focusses on one area while neglecting others, these actions may adversely impact the long-term sustainability of the company for all its stakeholders.[136]

For example, incentives linked to growing the revenue line while not addressing margins based on gross profit and operating profit can result in production costs or overheads respectively being ignored. Similarly, incentives linked only to improving Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA) could result in the company incurring excessive capital expenditure and taking on more debt in the drive to improve this measure year-on-year (as interest costs are excluded from this measure), and thereby not addressing the resulting adverse impact of these actions on the company's liquidity and solvency. Profitability ratios also do not consider how well working capital is being managed, as measured by efficiency ratios, which if neglected can also impact the company's liquidity and solvency.

Recent research by Padia, Naik and Callaghan indicate that there are concerns as to which measures of the company's financial performance are considered appropriate.[137] Ndzi suggests that the problem of linking executive remuneration to the company's performance is that there is a lack of best practice with respect to what factors should be used to measure the company's performance.[138]

ii. Short-term behaviour

Bebchuk, Cohen and Spamann indicate that the executive remuneration practices at Bear Stearns and Lehman Brothers provided executives with the opportunity to be awarded substantial incentives based on the short-term gains in the years that preceded the 2008 financial crisis and that these incentives were retained when these gains turned into massive losses.[139] Laux and Leuz indicate that these gains were made on the fair valuation (or 'mark-

[136] Correia, C. op cit note 134 1.10 – 1.13.

[137] Padia, N., Naik, M., & Callaghan, C. W. 'Variable executive remuneration and company performance: Insights from the Johannesburg Stock Exchange, South Africa' (2020) 20.1 *Acta Commercii* 1 at 9.

[138] Ndzi, E. 'Executive remuneration: the power and dominance of human greed.' (2019) 26.4 *Journal of Financial Crime* 978 at 989. See also Bussin, M op cit note 92 at 238.

[139] Bebchuk, L. A., Cohen, A., & Spamann, H. 'The wages of failure: Executive compensation at Bear Stearns and Lehman 2000-2008' (2010) 27.2 *Yale Journal on Reg*ulation 257 at 274. The authors also indicate that while the incentive scheme concerned provided them with the opportunity to take excessive risks, there is no indication in their analysis that the scheme influenced their behaviour. Their behaviour would have been the same whether they perceived risks to their companies or not (at 274-275).

to-mark' valuation) of securitisation assets (consisting of various mortgage bonds) that were classified as 'trading assets' in terms of the relevant US accounting standard. For large investment banks, like the Lehman Brothers and Bears Sterns, these assets would typically constitute around a third of the assets on their balance sheet. The accounting standard provided for these gains to be recognised as a profit in their income statements. However, these gains were merely an accounting or book profit as they did not materialise as a cash settlement due to the burst of the housing bubble which had developed in the preceding years. As such, these gains turned quickly into losses as these assets were devalued when mortgagees could not meet the repayments on their bonds and the real quality of these assets became apparent.[140]

Conceivably, these circumstances could arise wherever there are no corporate governance measures to recover or stop the payment of incentive awards where the award was based on the unrealised profit or gain at the end of one financial year and this profit or gain turns to a realised loss in the following financial year due to changes in exchange rates or fair values. Apart from awards based on the valuations of assets at fair value, there could also be instances where the transaction cycle spans more than one financial year and the cycle is not completed. These include the sale of a business or other assets at a profit near the end of one financial year with the proceeds only due in the following financial year and the purchaser defaults on the payment, as well as awards that are based on the beneficial impact of unrealised foreign exchange gains on financial instruments that result from a favourable movement in the closing exchange rate at the end of one financial year and which ultimately do not realise due to the settlement exchange rate depreciating.

iii. Windfall gains or other unintended remuneration

Kades defines windfall profits as 'economic gains [that are] independent of [the] work, planning, or other productive activities that society wishes to reward'.[141] Where the variable components of executive remuneration are linked to financial performance measures that have been elevated by external factors, these incentives may be awarded in circumstances that are not based on the efforts or the performance of the executives concerned. Of course, there may also be instances where despite the performance of the executive, the application

[140] Laux, C. and Leuz, C. 'Did Fair-Value Accounting Contribute to the Financial Crisis?' (2010) 24.1 *Journal of Economic Perspectives* 93 at 118.

[141] Kades, E. 'Windfalls' (1998) 108 *Yale Law Journal* 1489 at 1491.

of the incentive scheme, as impacted by these external factors, may result in no incentive being paid.[142] O'Neill and Berry indicate that research into remuneration practices in Australian companies has shown that these companies have in the past paid incentives to its executives based on the formulaic outcome of the incentive scheme despite profits being unreasonably high due to windfall gains as opposed to the efforts of the executive as they felt bound to honour the arrangements with the executive. Remarkably, where profits seemed unreasonably low due to unforeseen events, these companies often raised the incentive paid above that arrived at through the formulaic result of the scheme.[143]

The concern with windfall gains, especially where there are multiple winners, is that there are usually multiple losers.[144] An analysis by Oxfam and ActionAid of research conducted by Forbes indicates that many large international corporations in the energy, food and beverage sector, particularly, achieved substantial profits in 2021 and 2022 that exceeded the average of the profits in the four years preceding these. This is despite significant pay cuts taken by employees across the world and a cost-of living crisis that has seen many people hit by acute food insecurity in 2022. Extreme wealth and extreme poverty have also increased simultaneously for the first time in 25 years.[145] While Oxfam and ActionAid call for the imposition of a corporate windfall tax, the award of remuneration to executives based simply on the formulaic result of an incentive scheme can contribute to the sentiment of revulsion both within the companies where other employees do not share in the 'spoils' of these windfalls, and outside the company despite the imposition of a windfall tax. They indicate that the remuneration paid to Chief Executive Officers in 2022 in certain countries selected has risen at an alarming level despite a fall in the wages of workers.[146]

As with the issues associated with disproportionate levels of remuneration discussed above, the award of incentives that have been elevated by external factors can adversely

[142] IoDSA 'Linking Pay with Performance – Remuneration Committee Guidance' op cit note 130 at 15.

[143] O'Neill, G. and Berry, A. 'Remuneration of Australian Executives: A Practitioner Review' (2002) 40.2 *Asia Pacific Journal of Human Resources* 228 at 245.

[144] Kades, E. op cit note 140 at 1493.

[145] Oxfam 'Big business' windfall profits rocket to 'obscene' $1 trillion a year amid cost-of-living crisis; Oxfam and ActionAid renew call for windfall taxes' 6 July 2023 available at https://www.oxfam.org/en/press-releases last accessed on 1 February 2024.

[146] Ibid.

impact the company's corporate reputation, impact employee morale and cause societal instability which in turn can adversely impact the sustainability of these companies.

iv. Falsification or manipulation financial performance measures

Collier et al indicate that incentives may be based on financial measures that are subject to the manipulation of financial results by executive management.[147] According to Jones, financial statement line items can be falsified through financial statement fraud, or manipulated by means of creative accounting and creative management practices, thereby misrepresenting the state of the company's financial position and jeopardising it further in the payment of significant incentive payments.[148] The use of alternative performance measures for incentive purposes, as discussed above, are particularly subject to manipulation as it is typically the executives who decide what adjustments to make to the numbers in the financial statements to arrive at the measure concerned.[149]

Financial statement fraud involves using the financial statements to misrepresent the financial performance or position of the company and, based on the form of the misrepresentation involved, two types of this fraud can be distinguished. The first type involves the deliberate falsification of financial statements in which transactions and balances have been invented or are fictitious, while the second type involves the deliberate application of accounting practices which do not comply with the applicable regulatory framework.[150] Accounting practices engaged by Steinhoff International Holdings N.V. are an example of the first type of financial statement fraud. This company is alleged to have entered into fictitious transactions with parties that were said to be and made to appear independent of the company, when in fact it appears that these parties were related and/or controlled by the company.[151] These transactions, therefore, misrepresented the profits and asset values of the company in its financial statements. With respect to the second type of

[147] Collier, D. et al op cit note 118 at 98. Bussin, M. op cit note 27 at 236.

[148] Jones, M. *Creative Accounting, Fraud and International Accounting Scandals* (2011) 5; Ian Griffiths *New Creative Accounting* (1995) 62.

[149] IoDSA 'Principal-agent Problems and Executive Remuneration - Remuneration Committee Guidance' (2021) at 7 available at https://cdn.ymaws.com/www.iodsa.co.za/resource/collection/4DD0C370-28B5-4746-8CA3-29FA0AEAB54A /Paper_11_-_Principal-agent_problems_and_executive_remuneration.pdf last accessed on 14 December 2023.

[150] Jones, M. ibid at 9.

[151] PriceWaterhouseCoopers 'Overview of forensic investigation' (2019) at 3 available at https://www.corruptionwatch.org.za/wp-content/uploads/2020/08/overview-of-forensic-investigation.pdf last accessed on 15 June 2023.

financial statement fraud, Tongaat Hulett Limited is alleged to have engaged in accounting practices that contravened the financial reporting standards in order to inflate asset values and profits relating to, in particular, its sugar cane assets and certain plant and equipment.[152]

Creative accounting is defined by Jones as 'using the flexibility in accounting within the regulatory framework to manage the measurement and presentation of the accounts so that they give primacy to the interests of the preparers not the users'.[153] Schipper and Vincent suggest that preparers of financial statements would not deliberately misapply the requirements prescribed by the accounting standards due their professional memberships, yet they may take 'advantage of the requirements for exercising judgement, making estimates and forecasting inherent in implementing reporting standards'.[154] For example, Tongaat Hulett is alleged to have applied 'overly optimistic estimates in the standing cane valuations' and that this practice, therefore, had the impact of increasing the value of the assets and profits.[155] Similarly, the credit impairment model of African Bank Limited for certain loans was considered a very generous application of the financial reporting standard that was effective at the time (IAS 39: Financial Instruments - Recognition and Measurement), while their level of provisioning was also considered less prudent than the banking industry generally.[156]

Creative management practices, on the other hand, involve certain management interventions to make the statement of financial position appear more favourable at the end of a reporting period. Examples include running stock levels down near the reporting period end to improve working capital or holding back payments to suppliers until the day after the reporting period end to improve net borrowings.[157] Both actions would artificially increase outcomes for performance measures such as the ratio 'return on net assets'.

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[152] PriceWaterhouseCoopers 'Key findings of PwC investigation – Tongaat Hulett Limited' (2019) at 3-4 available at https://www.tongaat.com/wp-content/uploads/2019/11/Key-findings-of-PwC-Investigations-29-Nov-2019.pdf last accessed on 15 June 2023.

[153] Jones, M. ibid.

[154] Schipper, K. and Vincent, L. as cited by CE Rabin 'Determinants of auditors' attitudes towards creative accounting' (2005) *Meditari Accountancy Research* 67 at 74.

[155] PriceWaterhouseCoopers 'Key findings of PwC investigation – Tongaat Hulett Limited' ibid at 4.

[156] JF Myburgh *Report in terms of s69A (11) of the Banks Act – African Bank Limited* para 210, 332, 501, 504 available at https://www.resbank.co.za/en/home/publications/publication-detail-pages/media-releases/2016/7288 last accessed on 15 June 2023.

[157] Griffiths *New Creative Accounting* op cit note 147 at 62.

c) Stakeholder interests

A company's financial performance, as measured by its profitability, cash flows, efficiency, liquidity and solvency, is important for all the various stakeholders of the company including the company's shareholders, employees, customers, suppliers (including debt funders), receiver of revenue and society in general in supporting and furthering their interests.

Harrison and Wicks indicate, however, that the financial performance (or the financial value) of the company is not the only aspect of value that is important to stakeholders. The sole or dominant focus on financial value may lead the executive to pursue actions in this regard while reducing other types of value that stakeholders are interested in. In this sense, the value (or utility) to the stakeholder is anything that has potential to be of worth or merit to the company's stakeholders.[158]

Correia also indicates that 'there is nothing wrong in the objective of maximising [financial] value. What may be wrong is how this is achieved.'[159] He explains why financial value should not be the sole focus of the company's value and uses an example of a company that drives their costs down by placing undue pressure on suppliers to illustrate his point:

> '[a] company that continues to drive down the cost of its inputs by placing increasing pressure on its suppliers may find that its suppliers will either go out of business or will reduce the quality of their products in order to achieve lower prices. This may not be in the interests of the company in the longer term. The quality of the firm's products may be dependent on the quality of its inputs and so this policy may impact negatively on its own value.'[160]

Similarly, while employees may take comfort from listening to a year-end results presentation as to how well the company has performed from a financial perspective in that they feel that their jobs are secure, they may harbour feelings of resentment towards the executive for having to bear the brunt of cost cuts. These include working long hours due to vacant positions being frozen and receiving a mediocre bonus. Members of an indigent community living in the area that a company has its operations, may feel grateful for the employment created by the company, yet the community as a whole may feel aggrieved by the company polluting their immediate environment and/or not making some effort to improve their socioeconomic interests.

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[158] Harrison, J.S. and Wicks, A. C. 'Stakeholder theory, value, and firm performance' (2013) 23.1 *Business Ethics Quarterly* 97 at 99-102.

[159] Correia, C. op cit note 134 at 1.13.

[160] Ibid 1.10.

Where this reduction in stakeholder value results in a loss of support for the company from their stakeholders, the long-term sustainability of the company's financial performance may be jeopardised.[161] The company, therefore, has an interest in both protecting their stakeholders' interests by refraining from actions that may harm or otherwise adversely impact these interests, as well as advancing their stakeholders' interests by considering ways in which to promote these interests.

i. Protection of stakeholder interests

Certain actions of the company may adversely impact the interests of the company's various stakeholders where their rights, that are protected in terms of legislation, are transgressed. For example, the company may impact the health of the community in general where it fails to uphold its requirements in terms of environmental law. These include the sustainable development objectives of the National Environment Management Act 107 of 1998 which seek to address the impact of climate change and other environmental factors on present and future generations with respect to their socioeconomic interests.[162] Hope indicates that it is expected that climate change brought on by greenhouse gas emissions will impact vulnerable communities in Africa (including South Africa) the hardest. He indicates that these communities rely more heavily on natural resources for survival, and as these natural resources are susceptible to destruction by floods and drought that are likely to increase with climatic changes, climate change threatens their very existence.[163] Ignoring environmental-related measures also fails to take into consideration the growing number of younger investors that are looking at how companies are pursuing targets aimed at preserving the environment, and thereby this inaction can adversely impact the company's share price and its ability to raise capital and, therefore, its sustainability.[164] The company may also impact the interests of stakeholders by not upholding the health and safety requirements relating to employees in terms of labour law or customers in terms of consumer protection law, such

[161] Harrison, J.S. and Wicks, A. C. op cit note 158.

[162] Definition of 'sustainable development' in section 1 of the National Environmental Management Act 107 of 1998.

[163] Hope, K.R. 'Climate change and poverty in Africa' (2009) 16.6 *International Journal of Sustainable Development and World Ecology* 451 at 451-452.

[164] Deloitte 'Director and Prescribed Officer remuneration at JSE listed companies' September 2021 at 31 available at https://www.deloitte.com/za/en/services/consulting/analysis/deloitte-executive-remuneration-report-2021.html last accessed on 29 July 2024.

that the employee or the customer may be injured or killed.[165] The injury or death may also result in adverse consequences for the interests of the dependents of the employee or customer concerned. Similarly, unfair labour practices may leave employees with no option but to follow their trade union's call for a lawful strike. By embarking on the strike, the employee's wages will not be paid resulting in the interests of the employee and his or her dependents being compromised.

Even where the company's actions stay within the law, the company can adversely affect the interests of stakeholders. For example, the company's process with respect to the retrenchment of employees may be lawful in terms of the process set out in the Labour Relations Act,[166] yet the act of retrenchment itself may have serious consequences for the employee and his or her dependents with respect to food, housing and education where he or she cannot find an alternative employment. Wiese indicates that incentives linked to an increase in profits with no direction or restrictions on how this is to be achieved could result in executive management resorting to retrenching employees when other alternatives to reduce costs may exist.[167] The retrenchment of employees in these circumstances, especially with the concurrent award of short-term incentives to executives, could damage the reputation of the company with adverse consequences for its financial value going forward. Similarly, suppliers may be consolidated as a way of reducing production and maintenance costs thereby shutting out smaller players such as Small, Medium and Micro Enterprises. These actions reduce the opportunities for growth in this vital part of the economy and, in particular, the reduction of employment opportunities.[168] Suppliers may also be paid outside their contracted terms in order to optimise the working capital and borrowings of the company to support various financial initiatives. Where the liquidity of the supplier cannot sustain these delayed payments, certain payments that the supplier is required to make will also be late. These include the wages of their employees, leases for their operation's properties and various utility bills with adverse consequences for the socioeconomic interest of these individuals.

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[165] Occupational Health and Safety Consumer Protection Act 68 of 2008.

[166] Section 189 and 189A of the Labour Relations Act 66 of 1995.

[167] Wiese, T. 'Retrenchments in Order to Increase Profits: The Legal and Ethical Duties of Directors' (2015) 36.3 *Industrial Law Journal* 1748 at 1748-1749 and 1764.

[168] World Bank Group 'Overcoming poverty and inequality in South Africa: An assessment of drivers, constraints and opportunities' op cit note 2 at 88-91.

ii. Advancement of stakeholder interests

Harrison and Wick indicate that while financial measures, such as revenue growth, increased profitability, EBITDA or headline earnings per share as discussed above, are important in measuring the financial value of the company, they are incomplete and oversimplify the roles of the various stakeholders of the company and the value received by them in promoting the company's success. As such they provide a limited perspective on value creation for the company's stakeholders. They are also so aggregated that they are not particularly useful to executives in pinpointing problems within their companies that reduce the value that could otherwise be created.[169]

They indicate that the absence of explicit non-financial performance measures that gauge the value that stakeholders are deriving from the company may result in managers not paying attention to these aspects of value.[170] As a result, managers may not understand why their company fails to draw or retain stakeholders and why their company is not as successful as others.[171] The IoDSA indicates that where executives do not have a clear understanding of the drivers of value for the company, the line of sight between their targeted financial outcomes and the actions that they need to take to achieve them can also be poor. It can therefore be difficult for the executive to communicate the strategy that is required to achieve these outcomes to the employees of the company concerned and does not provide an early indication of whether the company's strategy is being implemented successfully. It can also be difficult to build a performance management system that aligns the jobs of all employees in the company to achieving these outcomes.[172]

Furthermore, while it is accepted that the state has a predominant role in addressing poverty and inequality in terms of the Constitution of the Republic of South Africa, 1996 ('SA Constitution'), especially in growing the economy and attracting investment to our shores, one may question whether large companies in South Africa are doing enough to address the socioeconomic crisis in South Africa where they have the financial capacity to do so. As discussed above, more than half of South Africans are considered poor and South Africa remains the most unequal country in the world with income distribution being highly

[169] Harrison, J.S. and Wicks, A. C. op cit note 158 at 109.

[170] Ibid at 113-116.

[171] Ibid at 98.

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polarised.[173] Unfortunately, the legacy of Apartheid still persists in the social and economic life of South African society with the link between historic privilege and inequality in opportunities to acquire the education needed to compete for skilled employment opportunities being still based on race.[174] The lack of access to tertiary education, in particular, is seen as prohibitive to the poor and is understandably the subject of regular campus protests throughout the country.

Although, these companies may already be contributing to the interests of the South African societies by providing employment opportunities and paying income tax to be used for socioeconomic initiatives, the failure of large listed companies to directly address the socioeconomic needs of indigent communities (within reasonable parameters) may impact the long-term sustainability of these companies.[175] As Roberts indicates, South Africa is at a tipping point and the failure of large businesses to take steps towards addressing the needs of stakeholder communities may lead to large businesses being seen as unempathetic towards them with adverse consequences.[176] Meyersfeld also indicates that these members are understandably becoming increasingly impatient with the pace at which their living conditions are being addressed.[177] The violence that accompanied the Lonmin strike is a stark reminder of the consequences that can flow from this sentiment.[178]

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[173] Chapter 2.3.1 (c) above.

[174] World Bank Group 'Overcoming poverty and inequality in South Africa: An assessment of drivers, constraints and opportunities' op cit note 2 at 43-49

[175] The limits to these contributions under the common law pertaining to companies is discussed in chapter 3.2.4 below.

[176] Roberts, G. 'Reducing inequality starts with increasing empathy among all South Africans' available at https://www.dailymaverick.co.za/article/2022-03-29-reducing-inequality-starts-with-increasing-empathy-among-all-south-africans last accessed on 26 July 2022.

[177] Meyersfeld, B. 'The South African Constitution and the human-rights obligations of juristic persons' (2020) 137.3 *SALJ* 439 at 454.

[178] Power, M. and Gwanyanya, M. op cit note 106 at 62-64. The mine workers of Lonmin's Marikana operations had been protesting against Lonmin for a 'living wage' against the backdrop of appalling living conditions. These mineworkers lived (and still live) in squalid informal settlements surrounding Lonmin's Marikana operations despite the company's legal requirements in terms of its Social and Labour Plan (SLP) to provide adequate housing. The Lonmin management insisted that it could not afford to construct adequate housing in terms of its legal obligations required by legislation due to the 2008 financial crisis. The Marikana Commission, however, rejected this considering the company had paid out US 607 million in dividends to shareholders between 2007 and 2011 and the cost of the housing was in the region of US 65 million. The lack of empathy displayed by Lonmin's executive towards addressing the living conditions of its employees despite it having both a legal obligation and the financial means to do so ultimately contributed to the loss of the lives of 44 people in the ensuing violence that accompanied the strike.

2.4 Effectiveness of the regulation of executive remuneration in South Africa

As executive remuneration may give rise to various issues that may adversely impact the long-term sustainability of the company where the level of the remuneration is excessive or the structure (and/or associated incentive-linked performance measures) is inappropriate, it is essential that executive remuneration is governed by an effective regulatory framework that addresses these issues and thereby protects and advances the interests of the company's stakeholders.

The remuneration paid to members of the executive management team is mainly regulated by the SA Companies Act and the JSE Listings Requirements (for listed companies). The latter incorporates the recommended practices and disclosures set out in King IV. As the provisions in the SA Companies Act dealing with the remuneration of executive management are minimal, the setting, approval and disclosure of executive remuneration is mainly regulated by King IV in terms of its more comprehensive provisions to this effect, while the Employment Equity Act also deals with certain required disclosures that serve to regulate executive remuneration. The recently enacted amendments to the SA Companies Act incorporate some of the requirements of King IV and the Employment Equity Act albeit with key differences.[179]

The provisions of this regulatory framework are briefly set out before their effectiveness in regulating the levels and structures (including incentive-linked performance measures) of executive remuneration is discussed.

2.4.1 SA Companies Act

The SA Companies Act mainly deals with the approval (by the board of directors) and the disclosure of executive remuneration.

a) Approval of executive remuneration

The SA Companies Act provides that directors are entitled to remuneration for their service as directors where the company's Memorandum of Incorporation provides for this and a special resolution has been approved by the company's shareholders within the previous two years.[180] Executive remuneration is also not dependent on the company earning sufficient profits.[181]

Cassim et al indicate that the phrase 'for service as directors' is ambiguous in that it is not clear whether the special resolution is required in respect of directors' fees for services as directors, such as attending board meetings, or whether the phrase also covers the remuneration

[179] Section 6 of the SA Companies Amendment Act 16 of 2024.

[180] Section 66(8)-(9) of the SA Companies Act.

[181] Cassim et al op cit note 25 at 456.

of executive directors that is derived from their employment contracts. They suggest that until the phrase 'for services as directors' is clarified by legislation or the courts, it would be advisable for the board of directors to obtain the approval of shareholders by special resolution for the fees for attending board meetings and for executive remuneration derived in terms of their employment contracts.[182]

While the board of directors is ultimately responsible for approving the remuneration of the executive management team by virtue of its powers under section 66(1) of the SA Companies Act, the Act does not deal with the formulation of the remuneration policy pertaining to executive members or the determination of the amounts actually paid to them. As such, the issues associated with excessive or disproportionate levels and inappropriate structures (or performance measures) need to be dealt with by the directors in the exercise of their fiduciary duties to act in good faith and in the best interests of the company, as well as to exercise this duty with the degree of care, skill and diligence expected of someone in the director's position.[183] Madlela and Lehloenya, however, indicate that the ability of the board to objectively and effectively discharge its duties in approving executive remuneration may be compromised by several factors including the presence of a dominant chief executive officer, not having sufficient independent-minded non-executive directors on the board and the presence of majority shareholders that can use their power to influence the board. In this respect, there are no provisions in the SA Companies Act dealing specifically with the independence of directors or the establishment of an independent remuneration committee.[184]

Where executive remuneration has been approved by the board of directors and this has led to adverse consequences for the company, the directors may be liable to the company in terms of section 77(2)(a) of the SA Companies Act for any loss, damages or costs incurred by the company as a consequence of the directors breaching their fiduciary duties. An action in this regard may be brought by a shareholder in terms of section 20(6) of the SA Companies Act where the breach was intentional, fraudulent or grossly negligent. Shareholders and any other person who has *locus standi* may also institute a derivative action on behalf of the company as provided in section 165 of the SA Companies Act.[185] Shareholders (typically minority

[182] Cassim et al op cit note 25 at 455-456.

[183] Section 66(1) and 76(3) of the SA Companies Act.

[184] Madlela, V. and Lehloenya, P. M. 'The regulation of executive remuneration in South Africa' (2016) 37.1 *Obiter* 1 at 6-7.

[185] In terms of s165(2) of the Companies Act, persons have locus standi are shareholders, directors and prescribed officers, registered trade unions and anyone else that has been granted leave of the court concerned.

shareholders) and directors (typically those that opposed the decision of the board) may conceivably also resort to the oppression remedy provided in section 163 of the SA Companies Act where the decision of the board of directors is considered oppressive or unfairly prejudicial to the applicant.[186] The orders that the court may make are extensive and includes an order to set aside any transaction or agreement to which the company is party and compensating the company or any other party to the transaction or agreement.[187] As to whether shareholders or any other person may institute a civil action in terms of section 218(2) of the Companies Act for any loss or damage suffered by that person specifically, it was confirmed in a recent case that a breach of fiduciary duty is directed towards the company itself (and not the shareholders or any other person) implying that any such civil action would need to relate to the losses or damages incurred by the company as a result of the breach.[188]

Despite the availability of these legal remedies to challenge the board's approval of the remuneration of executives, Collier et al indicate that there are no reported court cases in South Africa dealing with a purported breach of the directors' fiduciary duties relating to the approval of executive remuneration. The reasons for this may be due to the traditional view that matters concerning executive remuneration are internal management matters.[189] Cassim also indicates that parties instituting these actions may be challenged by the costs of the proceedings, access to unpublished company information and the operation of the rebuttable presumption that the decision not to sue the directors is in the best interests of the company.[190] Parties may also be discouraged by the protection that the board of directors has under the business judgement rule.[191]

b) Disclosure of executive remuneration

The SA Companies Act provides that companies are required to disclose details of remuneration paid to the executive management in their annual financial statements where these are required to be audited. The company is also required to disclose all shares issued to the executive

[186] Section 163(1) of the SA Companies Act.

[187] Section 163(2) of the SA Companies Act.

[188] *Hlumisa Investment Holdings (RF)Ltd and Another v Kirkinis and Others* (1423/2018) [2020] ZASCA 83 at paragraphs 48-51.

[189] Collier, D. et al op cit note 118 at 93-94.

[190] Cassim, M.F. 'Costs orders, obstacles and barriers to the derivative action under section 165 of the Companies Act 71 of 2008 (part 1)' (2014) 26.1 SA Merc LJ 1 at 1.

[191] Section 76(4) of the SA Companies Act. Collier, D. et al ibid at 95.

management including the consideration received by the company for those shares.[192] Although the term 'remuneration' is not specifically defined in the Act, section 30(6) of the Act lists some of the examples that must be disclosed in the annual financial statements of the company and includes salaries, bonuses, performance-related payments, taxable expense allowances, company pension fund contributions and share-based payments. This list is clearly not meant to be exhaustive by the use of the words 'includes' in the preamble to the subsection and is presumably wide enough to cover all taxable amounts comprising the executive's remuneration package.

The disclosure of executive remuneration plays a very important corporate governance role with respect to the level and structure (including incentive-linked performance measures) of executive remuneration. Madlela and Cassim suggest that the purpose of comprehensively disclosing the details of remuneration paid to the executive, including the performance measures applied, is to enhance the transparency and accountability with regard to the setting and approval of executive remuneration. In particular, they indicate that these disclosures compel the board to justify their decisions in this regard, and thereby also avoid inherent conflicts of interest that arise from the unitary structure of the board between executive and non-executive board members.[193] Madlela and Lehloenva indicate that these disclosures also enhance shareholder monitoring and specifically encourage institutional investors to play a more activist role.[194] Similarly, Luiz indicates that investment analysts, including the financial media, can make more informed analyses of how effectively the company concerned is being run by the executive and the appropriateness of the performance measures that have been adopted.[195] Madlela and Cassim, in turn, indicate that the publication of these shareholder findings and investment analyses can provide a level of deterrence against unsubstantiated levels of remuneration and inappropriate performance measures. Other stakeholders such as non-executive employees and

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[192] Section 30(4)-(5) of the SA Companies Act. Companies requiring an audit are generally all public companies, state-owned entities and private companies that are considered be economically and socially significant. With respect to these private companies, section 28(2)(c) of the SA Companies Regulations provides that the company must have its financial statements audited where the company has a public interest score of 350 (or 100 if internally compiled) calculated with reference to the number of employees of the company, its turnover and its third party liabilities per section 26(2) of the SA Companies Regulations.

[193] Madlela, V. and Cassim, R. 'Disclosure of directors' remuneration under South African company law: Is it adequate?' (2017) 134.2 *SALJ* 383 at 387-388.

[194] Madlela, V. and Lehloenya, P. op cit note 183 at 9. Viviers, S. op cit note 92 at 13.

[195] Luiz, S. 'An appropriate regime for the remuneration of executives' (2006) 39 (1) *Comparative and International Law Journal of Southern Africa* 57 at 65.

finance providers can also use the information disclosed to communicate their concerns with regard to these levels and performance measures with the board and the executive.[196]

In contrast to the intended objectives of providing comprehensive disclosure of executive remuneration as set out above, there are also concerns associated with these disclosures.[197] Markham indicates that disclosure of executive remuneration as a regulatory mechanism has produced some unforeseen and unfortunate consequences in countries such as the United States. Specifically it has resulted in high levels of competition and that disclosing details of their remuneration has given executive remuneration the appearance of being legitimate.[198] Research also suggests that the enhanced disclosure provisions introduced in the United Kingdom in 2013 have also failed to close the gap between the remuneration of executives and those of the rest of the workforce or to improve the link between the executive remuneration and company performance.[199] Despite these concerns, it would appear that public policy considerations favour the objectives sought to be achieved by comprehensive disclosures and that these objectives appear to outweigh the above concerns.[200] Furthermore, section 7(b) of the SA Companies Act states that the purpose of the company includes the promotion of the development of the South African economy by encouraging transparency and high standards of corporate governance given the significant role of enterprises within the economic and social life of the nation.

The SA Companies Act, however, makes no provision for the disclosure of details as to how the level of executive remuneration was arrived at or how their remuneration compares to other employees in the company and its peers. There are also no provisions dealing with how the structure of executive remuneration, and the nature of the performance measures and the incentive targets relating to variable components, were determined or what the performance measures and incentive targets indeed were. The enacted amendments to the SA Companies Act seek to enhance disclosure of executive remuneration in line with section 7 of the Act yet

[196] Madlela, V. and Cassim, R. ibid.

[197] See for example, Madlela, V. and Cassim, R op cit note 192 and Van Zyl, M. and Mans-Kemp, N. op cit note 13 at 9.

[198] Markham, J. W. 'Regulating Excessive Executive Compensation-Why Bother?' (2007) 2.2 *Journal of Business & Technology Law* 277 at 342. See also Iacobucci, E.M. 'The effects of disclosure on executive compensation' (1998) 48.4 *University of Toronto Law Journal* 489 at 510 where Iacobucci indicates that the disclosure effectively strengthens the executive's bargaining power.

[199] Ndzi, E. op cit note 138 at 992.

[200] Madlela, V. and Cassim, R ibid at 389.

these disclosures only apply to public companies and state-owned entities and do not address performance measures.[201]

2.4.2 King IV

King IV deals with remuneration committees and the constitution thereof, the principles upon which the remuneration policy should be based, the components of the remuneration report and the recommended disclosures therein, and the shareholder vote on the remuneration report. The provisions of King IV dealing with executive remuneration are mainly supported by the application guidance ('King IV Guide')[202] issued by the South African Reward Association ('SARA') and the IoDSA, as well as a series of publications offering guidance to remuneration committees issued by the IoDSA.

a) Application and legal status

King IV is a corporate governance code and as such consists of a 'set of voluntary principles and leading practices' which apply to all companies. The principles contained in the code consist of the aspirations as to what companies should strive to achieve and are considered fundamental to good governance, while the practices recommended by the code are considered to be the leading practises in the corporate governance sphere and are intended to give effect to the aspirations expressed by the principles to which they pertain.[203] The code applies on an 'apply and explain' basis meaning that the application of the principles by companies is assumed and an explanation should be provided as to how the principle was achieved or effected with reference to the practices recommended by the code or other practices that may have been applied.[204]

With respect to remuneration governance, principle 14 of King IV states that 'the governing body should ensure that the organisation remunerates fairly, responsibly and transparently so as to promote the achievement of strategic objectives and positive out comes in the short, medium and long term.' The board is therefore required to indicate how this principle is addressed either by way of the recommended practices set out under this principle, or by way

[201] The analysis of the disclosures contained in the enacted amendments are set out in chapter 2.4.4 below.

[202] SARA/IoDSA 'A Guide to the Application of King IV: Principle 14 – Governance of Remuneration' available at https://cdn.ymaws.com/www.iodsa.co.za/resource/resmgr/ccg_docs/King_IV_Guide_to_the_Applica.pdf last accessed on 15 June 2023.

[203] King IV at 35-36.

[204] King IV at 37.

of other practices.[205] For listed companies, the JSE Listings Requirements specifically require these companies to implement the code through its application and disclosure regime.[206] In essence, this requires listed companies to address each principle in the code by way of a narrative explaining how the principle was addressed whether by implementation of the recommended practices concerned or by way of other practices. Section 3.84 of the Listings Requirements also requires specific compliance with certain recommended practices in the code such as the appointment of a remuneration committee and the process of the shareholder vote on the remuneration report.[207] For unlisted companies and particularly large private companies, however, there are no regulatory instruments specifically requiring these companies to apply the recommended practices contained in the code. Although the practices recommended by King IV may give rise to legal consequences where courts consider the practices to have become so widely adopted as to reflect the required standard of conduct in the circumstances concerned,[208] the application of these practices remain essentially voluntary for unlisted companies.

b) Remuneration committee

King IV recommends that the oversight of executive remuneration should be allocated to a dedicated committee, typically referred to as the remuneration committee, or added to the responsibilities of another committee.[209] It appears to be common for the responsibilities of the remuneration committee to be combined with those of the committee dedicated to the oversight of the appointment and performance evaluation of the board members, typically referred to as

[205] The application and disclosure regime of King IV is set out in the code at 37-38. The recommended practices under principle 14 set out in Part 5.4 par 26-39 (at 64-67) of the code should be complied with either with respect to their application or disclosure, unless otherwise explained as to how the principle's aspirations are achieved, in accordance with this regime.

[206] Section 8.63(a)(i) of the JSE Listings Requirements.

[207] Sections 3.84 (c) and (k) of the JSE Listings Requirements with respect to Part 5.3 par 65-67 (remuneration committee) and Part 5.4 par 37-39 (shareholder vote on the remuneration report). Also see Section 8.63(a)(ii) of the JSE Listings Requirements.

[208] King IV at 35. See, for example, *Minister of Water Affairs and Forestry v Stilfontein Gold Mining Company Limited and Others* (7655/05, 7655/05) [2006] ZAGPHC 47 (15 May 2006) where, at paragraph 16.7, the Court stated in respect of an earlier predecessor of King IV that '[p]ractising sound corporate governance is essential for the wellbeing of a company and is in the best interests of the growth of this country's economy especially in attracting new investments. To this end the corporate community within South Africa has widely and almost uniformly accepted the findings and recommendations of the King Committee on Corporate Governance…'. He went on to indicate in the same paragraph that the conduct of several of the respondents in the case disregarded the recommended practices of the code. See also *South African Broadcasting Corporation Ltd and Another v Mpofu* (A5021/08) [2009] ZAGPJHC 25; [2009] 4 All SA 169 (GSJ) (11 June 2009) at paragraph 29 and 37-49.

[209] Part 5.3 par 65 of King IV (at 57).

the nominations committee.[210] The code recommends that the remuneration committee should consist of non-executive directors of the board of the company concerned with the majority of the committee members being independent, and that the committee should be chaired by an independent non-executive director of the board.[211]

Collier at al indicate that the purpose of the remuneration committee and the majority of the committee being independent non-executive directors is to avoid the potential conflicts of interest that could arise with the executive setting their own remuneration levels and performance measures.[212] The committee's effectiveness in constraining these levels and setting appropriate measures, however, is compromised by various factors with adverse consequences for the company's stakeholders. According to Madlela and Lehloenya, these factors include possible collegiality between executive management and non-executive directors thereby impairing the ability of non-executive directors to act independently, the shareholding of the members of the remuneration committee often being insignificant such that they have little financial incentive to monitor executive remuneration effectively, and members of the committee not having appropriate skills in this area.[213] In order to address the committee members' lack of skills in the remuneration setting process, Mongalo indicates that remuneration or compensation consultants are often appointed by the committee to provide advice on the setting of executive remuneration. However, as they are ultimately appointed by management, it is in their interest to maintain a reputation for higher levels of remuneration in the industry.[214]

While the definition of 'independent' as supported by the definition of a 'conflict of interest' in King IV requires an assessment of the interest, position, association, or relationship with the company concerned, which if conducted thoroughly may be sufficient to ensure the true independence of the committee members,[215] no provision is made in the code for a formal assessment in this regard or in determining the skills level of the members before being

[210] See for example the Remuneration and Nominations Committee of the Mr Price Group (per their Remuneration and Nominations Committee Report for 2023 available at https://www.mrpricegroup.com/wp-content/uploads/2023 /06/ Remuneration-report.pdf last accessed on 9 June 2024).

[211] Part 5.3 par 66-67 of King IV (at 57).

[212] Collier, D. et al op cit note 118 at 97.

[213] Madlela, V. and Lehloenya, P. M. op cit note 183 at 8.

[214] Mongalo, T. 'Shareholder activism in the United Kingdom highlights the failure of remuneration committees: lessons for South Africa' (2003) 120.4 *SALJ* 756 at 762.

[215] Glossary of Terms ('Independence' and 'Conflict of Interest') of King IV (at 13 and 11 respectively).

appointed. Furthermore, while King IV recommends that companies should state in their remuneration reports whether remuneration consultants have been used, and if so, whether the remuneration committee is satisfied that they are independent and objective,[216] the code provides no guidelines as to the determination of the consultant's ability to act independently and objectively from the influence of management. The code also does not provide for who should appoint the consultant in the first place or the remuneration committee's discretion with regard to the consultant's recommendations.

c) Remuneration policy

King IV recommends that the remuneration policy should set out the board's approach to ensuring that remuneration paid to all employees in the company is fair, responsible and transparent. The policy should be designed to attract, motivate and retain suitable individuals and should promote the achievement of the company's strategic objectives within its risk appetite, while at the same time promoting an ethical culture within the company and reinforcing the company's role as a corporate citizen in society.[217]

In particular, the remuneration of executive management should be 'fair and responsible in the context of overall employee remuneration in the organisation' and should make use of 'performance measures that support positive outcomes across the economic, social and environmental context in which the company operates; and/or all the capitals that the organisation uses or effects.'[218] As the code indicates, these recommendations recognise the need to address the differential between the level of executive remuneration and that of employees at the lower remuneration levels of the company, and that the executive's remuneration package should be structured between fixed and variable components with the variable components being based on the achievement of both financial and non-financial performance measures.[219]

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[216] Part 5.4 par 33(d) of King IV (at 66).

[217] Part 5.4 par 26-28 of King IV (at 64-65).

[218] Part 5.4 par King IV par 29(a)-(b) of King IV (at 65). The 'economic, social and environmental context' referenced is the so-called triple context upon which the governance principles set out in King IV are framed. The six capitals approach, on the other hand, forms the basis for Integrated Reporting as set out in the framework developed by the International Integrated Reporting Council. In recent years, there has been a strong move towards the environmental, social and governance ('ESG') approach to non-financial measures which should be incorporated by companies in their executive remuneration policies. ESG is considered an alternative complementary lens to the triple context. These three approaches and their efficacy as a basis for driving stakeholder value through the protection and advancement of all the company's stakeholders are discussed in depth in chapter 3.3.2 (c) below.

[219] Fundamental Concepts ('Remuneration') of King IV (at 31).

i. 'fair and responsible in the context of overall employee remuneration in the organisation'

King IV does not provide any indication of how companies should be addressing the level of executive remuneration and particularly the remuneration differential in their policy. The code also makes no provision for limiting or capping remuneration especially with respect to executive incentive awards which may be considerable relative to other employees. Consequently, these recommended practices are applied somewhat inconsistently by listed companies in South Africa. As discussed, excessive or disproportionate levels of executive remuneration can give rise to issues with respect to the company's corporate reputation, employee morale and societal stability and thereby adversely impact its long-term sustainability.[220]

The remuneration policy in *Vodacom Group Limited's* recent remuneration report, for example, includes a brief statement as to the remuneration levels within the company indicating that they 'review internal pay ranges annually and apply them consistently throughout the organisation', and then discuss the results of their 'annual fair pay analysis' which deals with various principles of how remuneration is dealt with in the company.[221] Critically, their disclosures do not include the 'internal pay ranges' or any other reference to pay differentials, such that there is no indication as to the effectiveness of their policy.

Similarly, the remuneration policy of *Sasol Limited* in their recent remuneration report attempts to explain how the company is addressing the remuneration differential or gap between the highest and lowest paid employees in the company.[222] However, the report provides no indication of what this gap is, or whether it has increased or decreased over the financial year concerned and, therefore, whether the company's efforts in addressing the differential are sincere. Their policy also states that the gap is tracked from the perspective of ensuring that the wages of their lowest paid employees are 'sufficient to accommodate a decent standard of living'.[223] This statement, of course, is remarkably vague and not specifically relevant to the issue of equality.

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[220] Chapter 2.3.1 above.

[221] Vodacom Group Limited Integrated Report for the year ended 31 March 2023 at 112 available at https://vodacom-reports.co.za/integrated-reports/ir-2023/documents/ last accessed on 10 February 2024.

[222] Sasol Limited Integrated Report for the year ended 30 June 2023 at 79 available at https://www.paperturn-view.com/sasol-pty-ltd/sasol-integrated-report-2023?pid=MzU352619&p=5&v=2 last accessed on 10 February 2024.

[223] Ibid.

The remuneration policy in *Naspers Limited's* remuneration report carries a general discussion on how the remuneration of their Chief Executive Officer ('CEO') compares to the average remuneration of other employees and even goes as far as disclosing the ratio of the CEO's remuneration to the average remuneration of other employees for the current and previous three years. The ratio increases each year from 311:1 in 2020 to 347:1 in 2022 before dropping to 253:1 with the reason for the drop in 2023 being that the CEO did not receive a long-term incentive award for this year. The ratio is also accompanied by a disclaimer suggesting that 'we do not consider the pay ratio to be an appropriate measure of fairness given the widely different pay levels that are observed in the countries where we operate.'[224] This diminution, of course, is open to all kinds of interpretations.

Although it appears that some form of limit is placed on the level of incentives awarded, the remuneration policies of some companies appear to set this cap at a certain percentage of the target for the performance measure concerned. The remuneration policies of *Vodacom Group Limited* and *MTN Group Limited*, for example, set this cap for the CEO's incentives at 200 percent of the target.[225] As the underlying measure (such as gross profit) upon which the target for the incentive is based may increase each year, the cap could accordingly also shift upwards resulting in possibly a significant upward trajectory of their total remuneration and an increasing differential between their total remuneration and that of other employees that are not remunerated on this basis. The remuneration policy of *Naspers Limited*, on the other hand, caps short-term incentive awards at 100 percent of the executive's base salary, yet the long-term incentive awards are only capped at 200 percent of the target for the performance measure concerned.[226] As long-term incentive awards are often considerable, these incentives may be the one of the main causes for the increasing pay disparity between executives and lower paid employees such as in the case of *Naspers Limited* above where the differential only decreased in 2023 when the CEO did not receive an award.

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[224] Naspers Limited Integrated Report for the year ended 31 March 2023 at 149 available at https://www.naspers.com/~/media/Files/N/Naspers-Corp-V2/investor/full-year-results-2023/naspers-integrated-annual-report-2023.pdf. last accessed on 10 February 2024.

[225] Vodacom Group Limited Integrated Report for the year ended 31 March 2023 op cit note 221 at 115-117. MTN Group Ltd Integrated Report for the year ended 31 December 2023 at 116-119 available at https://www.mtn.com/wp-content/uploads/2024/04/MTN-Group-FY-23-Integrated-Annual-Report-1.pdf last accessed on 18 June 2024.

[226] Naspers Limited Integrated Report for the year ended 31 March 2023 ibid at 140.

ii. *'use of performance measures that support positive outcomes across the economic, social and environmental context in which the company operates; and/or all the capitals that the organisation uses or effects'*

King IV does not provide an indication of what the split or weighting between the fixed and variable components of the executive remuneration package should be or how this should otherwise be determined. While there is no suggestion that executive remuneration packages of listed companies in South Africa do not contain variable components linked to performance measures, Bussin does indicate that research shows that the structure of executive remuneration packages in both South Africa and globally has noticeably been moving towards a greater component of their remuneration being fixed since the financial crisis of 2008.[227] As the dominance of fixed components can enhance risk-taking, the lack of guidance provided by the code in this regard may be enabling remuneration committees to design remuneration packages that are abetting this issue. The King IV Guide may also only be exacerbating this position.[228] Similarly, the code does not contain any recommendations as to other components of executive remuneration packages that are not subject to performance criteria or otherwise enhance risk taking by executives. This includes guaranteed payments, 'golden handshakes', appreciation schemes and minimum shareholding requirements. There is, therefore, nothing stopping companies from employing these arrangements. *Naspers Limited,* for example, appears to provide for share options and share appreciation rights in addition to performance shares.[229]

King IV also does not provide any indication of what the split or weighting between the financial and non-financial performance measures relating to the variable components should be. Although listed companies may be structuring their executive remuneration packages to include variable components linked to performance measures, financial performance measures may be overly dominant resulting in the reduction of other types of value that stakeholders are interested in due to these aspects of value not receiving the attention that they deserve. As such, the long-term sustainability of the company's financial performance may be

[227] Bussin, M. op cit note 27 at 240. Also see Bussin, M. and Modau, M.F. op cit note 122 at 15.

[228] The King IV Guide suggests that the fixed component should meet the executive's basic daily living expenses without too much dependence on the variable portion in this regard (RP 29.4). However, see Gomez-Mejia and Wiseman at note 63: where there is no threat to the executive's base pay, risk-taking can be enhanced.

[229] Naspers Limited Integrated Report for the year ended 31 March 2023 op cit note 223 at 140.

jeopardised.[230] The remuneration policy of *MTN Group Limited* in their recent remuneration report, for example, indicates that their short-term incentive (STI) performance measures are weighted 80 percent financial and 20 percent non-financial, while their long-term incentive (LTI) performance measures are weighted 75 percent financial and 25 percent non-financial.[231] With respect to the financial performance measures, the code does not contain any recommendations or provide any guidance on the aspects of financial performance that listed companies should be measuring. As such, financial performance measures may not provide a complete assessment of the financial performance or value of the company resulting in certain aspects impacting its health being overlooked. For example, the incentive financial performance measures in the remuneration policy of *Shoprite Holdings Limited's* recent remuneration report relate to the company's trading profit, EBITDA margin (being the earnings before interest, tax, depreciation and amortisation expressed as a ratio to revenue), sales growth and inventory to sales ratio, ROIC (being return on invested capital) and adjusted diluted HEPS (headline earnings per share).[232] Other than the inventory to sales ratio, which relates to the operating efficiency of the company, the measures all relate to the profitability of the company. Other aspects of financial performance such as cash flow, liquidity and solvency are not measured. There is also no explanation in the remuneration policy as to why these measures specifically were selected as being appropriate for the company's circumstances and as such, they may not address all the company's financial performance risks.

The code also does not contain any recommendations with respect to corporate governance measures that would otherwise prevent or discourage incentives being awarded on the basis of financial information that was manipulated through creative accounting or management practices. The remuneration policy of *Shoprite Holdings Limited*, for example, contains performance measures with respect to trading profit and the 'inventory to sales

[230] Chapter 2.3.2 (c). The King IV Guide (op cit note 201 - RP 29.3 at 8) also simply indicates that a balance should be achieved between financial and non-financial measures.

[231] MTN Group Ltd Integrated Report for the year ended 31 December 2023 op cit note 224 at 117-120. Interestingly, the financial performance measures for *Naspers Limited* for the 2024 financial year are weighted 90 percent for the STI with the LTI performance measures relating mainly to shareholder returns, while for the 2023 financial year the financial performance measures were only 67 percent for the STI with no reasons provided in the policy for this drastic increase (Naspers Limited Integrated Report for the year ended 31 March 2023 op cit note 223 at 149-155 and 159).

[232] Shoprite Holding Ltd Integrated Report for the year ended 2 July 2023 at 101-103 available at https://www.shoprite holdings.co.za/docs/shp-ir-2023.pdf last accessed on 15 January 2024.

ratio',[233] yet no details are provided as to what income or other expense items are excluded from the 'trading profit' measure or how the 'inventory to sales ratio' measure is calculated. Management may be tempted to employ creative accounting practices by excluding certain expense items from trading profit to inflate this measure. Similarly, if the 'inventory to sales ratio' is based on the inventory at the year-end or the average of two year-ends, the measure may be inflated by running inventory levels down in the last month of the year.

In addition, the code does not contain any recommendations with respect to corporate governance measures aimed at recovering incentives that were awarded, for example, on the basis of unrealised gains that culminated in realised losses on the settlement of the underlying financial instrument, or on the basis of financial information that was fraudulent or manipulated through creative accounting. In particular, the code does require remuneration policies to provide for the forfeiture of incentives that have been awarded but have not yet vested (so-called malus provisions), or the recovery of incentives that have already been paid (so-called clawback provisions) in these circumstances. Madlela indicates that clawback provisions, specifically, where formulated correctly can serve as an important mechanism to manage the risk of executives pursuing inappropriate strategies to enable them to benefit from short-term increases in the company's value that may undermine the sustainability of the company in the long-term. These provisions can also discourage the manipulation of information upon which their incentive-linked remuneration is based in order to increase these payments.[234] While the remuneration policy of *Shoprite Holdings Limited* has a comprehensive list of circumstances under which these provisions would apply, including fraud, dishonesty, misrepresentation and error relating to the financial performance of the group, these circumstances do not include the short-term beneficial impact of unrealised gains on financial performance measures which may be considerable and subsequently reverse on realisation.[235]

Similarly, the code does not contain any recommendations with respect to corporate governance measures aimed at preventing windfall gains (or unearned remuneration) or the pay-out of incentives during periods of economic downturns such as during the COVID-19

[233] Ibid.

[234] Madlela, V. 'Director and executive remuneration clawbacks: a suggested approach for South Africa' (2018) 39 (1) *Obiter* 45 at 48.

[235] Ibid. The remuneration policy of Gold Fields Limited, on the other hand, only requires the application of these provisions where there is an error related to the financial performance of the group (Gold Fields Limited Annual Financial Report including Governance Report for the year ended 31 December 2022 at 44 available at https://www.goldfields. com/pdf/ investors/integrated-annual-reports/2022/annual-financial-report-2022.pdf last accessed on 15 July 2023).

pandemic. A typical measure in this regard would be the requirement that remuneration policies must provide that remuneration committees may choose to apply their discretion in adjusting incentive awards which are based on formulaic outcomes in certain circumstances. For example, the remuneration policy of *Naspers Limited* provides that their remuneration committee may exercise its discretion to make 'appropriate adjustments',[236] while the remuneration policy of *Gold Fields Limited* provides that their remuneration committee may apply their discretion 'under extraordinary circumstances'.[237] On the other hand, the remuneration policy of *MTN Group Limited*, for example, does not appear to make any provision in this regard.[238]

Furthermore, the code does not contain any recommendations or provide any restrictions as to how financial performance measures may be achieved, such that companies may pursue these measures at the expense of the company's stakeholders while the award of incentives in these circumstances may also impair the company's corporate reputation with adverse consequences for its sustainability. For example, the 'trading profit' measure in *Shoprite Holdings Limited's* remuneration policy above may be inflated by savings in employee costs brought on by wholesale retrenchments at the beginning of the performance period with the retrenchment costs paid may being excluded from 'trading profit' due to their irregular nature. The use of so-called gate-keeper provisions which prevent incentives being paid out in these circumstances, or so-called modifier provisions which adjust financial performance measures to exclude savings achieved in these circumstances are examples of corporate governance measures that may be employed to protect stakeholders and are absent from the recommendations of King IV.

The code does not contain recommendations regarding the minimum vesting period for the awards of shares to executive management in long-term incentive plans or post-employment holding periods relating to these shares. Vesting periods consisting of a number of years over which targets need to be met for the award to vest, as well as post-employment shareholding requirements, are aimed at aligning the interests of the executives with the

[236] Naspers Ltd Integrated Annual Report for the year ended 31 March 2023 op cit note 223 at 141.

[237] Gold Fields Limited Annual Financial Report including Governance Report for the year ended 31 December 2022 ibid at 38.

[238] MTN Group Ltd Integrated Report for the year ended 31 December 2023 op cit note 224.

executives.[239] Similarly, the code does not contain recommendations regarding the minimum shareholding of executive management or post-employment shareholding requirements that need to be built up through long-term incentive plan awards or otherwise. By requiring executives to build up and hold a certain quantity of shares within a specified period of time is aimed at ensuring that executives interests are aligned with those of the shareholders or have 'skin in the game'.[240]

Lastly, the code does not contain any recommendations with respect to the identification or determination of key stakeholders for whom the value provided to them should be measured by means of non-financial performance measures. As such, companies may choose to measure the value provided to certain stakeholders and thereby not appreciate the reduction in value that certain other key stakeholders experience in their dealings with the company. The non-financial measures for *MTN Group Limited*, for example, only relate to the value provided to customers.[241] There are no non-financial measures addressing the interests of employees and other legitimate stakeholders such as suppliers or the community or society in general. There are also no measures addressing environmental concerns as recommended by King IV. The performance measures may also be too generalised such that one cannot understand the drivers of the performance concerned. While the *MTN Group Limited's* performance measures 'market share', 'customer churn' (being the percentage or number of subscribers that discontinued their service in a certain period) and 'relative customer NPS' (dealing with customer satisfaction as measured in terms of the Net Promoter Score Index) provide a fair indication of the value provided to customers,[242] they do not provide an indication of what drove the performance outcome. Van Zyl and Mans-Kemp also indicate that non-financial performance measures have proven to be very challenging to apply in practice, especially with respect to the triple context, and that King IV should have provided more guidance on how to apply these measures.[243]

[239] IoDSA 'Principal-agent Problems and Executive Remuneration - Remuneration Committee Guidance' op cit note 149 at 8-10.

[240] IoDSA 'Principal-agent Problems and Executive Remuneration - Remuneration Committee Guidance' ibid at 8-9.

[241] MTN Group Ltd Integrated Report for the year ended 31 December 2023 op cit note 224 at 117.

[242] Ibid.

[243] Van Zyl, M. and Mans-Kemp, N. op cit note 13 at 13.

d) Remuneration report

King IV recommends that executive remuneration should be disclosed in a standalone remuneration report consisting of three parts being the background statement, the overview of the remuneration policy and the implementation report.[244]

i. Background statement

The background statement should briefly provide context for the considerations and decisions relating to the executive remuneration of the company concerned. Reference should be made to aspects such as the internal and external factors that influenced remuneration, recent voting results on the remuneration policy and implementation report including any consequent measures taken, key areas of focus and decisions taken by the committee during the reporting period, whether remuneration consultants were used, whether the policy achieved its objectives and future areas of focus.[245]

While there appears to be some flexibility with these recommended disclosures, the disclosure with respect to the recent shareholder voting results and consequent actions taken appear to be more specific.[246] However, these details are not always provided in the background statement.[247]

ii. Overview of the remuneration policy

The overview of the remuneration policy should deal with the main provisions of the policy including its objectives and the manner in which it attempts to achieve these objectives. It should explain how the policy addresses fair and responsible executive remuneration in the context of overall employee remuneration, and set out the following arrangements with respect to remuneration of the company:

- the various components of remuneration and the design principles with respect to that of the executive (as well as for other employees at a high level);
- a description of the framework and the performance measures used to assess the achievement of strategic objectives and positive results including the relative weighting of each performance measure and the measurement period involved;

[244] Part 5.4 par 32 of King IV (at 65).

[245] Part 5.4 par 33 of King IV (at 66).

[246] Part 5.4 par 39 of King IV (at 67). In terms of this paragraph, the company should disclose with whom the company engaged, the nature and form of engagement and the steps taken to address the objections and concerns of the shareholders concerned.

[247] See for example, Naspers Ltd Integrated Annual Report for the year ended 31 March 2023 op cit note 223 at 139.

- an illustration of the potential impact on the total remuneration for executive management on a single, total figure basis of applying the policy at the minimum, on-target and maximum results;
- an explanation of how the principles 'fairness' and 'responsibility' relating to executive remuneration in the context of overall employee remuneration is addressed;
- the use and justification of benchmarks such as comparable companies with reference to factors such as the size of the company and their business lifecycle;
- details contained in executive contracts relating to termination payments; and
- a reference to an electronic link at where the remuneration policy can be accessed by the public.[248]

The policy should also indicate whether it includes any malus or clawback provisions.[249]

Perhaps the biggest concern with these requirements is that King IV does not set out how the potential impact on the total remuneration for executive management at the various performance thresholds should be illustrated. The current flexibility permitted with regard to these disclosures can lead to the potential impact of these incentive schemes being difficult to understand or compare between companies both for institutional shareholders with shareholdings in several companies and analysts faced with many listed companies. As such, this flexibility can compromise the efficacy of this governance measure.

iii. Implementation report

The implementation report should contain details of all remuneration paid or awarded to the members of the board and the executive management of the company. In particular, it should include the disclosures with regards to the remuneration paid to directors and prescribed officers of the company in terms of the SA Companies Act,[250] and ensure that the remuneration of each member of executive management is set out in separate tables for the following:

- a single, total figure of remuneration paid and payable to executive management for the financial year concerned, as well as all the various components that this comprises at the fair value of each component;

[248] Part 5.4 par 34 of King IV (at 66).

[249] Part 5.4 par 30 of King IV (at 65).

[250] Chapter 2.4.1 (b) above.

- the details of variable incentive awards that have not yet vested including the number of awards, the values at the grant dates, the award, vesting and expiry dates, and the fair value at the end of the reporting period; and
- the cash value of all awards made under variable remuneration incentive schemes that were settled during the financial year concerned.[251]

The following disclosures should also be set out in the implementation report:

- the performance measures used in respect of variable incentive schemes including the relative weighting of each, the targets set for the performance measures and the value of the related awards achievable at the various target levels, and the performance of the company and of the executive managers individually against the set targets;
- any termination payments made as well as the reasons for these payments;
- a statement as to the company's compliance with the policy and whether there were any deviations from the policy.[252]

The King IV disclosure recommendations are intended to apply to all executive management members, yet it appears that listed companies are not properly compliant in some cases. For example, the *MTN Group Limited* stated in their 2022 remuneration report that '[a]n executive by nature or sitting on an executive committee does not automatically mean that the executive role is defined as a prescribed officer'. They then identified four prescribed officers, in addition to the two executive directors, and then provided the above disclosures for these six individuals.[253] As previously discussed, King IV defines the executive management team as 'including' (as opposed to 'consisting' of) executive directors and prescribed officers as defined in the SA Companies Regulations.[254] It follows that not all executive management members necessarily have to be prescribed officers, and certainly does not mean that King IV's recommended disclosures in the implementation report are only applicable to executive directors and other prescribed officers. The correct interpretation of the King IV would be to provide disclosures for all 16 members of the executive committee. By virtue of their membership of the executive committee, these individuals may

[251] Part 5.4 par 35 preamble, (a) of King IV (at 67).

[252] Part 5.4 par 35(b)-(d) of King IV (at 67).

[253] MTN Group Ltd Integrated Report for the year ended 31 December 2022 at 92 available at https://www.mtn.com/wp-content/uploads/2023/04/MTN-Group-FY-22-Integrated-Annual-Report.pdf last accessed on 15 September 2023.

[254] Chapter 2.2.1 above.

in turn be prescribed officers in terms of the SA Companies Regulations. However, the *MTN Group Limited* is not alone in adapting these recommendations. As suggested by the statement contained in their report that their approach is supported by Deloitte research into JSE top 100 companies, there are clearly other companies listed on the JSE that are not properly compliant.[255] Some of these companies, such as *Naspers Limited* and S*hoprite Holdings Limited*, appear to have chosen to deviate even further from these recommendations by only disclosing the remuneration of their executive directors being the Chief Executive Officer and the Chief Financial Officer.[256]

As the disclosures recommended by King IV (and thereby, the JSE Listings Requirements) include the disclosures required by the SA Companies Act with respect to actual remuneration paid or awarded, listed companies are ultimately forced to duplicate these disclosures in the company's remuneration report and their financial statements. There is also no standard format for these disclosures such that companies may adopt their own formats making comparisons between companies and from one year to the next difficult to achieve for users of remuneration reports.

While the disclosure of share incentive awards is comprehensive and assists the user in understanding the potential liability of the company for these amounts, the code does not require disclosure as to the basis of the awards or how the value of the award was calculated. Consequently, users of the remuneration report may not understand the reasons for the awards or how the values of the awards were calculated, such that they may not be able to determine whether the awards were fair and responsible.

Viviers indicates that another area of concern, as raised by shareholder activists, is that there is insufficient disclosure of performance measures and targets in order to hold the companies concerned accountable with respect to executive remuneration in the context of the company's performance.[257] If one considers the remuneration reports of *Naspers Limited* for the 2022 financial year, for example, the report only indicates the measures, the weighting of the measures and that the targets were met. However, there is no indication of what those targets were and merely a reference to the relevant page number in the annual report with

[255] Ibid.

[256] Naspers Ltd Integrated Annual Report for the year ended 31 March 2023 op cit note 223 at 147-159. Shoprite Holding Ltd Integrated Report for the year ended 2 July 2023 op cit note 231 at 110-111.

[257] Viviers, S. op cit note 92 at 13.

respect to the company's performance for the measure concerned.[258] There is, therefore, no way to link the achievement of these measures with the performance of the company. Their implementation report for the 2023 financial year now reflects the measures, the weighting of the measure, the target and the actual performance of the company against that target. Unfortunately, the performance of the company indicated is subject to several adjustments, the amounts of which are not disclosed.[259] There is, therefore, still no way to link the achievement of these measures with the performance of the company. Related to this concern, King IV does not require disclosure for instances where the remuneration committee has overridden a formulaic outcome in order to prevent a windfall gain for the executive or to ensure that the executive receives an award.

Lastly, although King IV recommends that the implementation report provides a statement as to whether the remuneration paid or awarded is compliant with the remuneration policy as well as whether there have been any deviations from the policy, the code does not provide the circumstances under which deviations from the policy may be allowed, the process for the approval of these deviations and the details that must be disclosed. The payment of executive remuneration that does not comply with the approved remuneration policy may defeat the objectives that the company seeks to achieve with the level and structure of the remuneration set in terms of the policy. Stapledon indicates that excessive termination payments, particularly, can be a cause for concern especially where the executive's employment has been terminated due to poor performance and the company itself is not performing.[260]

e) Shareholder vote

King IV recommends that the remuneration policy and the implementation report are required to be tabled before the annual general meeting each year for a separate non-binding advisory vote by the shareholders of the company. Where 25 percent of the shareholders vote against either the remuneration policy or the implementation report, the board must, at a minimum, engage with the dissenting shareholders to ascertain the reasons for their votes and appropriately address their objections and concerns raised. This process may involve amending the

[258] Naspers Ltd Integrated Annual Report for the year ended 31 March 2022 at 132-133 available at https://www.naspers.com/~/media/Files/N/Naspers-Corp-V2/integrated-annual-report-footer.pdf last accessed on 15 June 2023.

[259] Naspers Ltd Integrated Annual Report for the year ended 31 March 2023 op cit note 223 at 150-151.

[260] Stapledon, G. 'Termination Benefits for Executives of Australian Companies' (2005) 27 *Sydney Law Review* 683.

remuneration policy, or clarifying or adjusting the remuneration governance and/or process. The dissenting shareholders with whom the company engaged, the manner and form of the engagement, and the nature of steps taken to address their objections and concerns, should be disclosed in the background statement of the remuneration report.[261]

The involvement of the company's shareholders in the approval of the executive remuneration typically gives rise to two issues. The first issue relates to the code only providing for the involvement of shareholders in the approval process as opposed to other stakeholders, while the second issue relates to the code providing for the vote of the shareholders on the proposed remuneration to be non-binding as opposed to binding.

i. Shareholder approval to the exclusion of other stakeholders

Johnston suggests that there are at least three reasons for the code not providing for the involvement of stakeholders other than the shareholders in the formal approval process of executive remuneration. These reasons include the shareholders being responsible for the appointment of directors, that company resolutions are tabled at the annual general meeting of shareholders and that it would be impractical, if not impossible, to require all stakeholders to express a view or vote on the remuneration policy and implementation report.[262]

However, Luiz indicates that only involving the shareholders in the approval process ignores the voices of other stakeholders who may have concerns as to the level and structure (and/or incentive-linked performance measures) of executive remuneration that have not been addressed by the shareholders.[263] Shareholders, many of whom are institutional investors, may be more focussed on the financial performance of the company and therefore more concerned with financial performance targets only. They may, therefore, not be concerned that the executive management of the company are paid incentive bonuses for achieving these targets through, for example, savings in employee costs as a result of employees that have been retrenched in the performance period when other cost saving options were available.[264]

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[261] Part 5.4 par 37-39 of King IV (at 66).

[262] Johnston, A. 'Proposed changes to the Companies Act–A case of two steps forward and one step back?' (2022) 22.1 *Without Prejudice* 9 at 11.

[263] Luiz, S. 'Executive remuneration and shareholder voting' (2013) 25 (3) *SA Merc LJ* 267 at 299.

[264] Wiese, T. op cit note 167 at 1748. Stewart, A., Stanford, J. and Hardy, T. *The wages crisis in Australia: what it is and what to do about it* (2018) 149, 152.

Mangen and Magnan also indicate that shareholders are often less risk adverse than other stakeholders, such as employees and lending institutions, and may approve policies that could jeopardise the long-term sustainability of the company.[265] The interest of creditors for the trade-related supply of goods and services to the company and of interest-bearing finance often exceed the interest that shareholders have in the company. For example, in the 2022 balance sheet of *MTN Group Limited*, the interest of the group's shareholders amounts to R117 billion, while the interest of the trade- and finance-related creditors amount to R139 billion.[266] As employees below the executive typically earn almost all of their income in the form of salaries or wages from the company, they also have a significant personal financial interest in the company. Other stakeholders such as key customers and the revenue authority also have significant interests in the company and would, therefore, be interested in the company following an appropriate strategy for its long-term sustainability.

ii. Non-binding vote compared to a binding vote

The IoDSA explains that the reason King IV provides for a non-binding vote is that it can be used constructively by shareholders to raise concerns with the remuneration policy or the implementation report, and initiate engagement between them and the remuneration committee. A binding vote, on the other hand, would not provide for this level of engagement in that a vote against the policy or the implementation report would simply be a rejection of the policy or report concerned. The threshold of 25 percent of the shareholders voting against the policy or the implementation report, as provided by King IV, is also considered sufficiently low to trigger this engagement. The importance of properly engaging with shareholders in the setting of the policy or determination of the actual remuneration is, therefore, emphasised.[267]

However, the IoDSA also indicates that many shareholders appear to be apathetic towards the approval process. They suggest that there are several reasons for this apathy. Shareholders may believe that a non-binding vote will not make any difference with respect to the approval of the executive remuneration policies or implementation reports, especially

[265] Mangen, C. and Magnan, M. '"Say on Pay": A Wolf in Sheep's Clothing?' (2012) 26.2 *Academy of Management Perspectives* 86 at 95.

[266] MTN Financial Statements 2022 at 22 available at https://www.mtn.com/wp-content/uploads/2023/03/MTN-Group-FY-22-Annual-Financial-Statement.pdf last accessed on 18 June 2024.

[267] IoDSA 'Understanding King IV and what it is intended to achieve' March 2018 available at https://www.iodsa.co.za/news/389613/Understanding-King-IV-and-what-it-is-intended-to-achieve last accessed on 5 September 2023.

those with an insignificant holding. Shareholders may also have insufficient resources, capacity or knowledge to do a detailed review of the financial statements and hold the executive to account. Similarly, they may not have sufficient insight into the company's operations to enable them to conduct a proper evaluation. Finally, they may be disinterested in shareholder matters or simply believe that the board is appointed to oversee management of the company and should, therefore, be left to get on with the business of running the company failing which they will be removed. [268]

Whether a binding vote would address shareholder apathy, studies show that the introduction of the binding vote on the remuneration policy in the United Kingdom has not improved the approach of shareholders over the previous dispensation where the vote was non-binding. Shareholder engagement does not appear to have improved and shareholders continue to abstain from voting on directors' remuneration.[269]

2.4.3 Employment Equity Act

In terms of the revised Income Differential Report (EEA4 form) issued in terms of the regulations to the Employment Equity Act, companies are required to submit details of the number of employees and income differentials at each level of the organisation by race and by gender to the Employment Conditions Commission.[270] In particular, companies are required to disclose the average annual remuneration of the top 10 percent and the bottom 10 percent of earners, as well as that of the median earners in the company. Companies are also required to indicate whether they have a policy in place to address the differential or gap between the highest and lowest paid employees in the company.[271]

While the Income Differential Report is a confidential document (the Commission is not permitted to disclose any identifiable information in the statement including the names of the companies submitting the information), these provisions play a role in requiring companies to take

[268] IoDSA 'Guidance Paper: Effective stakeholder engagement within the context of remuneration' May 2021 at 6-7 available at https://cdn.ymaws.com/www.iodsa.co.za/resource/collection/04630F89-33B7-43E7-82B3-87833D1DC2E3/King_Committee_Guidance_paper_on_effective_sta.pdf last accessed on 15 February 2024.

[269] The experience of the United Kingdom and the reasons for the continued shareholder apathy are discussed comprehensively in Chapter 4.4.5 (a)(ii) below.

[270] Regulation 12 of the Employment Equity Regulations of 2014 (GN 595 in GG 37873 of 1 August 2014).

[271] GN R1057 in GG 42627 of 8 August 2019.

positive measures to progressively reduce disproportionate income differentials where these are found to exist.[272]

2.4.4 SA Companies Amendment Act

The SA Companies Amendment Act introduces certain amendments to the SA Companies Act with respect to the remuneration of executives and other employees that incorporate some of the recommendations of King IV and types of disclosures required in terms of the Employment Equity Act. The amendments are intended to strengthen shareholder governance with respect to executive remuneration, and to make companies, shareholders and stakeholders aware of 'unsustainable pay discrepancies' and address these where necessary.[273] The amendments were assented to by the President on 25 July 2024, yet will only come into operation at a later date fixed in terms of a notice to this effect in the Government Gazette.[274]

The enacted amendments only apply to public companies and state-owned companies with no reference being made to whether the public companies envisaged in the amendments are required to be listed. Private companies, and even those for whom an audit is required due to their significant interest from an economic or social perspective, are excluded from the enacted amendments.[275] As the IoDSA and King IV Committee indicated in their response to the DTIC with respect to the Companies Amendment Bill of 2021, private companies should not be excluded from the requirements of the amendments as the pay gaps in many private companies are far bigger than that in listed companies but are not disclosed as there is no requirement for this information to be made public.[276]

Section 6 of the SA Companies Amendment Act provides for the insertion of section 30A and section 30B which require public and state-owned companies to prepare a remuneration policy

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[272] Section 27(5) of the Employment Equity Act.

[273] Part 1 par 3.10 of the Background Note and Explanatory Memorandum on the Companies Amendment Bill of 2021 (introduced by GN 586 of *GG* 45250 of 1 October 2021).

[274] Section 25 of the SA Companies Amendment Act.

[275] Note 191 ibid. Section 30(4) of the SA Companies Act, which deals with the disclosure of the remuneration of directors and prescribed officers in the financial statements of companies that need to be audited, is retained albeit with minor amendments. The implementation of the enacted amendments will consequently result in the duplication of disclosure for public companies in that they would need to disclose similar information with respect to executive remuneration in both this section (financial statements) and the enacted amendments (remuneration report).

[276] IoDSA and King Committee 'RE: IoDSA and King Committee Comment Letter on the 2021 Companies Act Amendment Bill' at B3 (comments) available at https://cdn.ymaws.com/www.iodsa.co.za/resource/collection/4AA44036-9D3A-40CF-BF7C-C84CAAD70011/IoDSA_and_King_Committee_Comment_Letter_on_2021_Companies_Act_Amendment_Bill_31_October_2021.pdf last accessed on 15 September 2023.

and remuneration report respectively which must be each presented separately at the annual general meeting for approval by the shareholders.

a) Remuneration policy

In terms of the enacted amendments, the company must prepare a separate remuneration policy.[277] The amendments do not address the content that should be contained in the policy, such that the recommendations of King IV with regard to this content are likely to continue being applied. As such, the concerns with the level and structure (including incentive-linked performance measures) of executive remuneration in remuneration policies currently may continue to fester in failing to address stakeholder interests once these amendments are in operation.[278] There is also no indication as to what the format of the policy should entail. Companies are, therefore, likely to continue adopting their own formats for the remuneration policy. As a result, the concerns expressed by some analysts that the lack of a standard format for the policy makes comparison between companies difficult will continue to prevail. Institutional shareholders with investments in many listed companies may also find that their ability to properly review the policy will continue to be challenging.[279]

b) Remuneration report

The enacted amendments provide that the remuneration report must consist of a background statement, a copy of the remuneration policy as discussed above and an implementation report.[280]

The implementation report of the company concerned is required to set out details of the following:

- the 'total remuneration' received by each director and prescribed officer in the company;
- the 'total remuneration' relating to the employee that has the highest total remuneration and that of the employee that has the lowest total remuneration,
- the average total remuneration and the median remuneration of all its employees;

[277] Section 6 (section 30A (1)) of the SA Companies Amendment Act.

[278] Chapter 2.4.2 (c) above.

[279] Chapter 2.4.2 (d)(ii).

[280] Section 6 (section 30B (2) and (3)) of the SA Companies Amendment Act.

- the remuneration gap of the company expressed as a ratio between the total remuneration of the top five percent of the highest paid employees of the company and of the bottom five percent of the lowest paid employees of the company.[281]

The amendments indicate that 'total remuneration' for the purposes of this section refers to 'all salary and benefits received including any employer contributions to benefit funds and any short-term or long-term incentives including share options and incentive awards'.[282]

The duty of the directors to prepare a remuneration report is consistent with the recommendations contained in King IV,[283] as well as the company legislation of several other countries including the United Kingdom, Australia and Germany.[284] Other than the disclosures with respect to the remuneration levels in the company, there is no indication as what additional information should be disclosed in the implementation report. Specifically, there is no requirement to provide information on performance measures as recommended by King IV, and as such the King IV recommendations are likely to continue being applicable until these disclosures are otherwise addressed. There is also no indication as to what the format of the remuneration report should involve. While the preceding Companies Amendment Bill of 2021 provided for the remuneration report to be set out in a 'prescribed manner' which appeared to suggest that this format might be set out in a revision to the SA Companies Regulations,[285] the enacted amendments make no provision for such a format.

With respect to the disclosures of the remuneration levels in the company, including the remuneration gap, the concept and reasoning behind these disclosures is similar to that in the company legislation of the United Kingdom and the securities legislation of the United States.[286] The Department of Trade, Industry and Competition ('DTIC') indicates in their 'Background Note and Explanatory Memorandum' to the Companies Amendment Bill of 2021 that these disclosures are intended to address the concerns associated with excessive executive remuneration and the remuneration differential (or gap) between the executives and the lowest paid employees. They indicate that these concerns are considered a historical challenge in South

[281] Section 6 (section 30B (3)(c)) of the SA Companies Amendment Act.

[282] Section 6 (section 30B (1)(a)) of the SA Companies Amendment Act.

[283] Chapter 2.4.2 (d).

[284] The company legislation of these countries with respect to executive remuneration is discussed in Chapter 4.

[285] Clause 6 (proposed section 30A (3)) of the Companies Amendment Bill 2021.

[286] The comparative position in this legislation is discussed in Chapter 4.4.4 (c) (v).

African and contribute to the country's inequality which in turn contributes to much of the workplace conflict in South Africa. The disclosures would also provide shareholders with a means of responding to their dissatisfaction with excessive remuneration and would have a 'shrinking effect' on remuneration through boards and executives refraining from awarding and receiving excessive remuneration due to the impact that these levels can have on the reputation of the company.[287] Arsalidou and Labi suggest that the thinking behind remuneration gap disclosures is ultimately to pressure companies into constraining executive remuneration by shaming those that have excessive remuneration ratios.[288] Deloitte suggest that unusually high ratios may also indicate that the lower-level employees in the companies concerned are under-remunerated thereby providing a further benefit to these disclosures.[289]

However, several commentators have expressed concerns with these disclosures. The IoDSA and the King Committee in their response to the DTIC with respect to the Companies Amendment Bill of 2021 indicated that, while they supported the remuneration gap disclosures in principle, the focus on executive remuneration by the DTIC creates the impression that executive pay is the only or main contributor to inequality in South Africa. Other contributors also include the country's political history, poor access to quality education, corruption and high levels of unemployment. Focus should, therefore, be on 'uplifting the bottom of the pyramid', creating value for all stakeholders, contributing to the South African fiscus and creating jobs for millions of citizens'.[290]

Chaplin and Jago, indicate that in light of the competition for available talent between South African and foreign companies, the downward pressure intended to be applied to executive remuneration by these disclosures may result in talented executives being encouraged to look for better paying positions overseas. This is especially pertinent considering that South Africa is experiencing a 'brain drain' with many skilled people leaving the country in search of better opportunities. These disclosures may also be somewhat difficult to calculate considering the relative complexity of executive remuneration compared to that of lower level employees.

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[287] Part 1 par 3.1 and 3.10 of the Background Note and Explanatory Memorandum on the Companies Amendment Bill 2021 op cit note 272.

[288] Arsalidou, D. and Labi, C. op cit note 104 at 297.

[289] Deloitte 'Director and Prescribed Officer remuneration at JSE listed companies' September 2021 at 35 available at https://www.deloitte.com/za/en/services/consulting/analysis/deloitte-executive-remuneration-report-2021.html last accessed on 15 June 2024.

[290] IoDSA and King Committee 'RE: IoDSA and King Committee Comment Letter on the 2021 Companies Act Amendment Bill' op cit note 275 at B2 and B3. See also Chapter 2.3.1 (c) above.

Furthermore, these disclosures may induce companies to restrict the number of entry-level employees it employs and rather choose to outsource these functions as a way to improve these disclosures. Although the commentary to the amendment bill deals with this possibility, the bill itself did not address this possibility.[291]

Deloitte also suggest that variations between companies, and even between companies in the same industry, with regard to their organisational characteristics including their operating models, organisation size and levels of automation can make comparisons misleading. Large companies, especially those with an international footprint, are likely to find the intricacies of these disclosure requirements onerous and cost intensive. Companies may also resort to focussing more on cash-based remuneration in order to improve the ratios and spending less on human capital development expenditure such as environmental, social and governance activities which would offer more value to employees and society in general. Executive remuneration is also typically variable with incentive payments intended to be linked to their company's performance while other employees tend to be less directly linked to company performance. In good years the executive remuneration may show higher remuneration gap ratios than in poor years.[292]

c) Shareholder approval

The enacted amendments provide that the remuneration policy needs to be presented to shareholders at the annual general meeting ('AGM') for a separate binding vote in terms of an ordinary resolution. The remuneration policy needs to be approved every three years or whenever there is a material change to the policy by means of an ordinary resolution. Where the remuneration policy is not approved by the shareholders, it must be presented at the next AGM or at a shareholders' meeting called for this purpose until the policy is approved.[293]

The amendments also provide that the implementation report relating to the previous financial year must be presented to shareholders at the AGM for a binding vote in terms of an ordinary resolution.[294] Where the implementation report is not approved at this AGM, the

[291] Chaplin, V. and Jago, D. 'Companies Amendment Bill 2021: Drawing attention to the remuneration gap' *Corporate and Commercial Alert* available at https://www.cliffedekkerhofmeyr.com/en/news/publications/2021/Corporate/corporate-and-commercial-alert-6-october-companies-amendment-bill-2021-drawing-attention-to-the-remuneration-gap.html last accessed on 20 June 2024.

[292] Deloitte op cit note 288 at 36.

[293] Section 6 (section 30A (2)) of the SA Companies Amendment Act.

[294] Section 6 (section 30B (2)) of the SA Companies Amendment Act.

remuneration committee (or any other committee of the company responsible for remuneration) must present an explanation at the next AGM as how to shareholder concerns have been considered and the non-executive directors who serve on the committee concerned must stand for re-election as members of the committee at this AGM.[295] If at this AGM, the implementation report relating to the previous financial year is also not approved, the non-executive directors that served on the committee concerned will not be eligible to serve on the committee for a period of two years following this AGM but may remain as members of the board.[296] These provisions do not apply to members of the committee concerned who have served for less than 12 months in the relevant year.[297]

In their Background Note and Explanatory Memorandum to the Companies Amendment Bill of 2021, the DTIC indicated that their separation of the vote on the remuneration policy and the implementation report, as well as the presentation of the remuneration policy to the AGM every three years, was based on the practices employed in several other countries.[298] The ordinary resolution, as opposed to a special resolution, on the remuneration policy and implementation report also appears to follow the practices adopted in several other countries.[299] The binding vote on the both the remuneration policy and the implementation report, with consequences for the members of the remuneration committee after an unsuccessful shareholder vote on the implementation report, appears to be aimed at providing shareholders with an improved mechanism of addressing their grievances where they are dissatisfied with either the remuneration policy or the implementation report.[300] These amendments would also be in line with their overall objective being to promote shareholder governance on executive remuneration as indicated above.[301]

The IoDSA and the King Committee, however, have expressed several concerns with the amendments. In their response to the DTIC with respect to the Companies Amendment Bill of 2021 they indicated that, while they supported a binding vote on the remuneration policy subject

[295] Section 6 (section 30B (4)) of the SA Companies Amendment Act.

[296] Section 6 (section 30B (5)) of the SA Companies Amendment Act.

[297] Section 6 (section 30B (6)) of the SA Companies Amendment Act.

[298] Part 1 par 3.11 of the Background Note and Explanatory Memorandum on the Companies Amendment Bill of 2021 op cit note 272.

[299] Part 1 par 3.14 ibid.

[300] Part 1 par 3.15 – 3.17 ibid.

[301] See note 272 ibid.

to certain conditions, they were strongly opposed to the introduction of a binding vote on the implementation report and the requirement that the members of the remuneration committee must step down from the committee in the event of a consecutive unsuccessful shareholder vote on the implementation report.[302] They indicated that the binding vote on the implementation report is 'untenable' and that 'no country in the world has a legislated binding vote on the implementation [report]'. They pointed out that the implementation report is a consequence of the remuneration policy and that the vote on the implementation report is retrospective in that it relates to the increases and incentives awarded in the prior year. Should the shareholders vote against the implementation report, the consequences for the company and executives with respect to amounts already paid or awarded are unclear as a mandatory requirement for executives to repay amounts that were not approved may be unconstitutional and illegal under employment and contract law.[303] Johnston also indicates that no provision appears to be made for whether the company will have a clawback with respect to remuneration paid in the previous year where there is dissent against the implementation report.[304] The adoption of a binding vote on the remuneration policy and implementation report would also appear to defeat the objective of a non-binding vote which, as the IoDSA suggests, is to encourage constructive engagement with shareholders.[305]

The IoDSA and the King Committee also indicated that the requirement for the members of the remuneration committee to step down from the committee in the event of a consecutive unsuccessful shareholder vote on the implementation report can lead to unintended consequences. These include the negative impact that this requirement could have on the board and its continuous functioning, as well as the reputation of these members such that directors may not wish to serve on remuneration committees in the future thereby exacerbating the shortage of skills in this area.[306]

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[302] IoDSA and King Committee 'RE: IoDSA and King Committee Comment Letter on the 2021 Companies Act Amendment Bill' op cit note 275 at B3.

[303] Ibid.

[304] Johnston, A. op cit note 261 at 12.

[305] Chapter 2.3.2 (e) (IoDSA op cit note 266) above.

[306] IoDSA and King Committee 'RE: IoDSA and King Committee Comment Letter on the 2023 Companies Act Amendment Bill' 2 October 2023 at par 3 available at https://cdn.ymaws.com/www.iodsa.co.za/resource/ collection/ 4AA44036-9D3A-40CF-BF7C-C84CAAD70011/ IoDSA_and_King_Committee_2023_CAB_Comment_Letter.pdf last accessed on 4 January 2024.

Apart from the concerns with the amendments above, there remains the concern as to why South African corporate law intends to continue excluding stakeholders other than shareholders from the formal approval process despite the concerns with the current process.[307]

2.5 Summary

The various components of a company's executive remuneration package are intended to attract, motivate and retain high calibre individuals, and the company's ability to achieve these objectives is dependent on determining the appropriate level and structure of executive remuneration. Typically, these levels are determined by both market forces and societal constructs as to what executives should be earning in line with the theories to this effect, while these structures are determined by the dictates of agency theory in needing to align the interests of executives with that of the shareholders or are determined as a consequence of agency theory by the influence of dominant chief executive officers. These levels and structures are also impacted by several other factors including the personal characteristics of the executive, particular attributes of the company and the specific features of the institutional environment in which the company operates. In South Africa, research suggests that the levels are influenced both my market forces and social constructs, while the structures are largely determined by the agency approach with the managerial power theory and other behavioural theories being stronger during periods of weak economic performance. In light of the current economic environment, effective corporate governance measures would need to ensure that executive remuneration packages align the interests of executives with those of the shareholders or the company itself. At the same time, the demands of the informal institutional environment of South Africa need to be considered during this process.

The level and structure of executive remuneration can give rise to various issues for the sustainability of companies and especially the interests of their stakeholders where these levels are disproportionate or the structures of remuneration packages, including incentive-linked performance measures and associated corporate governance measures, are poorly designed. Disproportionate levels may result in the company's reputation in the eyes of customers and suppliers being impaired, the loss of employee productivity and industrial action, and instability in the communities within which the companies operate, thereby adversely impacting the long-term sustainability of the company. Poorly designed structures and incentive-linked performance measures, on the other hand, may result in the encouragement of excessive risk taking by the executives, the use of financial

[307] Chapter 2.3.2 (e) above.

performance measures that may result in performance risk for the company, and the insufficient protection and advancement of stakeholder interests, thereby also adversely impacting the long-term sustainability of the company.

An evaluation of the current regulatory framework in South Africa pertaining to executive remuneration, as supported by evidence of the remuneration practices amongst some of South Africa's top listed companies, suggests that this framework is ineffective in addressing the issues caused by inappropriate levels and structures of executive remuneration. Apart from the disclosure of executive remuneration and the untested derivative remedy for executive remuneration, the SA Companies Act does not deal comprehensively with these issues and as such provides little protection or advancement for the company's stakeholders. These issues are left largely for King IV to address which is essentially voluntary for non-listed companies. The code also tends to provide too much flexibility in the application of its recommended practices especially with regard to the level of executive remuneration, and the nature of incentive-linked performance measures and associated corporate governance measures including disclosures. As a consequence, some of the top JSE-listed companies in South Africa appear to be paying lip service to the level of executive remuneration relative to other employees and allowing for the dominance of financial performance measures which may also be incomplete and capable of manipulation, while the disclosures relating to their remuneration policies and implementation reports may be difficult to understand and compare to other companies. The code also does not require the inclusion of important corporate governance measures in the remuneration policy with regards to executive remuneration such as malus and clawback provisions, gatekeeper and modifier provisions, and the discretion of the remuneration committee with respect to the implementation of the policy. The amendments to the SA Companies Act appear focussed on addressing the levels of executive remuneration by means of the pay differential disclosures and by providing shareholders with more influence over the remuneration policy and implementation report. Critically, however, the structure of executive remuneration including the associated incentive-linked performance measures and corporate governance mechanisms, on the other hand, are not dealt with by these amendments.

Chapter 3

Advancement of corporate stakeholder interests in South Africa

3.1 Background

Financial performance measures amongst the top JSE-listed companies, as discussed in the previous chapter, can be overwhelmingly dominant and incomplete with non-financial performance measures often being vague and insignificant. This condition suggests that the recommendations of King IV, as incorporated into the JSE Listings Requirements, to this effect are ineffective in regulating the nature and governance of performance measures and thereby the protection and especially the advancement of the company's stakeholders other than its shareholders. While the DTIC attempts to address the issues associated with the level of executive remuneration (and in particular, the inequality in South Africa) by means of the pay differential disclosures in their recently enacted amendments to the SA Companies Act, they have missed the opportunity of incorporating provisions dealing with the structure of executive remuneration including the nature of performance measures and associated corporate governance measures into the Act. Yet these amendments, however, may represent a welcome change to their approach to the role of the SA Companies Act, as stated by the DTIC (or the Department of Trade and Industry as it was formerly known) during the Act's development, in addressing the socioeconomic concerns prevalent in South Africa. Their original approach advocated methods outside the SA Companies Act to address these socioeconomic concerns; these amendments are conceivably a move towards addressing these concerns now also through the Act.

In this chapter, the development of the DTIC's original approach is loosely retraced with reference to their consideration of the different approaches to stakeholder interests and the current common law of South Africa, the approach adopted by the United Kingdom in developing their Companies Act which had occurred a few years earlier, and the relevant provisions of the Constitution of the Republic of South Africa 1996 ('SA Constitution'), while also considering some of the developments which have occurred in these areas since this process was undertaken. This review is intended to provide an understanding of the context for the approach that they ultimately arrived at in order to establish whether this approach is still valid and whether subsequent developments may suggest a new approach to addressing the socioeconomic concerns in South Africa.

Consideration is then given to the various state interventions and the various facilitative means that were aimed advancing stakeholder interests, as envisaged by the DTIC in terms of their original approach, with a view to assessing their efficacy in this regard as experienced in the two decades following the DTICs policy paper. In particular, the legislation and policies addressing socioeconomic concerns directly and indirectly are discussed, before the facilitative means consisting of stakeholder board representation, charitable contributions and the different approaches of King IV and its predecessors to stakeholders other than shareholders are discussed. The prominent Environmental, Social and Governance (ESG) movement, considered an alternative lens to the approaches in King IV, is also discussed.

Consideration is lastly given to a new approach to advancing stakeholder interests and, in particular, the nature of performance measures that address these interests. This approach is introduced as the basis upon which reforms to the current corporate governance code, and the SA Companies Act pertaining to executive remuneration and the nature of incentive-linked performance measures could be drafted. It draws from contemporary stakeholder theory and takes into account the demands of the SA Constitution, while also being consistent with the common law pertaining to company law.

3.2 Development of the current approach to advancing stakeholder interests

In 2004, the DTIC (or the Department of Trade and Industry as it was known at this time) embarked upon a process to reform South African Company law in light of the fundamental changes that had occurred globally and in South Africa particularly since the last review was performed.[308] They noted that the Companies Act of 1973 was 'largely out of line with modern business practices and deficient in some critical areas, notably in the area of shareholder protection, capital rules and corporate governance generally'.[309] The process involved a review of the Companies Act 1973, the Close Corporations Act and the common law relating to these corporate entities with a view to developing a new Companies Act that would include the promotion of growth in companies and the economy, additional employment and good governance, while also recognising the unique South African context and promoting equity in a manner that is consistent with the Constitution.[310]

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[308] South African Company Law for the 21st Century: Guidelines for Corporate Law Reform' (GN 1183 in *GG* 26493 of 23 June 2004) at 7. The last review was undertaken in 1973 and culminated in the promulgation of the Companies Act 61 of 1973 (the predecessor to the current Companies Act 71 of 2011). This document is hereinafter referred to as the 'SA Company Law Reform Guidelines'.

[309] Ibid at 19.

[310] Ibid at 9 and 14.

The DTIC started the reform process by attempting to address the fundamental question 'in whose interest should the corporation be run' with reference to the interests of the company's shareholders and its other stakeholders. A stakeholder of a company is traditionally defined as 'any group or individual who can affect or is affected by the achievement of the organisation's objectives',[311] and include the shareholders, employees, customers, suppliers of the company as well as the community in which the company operates.[312] While noting that in terms of the common law, directors owe a fiduciary duty to act in the interests of the company, which in this context has been interpreted by the courts to mean the collective interests of both present and future shareholders of the company,[313] the DTIC addressed this question with reference to the consideration of the history of the shareholder and stakeholder approaches, the reform process leading to the United Kingdom's Companies Act[314] which had happened several years earlier, and the mandates of the SA Constitution. In doing so, they considered whether a change to the common law position should be legislated through the SA Companies Act to address the socioeconomic concerns prevalent in South Africa.

3.2.1 Consideration of the history of the shareholder and stakeholder approaches

The question as to how the interests of these stakeholders should be protected and advanced by the executive management of the company has been debated since at least the early twentieth century. Although it is generally accepted that the executive management of the modern company should consider the interests of the company's stakeholders other than its shareholders in that it makes good business sense to do so, Cassim suggests that the crux of the matter is whether executives of South African companies 'must' consider these interests.[315]

a) Shareholder approach

The 'shareholder' approach argues that the company is represented by the shareholders of the company as it is these shareholders that have invested funds in the company and are entitled to the residual interest in the company on liquidation. As the executives of the company are required to exercise their fiduciary duties to act in the best interests of the company, they are therefore required to act the best interests of the shareholders. These interests are considered to

[311] Freeman, R.E. *Strategic management: A stakeholder approach* 25th Anniversary reissue (2010) 25.

[312] Cassim, F.H.I. et al op cit note 25 at 519.

[313] SA Company Law Reform Guidelines op cit note 307 at 19-23. Cassim, F.H.I. et al ibid at 515-516.

[314] Companies Act 2006 (c.46).

[315] Cassim et al ibid at 517-519.

be the pursuit of the maximation of profits and increased value for the shareholders of the company.[316]

The traditional shareholder approach and the enlightened shareholder approach differ in how the interests of other stakeholders should be taken into account in the pursuit of this objective.

i. Traditional shareholder approach

The 'traditional' shareholder approach takes the view that no responsibilities or obligations are borne towards other stakeholders, such as employees, customers, suppliers and the society at large.[317]

Allen indicates that the traditional shareholder approach has its origins in the mid-nineteenth century where the emphasis was on the individuals who had constituted the company, or the shareholders as owners of the company, and hence this understanding of the company came to be known as the 'property' conception of the company. Companies were considered to be distinctive, artificial corporate entities only in a weak sense and were in effect regarded as similar to limited partnerships. This concept could also be seen in the consequences for the shareholders where they did not enjoy the protection of limited liability as they do currently.[318]

He indicates that this concept was also particularly evident in the role of the board and the executive. As they were elected by the shareholders, it was unquestioned as to on whose behalf they were required to act and as such they were seen as agents of the shareholders.[319] In the Michigan Supreme Court case of *Dodge v Ford Motor Co*,[320] for example, the Dodge brothers, as shareholders of the company, successfully challenged Henry Ford's decision to suspend the further payment of dividends in order to retain these profits for the further expansion of his business and to lower the price of its products.

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[316] Cassim, F.H.I. et al op cit note 25 at 514-517. Norwitz, T.S. '"The Metaphysics of Time": A Radical Corporate Vision' (1991) 46.2 *The Business Lawyer* 377 at 377.

[317] Cassim, F.H.I. et al ibid at 514. Padia, N., Naik, M. and Callaghan, C. W. 'Variable executive remuneration and company performance: Insights from the Johannesburg Stock Exchange, South Africa' (2020) 20.1 *Acta Commercii* 1 at 8 and 9.

[318] Allen, W.T. 'Our Schizophrenic Conception of the Business Corporation' (1992) 14 *Cardozo Law Review* 261 at 266-270.

[319] Ibid.

[320] 204 Mich 459; 170 NW 668 (1919).

The Court stated that:

> 'A business corporation is organised and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of the directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the non-distribution of profits among stockholders in order to devote them to other purposes.'[321]

As Friedman states 'there is one and only one social responsibility of business - to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.'[322] His view is that the executive, as an employee of the shareholders or owners of the business, has a direct responsibility to these shareholders to act within their interests. These interests in relation to a profit organisation would be to make as much money as possible for the shareholders while conforming to the basic rules of society. Where the executive addresses some social cause such as not increasing the price of products or employing persons beyond that which is necessary, he or she is reducing the returns to these shareholders. In effect, the executive is both imposing taxes on the business and then deciding how the proceeds of the tax should be spent.[323] Profit maximisation or more wealth creation should, therefore, always be the objective of the company regardless of who benefits. The jurisdiction within which the company operates should then be responsible for addressing the redistribution of wealth and social welfare costs through the imposition of taxation and other regulatory measures.[324]

ii. 'Enlightened' shareholder approach

In terms of the 'enlightened' shareholder approach, the interests of stakeholders other than shareholders may be taken into account by executive management in discharging their fiduciary duties provided that these interests remain subordinate to those of the shareholders.[325]

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[321] 170 N.W. at 684.

[322] Friedman, M. *Capitalism and Freedom* 1962 at 133.

[323] Friedman, M. 'The Social Responsibility of the business is to increase its profits' (1970) *The New York Times Magazine* 13 September 1970 available at https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to last accessed on 2 July 2023.

[324] Friedman, M. op cit note 321 at 134-161.

[325] Cassim, F.H.I. op cit note 25 at 519.

The theory appears to have first been coined by the steering group responsible for reforming the United Kingdom's Companies Act in the late 1990s.[326] However, the origin of the theory can be traced back to at least the last quarter of the nineteenth century. As Allen indicates, the last quarter of the nineteenth century saw the emergence of social influences that would challenge the concept of the company simply being the property of the shareholders. This move largely coincided with the emergence of large conglomerates with a more dispersed share ownership such that shareholders of large companies became more comparable to investors rather than owners (or proprietors), while the companies themselves appeared to act as independent entities with their own objectives. These developments led to the rise of the so-called 'entity' concept of the company.[327]

During this time, it appears that the law attempted to reconcile the 'property' and 'entity' concepts by maintaining the property concept of the company but diminishing the profit maximisation objective of the company under the traditional shareholder approach particularly where the expenditure concerned could be considered as being for the long-term benefit of the company and its shareholders. The courts would allow the executive to incur reasonable corporate expenditures for charitable or social welfare purposes, which in effect reduced the amount of profit that shareholders would otherwise enjoy, provided these actions were aimed at ultimately increasing the value of the shareholders' interests in the company in the long-term.[328] This principle appears to be evident, for example, in the judgement of the *Hutton v West Cork Railway* case.[329]

The court stated that:

> 'It seems to me you cannot say the company has only got power to spend the money which it is bound to pay according to law, otherwise the wheels of business would stop, nor can you say that directors who have got all the powers of the company given to them …are always to be limited to the strictest possible view of what the obligations of the company are. The test [is whether it is done bona fide and] it is done within the ordinary scope of the company's business, and whether it is reasonably incidental to the carrying on of the company's business for the company's benefit. It is

[326] See 3.2.2 below.

[327] Allen, W. T. op cit note 317 at 270.

[328] Allen, W. T. ibid at 270-272.

[329] (1883) 23 ChD 654 (CA).

for the directors to judge…The law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company.'[330]

Cassim et al indicate that the principle in the *Hutton*-case is similar to the modern enlightened shareholder approach in that corporate philanthropy is acceptable provided that this is intended to benefit the company and its shareholders. They indicate that the courts over the years have tended to interpret this principle liberally such that the consideration of the interests of stakeholders including employees would be seen as being in the best interests of the company and ultimately its shareholders.[331]

b) Stakeholder approach

In terms of the 'stakeholder' (or 'pluralist') approach, executive management must consider the interests of both shareholders and other stakeholders of the company without any stakeholder having a predetermined place of precedence.[332] The interests of these other stakeholders, therefore, have independent value which is not subordinate to those of the shareholders.[333] As such the executive must balance these competing interests and in certain circumstances ignore the interests of the shareholders in favour of the interests of other stakeholders. The integration and trade-offs between the various stakeholders are then made on a case-by-case basis to serve the best interests of the company in the long term. [334]

The stakeholder approach appears to have had its origins in the early part of the twentieth century and grew out of the 'entity' concept of the company. As indicative of the sentiment at this time, the chief officer of General Electric made a public address in the early part of the twentieth century indicating that, although he acknowledged that he had an obligation to the shareholders of the company, he also bore a responsibility to employees, customers and the general public. These developments ultimately led to what become known as the '*social* entity' concept of the company whereby the company was seen as having responsibilities not only to the shareholders, but also to other parties such as employees and customers, such that the interests of no single constituency should be given preference by the executives of the

[330] Per Bowen LJ in *Hutton v West Cork Railway Co* (supra) at 672-673

[331] Cassim, F.H.I. et al op cit note 25 at 521 with reference to *Teck Corp Ltd v Millar* (1972) 33 DLR 93d) 288 (BCSC) 313-14.

[332] King IV at 25-26 ('Fundamental Concepts: Stakeholder-inclusive approach')

[333] Cassim, F.H.I. et al l ibid at 520. The approach requires the executive to consider the interests of stakeholders other than shareholders as 'an end in themselves rather than as a means to an end'.

[334] King IV ibid.

company.[335] The merits of the 'property' and 'entity' concepts of the company sparked the infamous debate between Harvard University professors Adolf A Berle and E Merrick Dodd Jr. in the early 1930s. While Berle adopted the view that the company bore a responsibility to maximise profits and increase wealth for its shareholders who were the providers of funds to the company (i.e. the property or shareholder approach), Dodd adopted the view that the company was both a profit making and social institution and therefore bore obligations or responsibilities to parties other than its shareholders (i.e. the 'social entity' or 'stakeholder' approach).[336] This latter approach is considered to be the origin of modern stakeholder theory.[337]

Parmar, Freeman, Harrison, Wicks, Purnell and De Colle indicate that the term 'stakeholder', in the context that it is currently used, appears to have only first been used in an internal memorandum at the Stanford Research Institute (now named SRI International Inc.) in 1963. The term was intended to challenge the idea that shareholders were the only group that management should consider. Essentially, stakeholder theory developed from efforts to address management problems that involved high levels of uncertainty and change by the late 1970s and early 1980s. These developments culminated in R. Edward Freeman's seminal book *Strategic management: A stakeholder approach* published in 1984.[338] In his book he attempted to address three interconnected problems. First, one needed to understand how value is created and traded and suggested that one should see business as a set of relationships among groups that have a stake in the activities that constitute the business. He argues that in order to understand the business, the executive needs to establish how these relationships work and change over time. He or she needs to manage these relationships to create as much value for the stakeholders of the company and to manage the distribution of that value. Where conflicts amongst the various stakeholder interests arise, management needs to work to resolve these conflicts and ultimately derive more value from the stakeholders concerned. Second, the theory deals with the problem of the connection of ethics and capitalism in that it deals with questions of values, choice, potential harms and benefits for large groups and individuals. Third, the theory deals with how

[335] Allen, W. T. op cit note 317 at 270-272.

[336] Cassim, F.H.I. et al et al op cit note 25 at 518.

[337] Elson, C. M. and Goossen, N. J. 'E. Merrick Dodd and the rise and fall of corporate stakeholder theory' (2016) 72.3 *The Business Lawyer* 735 at 735.

[338] Parmar, B. L., Freeman, R. E., Harrison, J. S., Wicks, A. C., Purnell, L. and De Colle, S. 'Stakeholder theory: The state of the art' (2010) 4.1 *Academy of Management Annals* 403 at 405. The book referenced is Freeman, R. E. *Strategic management: A stakeholder approach* (1984) (this original work has been reissued and is cited in this thesis – refer note 310 above).

management should improve their creation of value and explicitly connect business operations with ethics.[339]

Freeman et al recently summed up these features of stakeholder theory as follows:

> 'the distinctive elements of stakeholder theory include human actors and their interactions in the process of (particularly, but not limited to, economic) value creation and trade in a turbulent world including the alignment of values, norms, and ethics as mechanisms for efficient and effective flouring within and among organisations. It reflects a coherent worldview of business that reflects a broader awareness about its role, purpose, and full range of immediate and long-term impacts on society. It is rooted in a more humanistic conception of business as a vehicle for human cooperation to realise outcomes not otherwise attainable.'[340]

As Freeman et al indicate, stakeholder theory can be described as framework or genre of management theory which embraces various disciplines including law, healthcare, public administration, environmental policy and ethics.[341]

3.2.2 Consideration of the UK approach

The United Kingdom began a process of reviewing its company law in 1998 through its Department of Trade and Industry during which it also dealt with the question as to whose interests the company represents. This process led to a number of consultancy documents which dealt with the stakeholder debate in detail.[342] The first document issued by the Company Law Review Steering Group ('CLRSG'), the body which was engaged to conduct the review, was termed the 'Modern Company Law for a Competitive Economy: the Strategic Framework' in February 1999. Apart from the traditional shareholder approach and the stakeholder (or pluralist) approach, the steering group also considered the prevailing approach in common law as a third approach which they termed the 'enlightened shareholder value' approach.[343]

The steering group indicated that while the maximisation of shareholder value was the ultimate objective of companies as enshrined in the common law, this objective could not be achieved without companies building long-term relationships with its various stakeholders. The

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[339] Ibid at 405-406.

[340] Freeman, R. E., Phillips, R. and Sisodia, R. 'Tensions in stakeholder theory' (2020) 59.2 *Business & Society* 213 at 219.

[341] Parmar, B. L. et al at 337 ibid.

[342] Esser, I. M. and Du Plessis, J. J. 'The stakeholder debate and directors' fiduciary duties' (2007) 19.3 *SA Mercantile Law Journal* 346 at 351.

[343] SA Company Law Reform Guidelines op cit note 307 at 22-23. Keay, A.R. and Iqbal, T. 'The Impact of Enlightened Shareholder Value' (2019) 4 *Journal of Business Law* at 3.

law, however, did not provide the necessary inclusive approach in this regard and the 'enlightened shareholder value' approach was hence advocated as an approach to address this concern. By applying this approach, the law could retain the fundamentals of the directors' duties while correcting the approach taken by some directors in only managing for the short-term and the narrow interests of the shareholders at the expense of a more long-term and broader approach.[344] Little reform would therefore be required as the objective of companies would remain profit maximisation for the company's shareholders, yet directors would be required to foster long-term relationships with its stakeholders in achieving this objective. The adoption of the stakeholder approach, on the other hand, would require a change to the common law position as to whose interests the company represents in that these would also include those of stakeholders other than shareholders.[345]

The steering group then recommended the adoption of the enlightened shareholder approach and this approach was ultimately codified in section 172 of the United Kingdom's Companies Act 2006 (c.46) ('UK Companies Act').[346]

Section 172(1) of the UK Companies Act states:

> 'A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to –
> (a) the likely consequences of any decision in the long term,
> (b) the interests of the company's employees,
> (c) the need to foster the company's business relationships with suppliers, customers and others,
> (d) the impact of the company's operations on the community and the environment,
> (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
> (f) the need to act fairly as between members of the company.'

While the provisions of section 172(1) clearly indicate that the interests of shareholders are afforded primacy, the consideration of the interests of stakeholders appeared to have been given more weight in determining the best interests of the company. However, Williams indicates that these provisions did little more than to explicitly state what was already implicit in the common law which required directors to consider the interests of all stakeholders in promoting the interests of the company. Although he accepts that section 172 does result in an obligation of the directors to at least consider these interests, he indicates that the provisions are vague, and the obligation is

[344] Keay, A.R. and Iqbal, T. op cit note 342.

[345] SA Company Law Reform Guidelines op cit note 307 at 24.

[346] Ibid 24-25.

only to 'have regard' to them. As such, he argues that this approach does not afford stakeholders with improved protection beyond the position in common law and is therefore of 'doubtful usefulness to other jurisdictions in seeking to enhance social responsibility in their company law'.[347] Cassim et al confirm that the interests of stakeholders other than the shareholders remain subordinate to the shareholders and the duty of the directors to consider their interests is not directly enforceable by them.[348]

The requirement of section 172 to 'have regard' to the interests of stakeholders other than shareholders appears to have now been strengthened by the consultation and reporting recommendations of the UK Corporate Governance Code 2018 ('UK Corporate Code'), which are mandatory for companies listed in the United Kingdom, and the 2018 amendment to the UK Companies Act.[349] The UK Corporate Code recommends that the board obtains an understanding of the interests of its key stakeholders and must describe in the annual report how these interests have been considered in board discussions and decision-making.[350] To this end, the code recommends that the board engages with the workforce by adopting methods such as appointing a director from the workforce, establishing a formal workforce advisory panel, using a designated non-executive director or using an alternative method.[351] A method should also be provided for the workforce to raise any concerns that they have in confidence (and if required, anonymously). Furthermore, the board should routinely review these means and any reports arising from this body, while ensuring that it has a process in place for the proportionate and independent investigation of any such matters raised.[352] The 2018 amendment to the UK Companies Act introduced section 414CZA of the UK Companies Act which requires directors to describe how they have had regard to the various matters listed in section 172(1)(a)-(f) of the UK Companies Act in performing their duty to promote the success of the company in terms of this section.[353] The explanatory memorandum to the introduction of section 414CZA indicates that this requirement was intended

[347] Williams, R. 'Enlightened shareholder value in UK company law' (2012) 35.1 *University of New South Wales Law Journal* 360 at 362, 367.

[348] Cassim, F.H.I. et al op cit note 25 at 520.

[349] Par. 4 of the Companies (Miscellaneous Reporting) Regulations 2018.

[350] Provision 5 of the UK Corporate Code.

[351] Ibid.

[352] Provision 6 of the UK Corporate Code.

[353] Section 414CZA of the UK Companies Act.

to encourage directors to think more carefully about how they are taking account of these matters, while also encouraging better boardroom engagement with employees and other stakeholders.[354]

3.2.3 Consideration of the SA Constitution's Bill of Rights

The SA Constitution, brought into effect in February 1997, is the highest law in the country which infers that all law, whether legislation or common law, must be consistent with it.[355] The SA Constitution's Bill of Rights are contained in the provisions of chapter 2 of the SA Constitution and affirms South Africa's democratic values of human dignity, equality and freedom.[356] These provisions set out certain civil and political rights which give freedom to participate in the political and social life of our country, as well as certain socioeconomic rights which provide access to certain basic resources, opportunities and services that are required to lead a dignified life.[357] In terms of section 7(2) of the SA Constitution, the state is required to 'respect, protect, promote and fulfil' these rights.

Socioeconomic rights include the rights to sufficient food and water, health care services, adequate housing, education and social security.[358] Feris also argues that the right to an environment that is not harmful to one's health or well-being per section 24 of the SA Constitution is also a socioeconomic right in light of the state's duty to realise this right.[359] The importance of the state's duty to ensure these rights are fulfilled is highlighted by Justice Chaskalson in *Soobramoney v Minister of Health, KwaZulu-Natal*[360]where he stated:

> 'We live in a society in which there are great disparities in wealth. Millions of people are living in deplorable conditions and in great poverty. There is a high level of unemployment, inadequate social security, and many do not have access to clean water or to adequate health services. These conditions already existed when the Constitution was adopted and a commitment to address them, and to transform our society into one in which there will be human dignity, freedom and equality, lies at the heart of our

[354] Department for Business, Energy and Industrial Strategy 'Explanatory Memorandum to the (Miscellaneous Reporting) Regulations 2018 No. 860' at par 7.3. available at https://www.legislation.gov.uk/uksi/2018/860/ pdfs/uksiem_20180860_en.pdf last accessed on 2 August 2024.

[355] Section 2 of the SA Constitution.

[356] Section 7(1) of the SA Constitution.

[357] Chapter 5.1 of the Constitutional Court Street Series available at https://www.concourt.org.za/images/phocadownload/ last accessed on 30 April 2024.

[358] Sections 26, 27 and 29 of the SA Constitution.

[359] Feris, L. 'The socio-economic nature of section 24 (b) of the Constitution - some thoughts on *HTF Developers (Pty) Ltd v Minister of Environmental Affairs and Tourism (HTF)*: case note' (2008) 23.1 *SA Public Law* 194 at 203.

[360] 1998 (1) SA 765 (CC), 1997 (12) BCLR 1696 (CC).

new constitutional order. For as long as these conditions continue to exist that aspiration will have a hollow ring.'[361]

Liebenberg indicates that this paragraph in the judgement confirms the link between socioeconomic rights and the values of human dignity, equality and freedom contained in the SA Constitution. She also indicates that this paragraph confirms that poverty and inequality must be addressed to transform our society based on these values. Addressing socioeconomic rights is therefore indispensable to the success of South Africa's constitutional democracy.[362]

The requirements of the SA Constitution with respect to corporate law are contained in section 8(1) which states that the provisions contained in the SA Constitution apply to all law, while section 39(2) requires that the interpretation of legislation and the development of common law must 'promote the spirit, purport and objects of the Bill of Rights'. Its application to the possible obligations of companies and in particular, its direct horizontal application between companies and its stakeholders, is contained in section 8(2) which states that these provisions are applicable to companies 'if, and to the extent that, it is applicable, taking into account the nature of the right and the nature of any duty imposed by the right.' In order for company law to remain consistent with the SA Constitution, the DTIC indicated that the interests of the shareholders should be balanced with those of other stakeholders when this is appropriate or required by the SA Constitution and related legislation. This means that under the SA Constitutional framework, the position of the interests of stakeholders other than shareholders differs from the common law position in that the directors may be required in certain situations to promote these stakeholders' interests as ends in themselves (in other words, not as a means to promoting the interests of the shareholders).[363]

The question as to when these 'certain situations' are applicable, or what the implications of section 8(2) are, have been subject to much discussion among academics, the Constitutional Assembly and the Constitutional Court.[364] Meyersfeld refers to recent interpretations by the Constitutional Court that appear to suggest that in limited circumstances companies may have obligations towards other companies and its stakeholders. She states that the current position in case law is that it is accepted that section 8(2) imposes negative obligations on private persons to

[361] Ibid at par 8.

[362] Liebenberg, S. Chapter 33 'Interpretation of Socio-economic Rights' of SA Constitutional Law available at https://constitutionallawofsouthafrica.co.za last accessed on 30 April 2024.

[363] SA Company Law Reform Guidelines op cit note 307 at 25-26.

[364] Meyersfeld, B. op cit note 176 at 439.

refrain from conduct that violates the rights of another,[365] yet with respect to positive obligations, there is still uncertainty and, potentially, conflict between the judgements of the Constitutional Court.[366] She does, however, suggest that 'it is legally, textually and historically justifiable to impose positive obligations on juristic persons for socioeconomic rights in curtailed, specific circumstances' while emphasising that section 8(2) should not be seen as imposing obligations on companies to fulfil the socioeconomic rights of individuals in the same way as is imposed on states.[367] Similarly, Bilchitz indicates that the corporation should not simply be seen as an extension of the state with regards to the fulfilment of socioeconomic rights.[368] He also suggests that a distinction should be made between the 'maximisation of profit and the achievement of profit' and that positive obligations of companies could be realised through their own commercial activities even though it may invariably reduce the profits that are otherwise achievable by the corporation.[369]

The instances of positive obligations cited by Meyersfeld and Bilchitz flow from irregularly occurring events that in the circumstances concerned could give rise to the obligations. The dire state of socioeconomic rights in our country, however, requires a more sustained exercise of these obligations over a period of time for their realisation. As discussed in previous chapter, the main drivers currently of poverty and inequality in South Africa are the prevalence of low wages and the high unemployment rate.[370] The path to alleviating poverty and inequality, therefore, is largely dependent on growing the economy and creating and filling high paying positions. The success of Small Medium and Micro Enterprises (SMMEs) in creating employment is essential to this cause, as is the need to increase the skills levels of the workforce, and thereby the general wage level, particularly in those areas of the economy where there is a high demand for these workers.[371] While it is accepted that the state has a predominant role to play in these areas, especially in growing the

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[365] Meyersfeld, B. op cit note 176 at 465 with reference to *Governing Body of the Juma Musjid Primary School v Essay NO* 2011 (8) BCLR 761 (CC).

[366] Ibid at 473-475 with reference to *Daniels v Scribante* 2017 (4) SA 341 (CC) and *AB v Pridwin Preparatory School* [2020] ZACC. Meyersfeld indicates that the Constitutional Court mentioned the possibility of positive obligations in certain circumstances but made no judgement in this respect.

[367] Ibid at 476.

[368] Bilchitz, D 'Do corporations have positive fundamental rights obligations?' (2010) *Theoria: A Journal of Social and Political Theory* 1 at 25.

[369] Meyersfeld, B. ibid at 475.

[370] Chapter 2.3.1 (c) above.

[371] World Bank Group 'Overcoming poverty and inequality in South Africa: An assessment of drivers, constraints and opportunities' op cit note 2 at 88, 100 and 109-112.

economy and attracting investment to our shores, companies could also play a major role where they have the resources to do so.

However, the magnitude of the socioeconomic concerns in our country and the difficulty in defining the limits to positive obligations suggest that the implementation of legislation compelling companies to implement positive measures to address these concerns directly may not be feasible. While Bilchitz indicates that companies should not be reduced to loss making entities in the exercise of positive duties, the need for companies to retain sufficient profits as a buffer against business risks that may materialise as well as for further growth implies that the limits to these duties would need to be implemented long before the company reaches the point of making losses. There would still be the concern as to how these costs (and reduced margins where applicable) would be recovered as the recipients of the goods or services provided may not be able to pay for them. Positive obligations may also make South Africa an unattractive destination for much needed investment thereby inhibiting growth and making the alleviation of unemployment even more difficult to attain.

3.2.4 The position arrived at in the SA Companies Act

After consideration of the global stakeholder debate amongst academics and policy documents, including the UK approach, as well as the mandates of the SA Constitution and the particular interests of the South African population, the DTIC appeared to be lean towards the adoption of a stakeholder approach with respect to the fiduciary duties of the executive under company law.[372]

However, while accepting that company law should be subject to the supremacy of the SA Constitution, the DTIC steered clear from attempting to change the common law approach suggesting that there were other means to address the socioeconomic concerns in South Africa. In particular, they indicated that there were certain stakeholder interests which would be better served through separate specific legislation as by using company law to effect social change would only impact South African incorporated companies and not foreign companies conducting their business in South Africa through a branch (registered as an external company in terms of section 23 of the SA Companies Act). They argued that this would create an uneven playing field to the detriment of South African companies. They also argued that by allowing the enforcement of rights for all the company's legitimate stakeholders in company law would lead to many unnecessary and avoidable instances of litigation. The DTIC concluded by indicating that although company law must recognise that companies have an impact on the interests of a wide range of stakeholders

[372] SA Company Law Reform Guidelines op cit note 307 at 27.

including society, these interests may best be advanced through specific legislation outside of company law, as well as through facilitative mechanisms such as optional board representation for stakeholders, charitable or social contributions, and codes of best practice.[373]

Consequently, as Cassim indicates, when the common-law principle that directors should act in the best interest of the company was ultimately codified in section 76(3)(b) of the SA Companies Act and as the word 'company' was not defined for the purposes of these provisions, the primacy of the shareholder under the common law was effectively retained.[374] The regulators did not even go as far as codifying the responsibility of the executive to consider the interests of stakeholders, other than shareholders, in determining the best interests of the company in a manner similar to that contained in the provisions of section 172 of the UK Companies Act. Although, as discussed earlier, the codification of the common law approach in the SA Companies Act would probably not have provided any further protection or especially the advancement for the company's stakeholders other than its shareholders.[375]

Whether the introduction and codification of the stakeholder approach into the SA Companies Act would have made a difference to the protection and advancement of stakeholder interests other than shareholders is, however, also debatable. The common law and section 172 of the UK Companies Act contrast with the stakeholder approach advocated by Esser who stated that the company as a separate legal entity could not mean anything these days other than a blend of the all interests of the stakeholders of the company.[376] Before the Companies Act 71 of 2008 was promulgated, she had called for the definition of the word 'company', which was similar in the bill preceding the Act, to be revised to include the representation of all stakeholder interests.

Esser suggested that the definition of 'company' be changed as follows:

> '*company* means a juristic person to the extent that it is, or its activities are, regulated by this Act in terms of section 7 and includes, from time to time, any or all the interests of –
>
> a) the company's members as a whole;
> b) the company's employees;
> c) the company's suppliers, customers and others;

[373] Ibid.

[374] Cassim, F.H.I. et al op cit note 25 at 515.

[375] Williams op cit note 346 ibid.

[376] Esser, I. M. and Du Plessis, J. J. op cit note 341 at 360.

d) the community and the environment to the extent that it could be affected by the company's business activities'[377]

The recently enacted amendment to the Canadian Business Corporations Act, RSC 1985, c. C-44 ('Canadian Business Corporations Act') is similar to Esser's approach in that all the stakeholders of the company, including the shareholders, appear to be placed on an equal footing with respect to whose interests the executive may consider in the exercise of their fiduciary duties.

Section 122 (1.1) of the Canadian Business Corporations Act states:

'When acting with a view to the best interests of the corporation under paragraph (1)(a), the directors and officers of the corporation may consider, but are not limited to, the following factors:

(a) the interests of

(i) shareholders,

(ii) employees,

(iii) retirees and pensioners,

(iv) creditors,

(v) consumers, and

(vi) governments;

(b) the environment; and

(c) the long-term interests of the corporation.'

What the common law and section 172 of the UK Companies Act on the one hand, and Esser's suggested definition of the 'company' and section 122 (1.1) of the Canadian Business Corporations Act on the other hand demonstrate, is that both the 'enlightened shareholder' and 'stakeholder' (or 'pluralist') approaches involve balancing the competing interests of the various stakeholders, including the shareholders, of the company in determining the course of action that is in the best interests of the company. While the shareholder approach affords a preference towards the interests of shareholders, Ramnath and Nmehielle indicate that the distinction between these approaches should not be overemphasised where the human rights of stakeholders other than shareholders are at stake. They argue that a liberal interpretation of the company's best interests and the protection that the business judgement rule provides to executives would especially make the distinction between the two approaches less relevant. The executive would be expected to exercise his or her fiduciary duty to act in the interests of stakeholders other than shareholders under both approaches where the course of action concerned is in the long-term interests of the company whether the

[377] Esser, I. M. and Du Plessis, J. J. ibid at 341.

company is represented by the interests of the shareholders only or all the stakeholders of the company.[378]

Ramnath and Nmehielle, of course, dealt specifically with the fiduciary duty of the executive to respect or protect the human rights of it stakeholders, where these rights may be infringed by the company directly, indicating that studies have shown that the exercise of their duty in this regard is necessary for the success of a business.[379] This argument is consistent with the SA Constitutional Court's interpretation of the provisions of section 8(2) of the Constitution with regard to the negative obligations of companies as discussed above.[380] Katzew also contends that these provisions are supported by sections 5 and 7 of the SA Companies Act.[381] Section 7 indicates that the purposes of the SA Companies Act include the promotion of compliance with the Bill of Rights in the application of company law, while section 5 of the SA Companies Act requires that the SA Companies Act must be interpreted and applied in a manner that supports the purposes set out in section 7. She suggests that these provisions appear to change the nature of the executive's fiduciary duties in that the executive is required to consider the impact of their decisions on the rights of all who may be impacted by their decisions, including both shareholders and other stakeholders such as society in general, ensuring that these are duly respected. The failure to consider these rights in their decision-making would expose the company to litigation and reputational damage which can never be in the company's best interests.[382]

There may also be instances where the interests of the company's stakeholders other than its shareholders do not relate to the direct infringement of their human rights, yet the actions of the executive could result in serious socioeconomic hardship for these stakeholders. While the executive would be expected to favour the interests of the stakeholders other than shareholders where the human rights of these stakeholders are directly at stake due to the adverse reputational and even legal consequences for the company, the executive may tend to favour the interests of the shareholders rather where the human rights of these stakeholders are not directly impacted. For example, the executive may believe that a profit or cash flow drive is essential for the period and

[378] Ramnath, M. and Nmehielle, V. O. 'Interpreting Directors' Fiduciary Duty to Act in the Company's Best Interests Through the Prism of the Bill of Rights: Taking Other Stakeholders into Consideration' (2013) 2 *Speculum Juris* 98 at 110.

[379] Ibid at 110-111.

[380] Chapter 3.2.4 above.

[381] Katzew, J. 'Crossing the divide between the business of the corporation and the imperatives of human rights – the impact section 7 of the Companies Act 71 of 2008' (2011) 128 *SALJ* 686 at 686-687.

[382] Ibid at 704-706.

as a result certain measures are required to be taken that adversely impact its employees such as reducing employees' salaries or retrenching a significant portion of its workforce, or adversely impact its suppliers such as rationalising its supplier base or unilaterally extending its supplier payment terms. Such actions of the executive may of course also result in reputational fallout and harm to the company's operations, yet these actions may be explained away as tough decisions that were needed to be made by the executive and would not likely result in adverse legal consequences for the company. In these circumstances, the adoption of either the shareholder or stakeholder approaches would also not make any real difference to the protection of indigent stakeholder interests.

With respect to the advancement of stakeholder interests, and in particular the socioeconomic rights of indigent communities, the position of the executive with respect to the exercise of his or her fiduciary duties in the best interests of the company is somewhat more complicated. There may be companies in South Africa that have the resources to address these interests beyond their normal tax obligations, yet the decision as to when addressing these interests is in the best interests of the company may be difficult to make. There may well be an argument under the common law pertaining to companies that the threat of societal instability flowing from poverty and inequality to the sustainability of companies may support the executive's actions to address these interests in the best interests of the company provided they were in good faith and the costs of doing so were reasonably incidental to the company concerned. Of course, the executive at the same time may ignore these threats and make no efforts in advancing these interests. As such, the adoption of either the shareholder or stakeholder approaches would not make any real difference to the advancement of indigent stakeholder interests.

In line with the argument above for the positive obligations of the company under the SA Constitution above,[383] compelling companies to contribute directly to addressing socioeconomic concerns would effectively amount to an increase in the corporate tax rate, inhibit growth and make the alleviation of unemployment even more difficult to attain in South Africa. Even if the contribution required was considered reasonably incidental to the carrying on of their business, in line with the common law, there may be difficulties in defining the limits to that contribution which would not be in the interests of the company whether represented by the shareholders or all of the company's stakeholders.

[383] Chapter 3.2.3 above.

It is submitted, therefore, that codifying the common law position or introducing and codifying the 'stakeholder' approach would not add any meaningful change to the protection or especially the advancement of indigent stakeholder interests. In the best interests of the company, the executive would be expected to protect its stakeholders from the detrimental socioeconomic consequences caused by its operations directly as the failure to do so could result in adverse consequences for the sustainability of the company flowing from the adverse legal consequences and reputational fall out following such actions. The executive may also protect its stakeholders from the detrimental socioeconomic consequences caused by its operations indirectly as the failure to do so could also result in adverse consequences for the sustainability of the company flowing from the reputational fall out following such actions. Similarly, in the best interests of the company, the executive would be expected to advance the socioeconomic interests of its indigent stakeholder communities provided the costs of doing so can be considered reasonable to the company concerned and can be considered incidental to the company's profit maximisation objective under the common law as the failure to do so could also result in adverse consequences for the sustainability of the company. In the latter case, these consequences may flow from the failure to be seen to be addressing socioeconomic concerns, despite having the resources to do so, either through violent societal action or through customers and suppliers not wanting to be associated with the company.

Yet, despite these potential consequences and as both approaches require the balancing of competing stakeholder interests, the executive may still give preference to the shareholders' interests such that the interests of other stakeholders including the socioeconomic concerns of indigent communities may not be given the attention that they deserve with serious repercussions for the long-term sustainability of the company. While legislation can serve to protect these interests from direct infringement by the company, it may be more difficult to legislate against the indirect infringement of these interests by the company. It is also certainly not feasible to legislate the advancement of these interests by the company.

3.3 Current approach to advancing stakeholder interests

While there are legal and practical constraints to the company advancing the socioeconomic interests of its stakeholders through positive obligations in terms of the SA Constitution, or by means of the current common law approach to their stakeholders even if the stakeholder approach were to be adopted or either approach was codified, the alternative methods suggested by the DTIC in terms of their approach to advancing these interests may have merit. Consideration is given to these methods being specific legislation outside of company law and various facilitative mechanisms such as

optional board representation for stakeholders, charitable or social contributions, and codes of best practice. These legislative and facilitative methods, which were already largely in play at the time of the DTIC's paper in 2004, are discussed with a view to establishing their efficacy in advancing stakeholder interests and thereby addressing the socioeconomic concerns in South Africa in the last three decades.

3.3.1 Legislation and programs aimed at advancing socioeconomic interests

Following the implementation of the SA Constitution, the state enacted various pieces of legislation outside of company law and implemented various programs in support of this legislation that were intended to achieve their duty of addressing socioeconomic concerns in South Africa. This legislation and supporting programs were intended to either directly advance these interests using fiscal funding raised mainly from tax revenues, or indirectly by regulating the relationship between companies and their stakeholders ensuring that the SA Constitutional values of equality, dignity and freedom were promoted.

a) Legislation and programs aimed at advancing socioeconomic interests directly

Legislation and programs dealing with the state's duty to fulfil socioeconomic rights directly involve legislation addressing the right of access by indigent communities to sufficient food and water, adequate housing, healthcare, education and social security. These interventions were supported initially by the Reconstruction and Development Program (RDP) implemented in 1994 which directed significant funds away from the defence budget to this social spending (or the 'social wage'). This program was followed up by the 1996 Growth, Employment and Redistribution (GEAR) program in 1996, the Accelerated and Shared Growth Initiative for South Africa (ASGISA) program in 2006, and ultimately the National Development Plan 2030 (NDP) in 2011.[384]

i. Access to sufficient food

The right to sufficient food is enshrined in section 27(1)(b) of the SA Constitution, while the state's obligations in this regard are complemented by section 28(1)(c) and section 35(2)(e) of the SA Constitution with respect to a child's right to basic nutrition and a prisoner's right to nutrition at the state's expense while in detention respectively.

There is no framework legislation which defines the State's obligations and private parties to fulfil the right to food. Attempts to fulfil this right have been made though the

[384] World Bank Group 'Overcoming poverty and inequality in South Africa: An assessment of drivers, constraints and opportunities' op cit note 2 at 1.

intervention of two overarching policies since the implementation of the SA Constitution. The original Integrated Food Security Strategy, implemented in 2002 was reviewed and replaced by the National Food and Nutrition Security Policy in 2014 which seeks to ensure the availability, accessibility and affordability of safe and nutritious food at national and household levels.[385] The policy was intended to provide a platform for various strategies which included increased and better targeted public spending in social programmes which impact food security, efforts to increase food production and distribution, leveraging government food procurement to support community-based food production initiatives and smallholders, and the strategic use of market interventions and trade measures aimed at promoting food security.[386]

Despite these interventions, the Studies in Poverty and Inequality Institute ('SPII') indicates that government policies have not been properly co-ordinated and where they exist, they have suffered from a lack of accountability and an implementation process that has failed to match government's commitments to address food security, especially in terms of scope, coordination and high-level support.[387] A recent report issued by Oxfam indicates that the 2014 policy has 'severe gaps in both analysis and proposed solutions, particularly in terms of income and jobs, distribution, access, gender, food prices, volatility and fixing, the retail industry, climate change and the environment, standards and nutrition'.[388]

As a result, more than a fifth of household in South Africa do still do not have adequate access to food. In a recent survey, Statistics South Africa ('StatsSA') found that 15 percent of households in South Africa have inadequate access to food while a further 6 percent of households have severe inadequate access to food.[389]

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[385] Section 3 (at 6) of 'The National Policy on Food and Nutrition Security for the Republic of South Africa' (GN 637 GG 37915 of 22 August 2014).

[386] Ibid.

[387] SPII 'The Right to Food in South Africa - An analysis of the content, policy effort, resource allocation and enjoyment of the constitutional right to food' (July 2015) at 5 available at https://spii.org.za/ wp-content/uploads/2016/06/SPII-The-Right-to-Food-in-South-Africa-2015-Executive-Summary.pdf last accessed on 15 March 2024.

[388] Oxfam 'Hidden Hunger in South Africa – The Faces of Hunger and Malnutrition in a Food-secure Nation' at 31 available at https://www-cdn.oxfam.org/s3fs-public/file_attachments/hidden_hunger_in_south_africa_0.pdf last accessed on 15 March 2024.

[389] Statistics South Africa 'General Household Survey 2021' at 53 available at https://www.statssa.gov.za/publications/P0318 last accessed on 10 March 2024.

ii. Access to sufficient water

The right to access sufficient water is enshrined in section 27(1)(b) of the SA Constitution. This right is understood to relate to both the right to access sufficient drinking water and the right to adequate sanitation (and consequently environmental hygiene). The state is required to realise these services progressively in line with the availability of resources.

The main legislative measure giving effect to the state's duty to provide access to water and sanitation is the Water Services Act 108 of 1997. The Act provides for the rights of access to basic water supply and basic sanitation that are necessary to secure sufficient water and an environment that is not harmful to human health or well-being, while also dealing with other matters such as providing standards for the supply of services, the development of plans for service authorities and the promotion of resource management and conservation.[390] In addition to this Act, the National Water Act 36 of 1998 deals with the governance of water resources and their management in South Africa. While it does not deal directly with the provision of water services, it provides the framework within which the Water Services Act 108 of 1997 is implemented.[391]

In addition to this legislation, the National Water and Sanitation Master Plan 2030 sets out a schedule of prioritised actions for the period to 2030 that is aimed at 'addressing the crisis in the water and sanitation sector' and 'a water secure future with reliable water and sanitation services for all'. The plan is an initiative of the Department of Water and Sanitation in conjunction with other government departments and agencies, the private sector and civil society.[392] The plan was launched in November 2019 and is estimated that it will cost around R898 billion over the next 10 years with an expected shortfall of R333 billion. This funding gap is expected to be reduced through various interventions including policy reviews, enhanced regulation and the implementation of cost-efficient measures.[393]

Although it is too early to tell whether this plan is making progress in the realisation of these rights, the recent survey by StatsSA suggests that there is still much work to be done. Their survey of the sources of drinking water in South Africa found that only an estimated

[390] Section 2 of the Water Services Act 108 of 1997.

[391] Section 2 of the National Water Act 36 of 1998.

[392] Department of Water and Sanitation 'National Water and Sanitation Master Plan (NW&SMP)' available at https://www.dws.gov.za/Projects/sdg/National%20Water%20Sanitation%20Master%20Plan.aspx#:~:text=The%20NW%26SMP%3A,and%20the%20Sustainable%20Development%20Goals last accessed on 20 June 2024.

[393] Odendaal 'DWS launches national water master plan' (November 2019) *Engineering News* available at https://www.engineeringnews.co.za/article/dws-launches-national-water-master-plan-2019-11-28 last accessed on 20 June 2024.

45 percent of households had access to piped water in their dwellings while a further 29 percent of householders accessed water from a tap in their yard. 12 percent of households had to fetch their water from communal taps, while a further 3 percent of households still had to fetch water from rivers, streams, stagnant water pools, dams, wells and springs.[394] With respect to communal taps, a recent survey in the Khayelitsha township in Cape Town found that these taps are not maintained, are often unhygienic and polluted with dirt. Their design and location also make them inaccessible for vulnerable groups such that it is not safe to collect water at night.[395] Furthermore, with respect to the functionality of municipal water supply services, approximately one-third of South African households reported their supply as being dysfunctional in 2021.[396] With respect to their survey of access to sanitation facilities, their survey found that only two thirds of households used flush toilets that were either connected to a public sewerage system or a septic or conservancy tank, while the other third of households depended on pit toilets in 2021.[397]

iii.Health care services

The right to health care services including reproductive health care is enshrined in section 27(1)(a) of the SA Constitution. Section 28(l)(c) of the SA Constitution also provides that every child has the right to basic health care services. While the state is required to realise these services progressively in line with the availability of resources, section 27(3) of the SA Constitution provides that no one may be refused medical treatment.

The main legislative measure giving effect to the state's duty to provide health care services to indigent persons who typically cannot afford healthcare by their own means in South Africa is the National Health Act 61 of 2003 ('Health Act'). The main objectives of the Act are to regulate national health and to provide uniformity in respect of health services. The Act seeks to achieve this by establishing a national health system comprising of private and public health care providers that provides the best possible health services that the

[394] Statistics South Africa 'General Household Survey 2021' op cit note 388 at 32. The balance of households (14 percent) access their water from other sources including rivers, tankers and vendors.

[395] Schmiegel, L.M. 'SDG6: Access to Clean, Safe Water: A Case Study of Khayelitsha Township, Cape Town' (2021) 3.22 *ESR Review* 16 at 18.

[396] Statistics South Africa ibid at 34. Dysfunctional supply services are measured by the number of interruptions that lasted more than two days at a time or more than 15 days in total during the 12 months before the survey was conducted.

[397] Statistics South Africa ibid at 36.

government can afford, as well as setting out the rights and duties of health care providers, health care workers, health care establishments and users.[398]

Despite the objectives of the Health Act, health care in South Africa is characterised by a two-tier system of health care provision where the quality of health care provided is based on whether or not the provision of care is funded by a private medical aid. The recent survey by StatsSA indicates that the percentage of the population covered by a private medical aid scheme has changed very little between 2002 and 2022, increasing only slightly from 15.9 percent to 16.1 percent.[399] While eight out of 10 patients depend on public clinics and hospitals, most of the country's doctors, dentists and specialists serve a small section of the population who can afford private healthcare as this is where the skills and resources are drawn. Consequently, those without medical aid, being usually the poorer members of society, are precluded from a large number of health professionals, services and facilities.[400] The South African Human Rights Commission ('SAHRC') indicates that public health care is also under-resourced with respect to suitable medication, infrastructure (including out-dated technology and shortages of emergency transport) and support staff such as those responsible for ensuring the cleanliness of public healthcare facilities. The shortage of medical practitioners in the public sector can also lead to long waiting times and overcrowding at these facilities.[401]

In order to provide more universal access to quality health care, the Department of Health set about implementing a national health insurance scheme ('NHI') for South Africa by introducing the National Health Insurance Bill to Parliament during August 2019.[402] The bill was assented to by the President of South Africa on 15 May 2023 and will be phased in gradually based on the availability of resources from 2024 to 2028.[403] The Department of Health explains that the NHI is ultimately designed to pool funds in a National Health

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[398] Section 2 of the National Health Act 61 of 2003.

[399] Statistics South Africa 'General Household Survey 2021' op cit note 388 at 24.

[400] Department of Health 'Some Key Messages on National Health Insurance (NHI)' at 3-4 available at https://www.health.gov.za/wp-content/uploads/2020/11 last accessed on 13 March 2023.

[401] SAHRC 'Access to Health Care' at 3 available at https://www.sahrc.org.za/home last accessed on 13 March 2023.

[402] Bill B11-2019. Parliamentary Monitoring Group 'Bill history' available at https://pmg.org.za/bill/886 last accessed on 13 March 2023.

[403] Department of Health - National Health Insurance at https://www.health.gov.za/nhi/#:~:text=The%20signing%20of%20the%20NHI,quality%20health%20coverage%20for%20all. The National Health Insurance Act 20 of 2023 was gazetted on 16 May 2024 (GG 50664 of 16 May 2024).

Insurance Fund ('NHI Fund') to provide access to quality affordable personal health services for all South Africans based on their health needs irrespective of their socio-economic status. The fund will be funded from general taxes, contributions of persons earning above a stipulated amount and monthly contributions by other employees. While private medical aid schemes will continue to exist, their role will change as they will only provide cover for services not reimbursable by the NHI Fund when the NHI is fully implemented. The NHI Fund will therefore provide most of the services currently provided by private medical aid schemes but at a reduced rate. The intention is that the NHI fund will not permit the high level of fees charged currently by private hospitals and medical practitioners.[404]

Despite the ideals of a universal health care system, several concerns have understandably been raised with the planned system. Prinsen indicates that drastically reducing the role of private medical aid schemes will be counterproductive to universal healthcare as there are insufficient resources to meet the needs of the South African population. This may lead to a decrease in the quality of the healthcare provided and long waiting times. The redundancy of much of the medical aid schemes may also lead to increased unemployment and private medical practitioners seeking more lucrative employment overseas. She also indicates that the limitation of the right to choose to purchase private health insurance would be similar to limiting the right to purchase private education for one's children or private security on the basis that the state already provides state schooling and security services. This move is therefore unprecedented, inappropriate and might even constitute a limitation of rights.[405]

iv. Adequate housing

The right to adequate housing is enshrined in section 26(1) of the SA Constitution. The state is required to progressively realise this right within its available resources through legislation and other measures.

The main legislative measure giving effect to the state's duty to provide adequate housing to indigent persons who typically cannot afford such housing by their own means in South Africa is the Housing Act 107 of 1997 ('Housing Act'). The Housing Act provides for

[404] Department of Health 'The National Health Insurance (NHI) Bill' available at https://www.parliament.gov.za/storage/app/media/EducationPubs/2019/october/25-10-2019/NHI last accessed on 13 March 2023.

[405] Prinsen, L. 'The pros and cons of the National Health Insurance (NHI) Bill' *UFS Campus News* 5 July 2023 available at https://www.ufs.ac.za/templates/news-archive/campus-news/2023/july/the-pros-and-cons-of-the-national-health-insurance-(nhi)-bill.

the facilitation of a sustainable housing development process by laying down principles for housing development in all spheres of government including the national, provincial and local levels.[406] The minimum criteria as to what 'adequate housing' constitutes is set out in the Housing Act, the Breaking New Ground (BNG) policy of 2004 as well as the National Housing Code 2009 (established in terms of section 4 of the Housing Act).[407] Apart from the dimensions and functionality of the structures concerned, the structure must also have access to services consisting of potable water, sewage removal and power supply, while also being situated in residential environments that have convenient access to economic opportunities, as well as health, education and social amenities.[408]

While progress has been made in providing adequate housing, StatsSA indicates in their recent survey that more than a sixth of South Africans continue to live in informal structures (12 percent) and traditional dwellings (4 percent).[409] The inhabitants of these dwellings also do not have access to essential services such as water and electricity, while these informal settlements are generally far from healthcare facilities, police stations, public transport and places of work and schools thereby aggravating their living experience.[410]

Selebalo and Webster also indicate that there are concerning trends with respect to the number of housing units delivered. Between 2014 and 2017, studies show that the number of units delivered each year represent successive record lows since 2000. While this persistent decrease is partly due to the increased emphasis on the standard of housing delivered, they point out that this trend is unsustainable in light of South Africa's intractable and growing housing back log. They indicate that in Cape Town, for example, the current back log in delivering housing will take more than 70 years to address (with this number excluding the number by which this back log would increase during those 70 years).[411] The SAHRC also

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[406] Introduction to the Housing Act 107 of 1997.

[407] SAHRC 'The Right to Adequate Housing Fact Sheet' at 4 available at https:// www.sahrc.org.za/ home/21/files/Fact%20 Sheet%20on%20the%20right%20to%20adequate%20housing.pdf last accessed on 24 June 2024.

[408] Section 1(vi) of the Housing Act 107 of 1997.

[409] Statistics South Africa 'General Household Survey 2021' op cit note 388 at 29.

[410] OHCHR 'Informal Settlements and Human Rights in South Africa' at 7-13 available at https://www.ohchr.org/sites/ default/files/Documents/Issues/Housing/InformalSettlements/SERI.pdf last accessed on 24 June 2024.

[411] Selebalo, H. and Webster, D. (SPII) 'Monitoring the Right of Adequate Housing in South Africa' (2017) at 51 available at https://spii.org.za/wp-content/uploads/2018/02/Right-to-Housing_2017.pdf last accessed on 24 June 2024.

indicates that the quality of the housing provided is a concern with almost a sixth of structures experiencing some or other building defect including cracks in their walls.[412]

v. Education

The right to education is enshrined in section 29(1) of the SA Constitution. The right to education consists of the right to basic education which must be immediately realisable by the state,[413] and the right to further education which must be progressively realised by the state in line with its available resources.[414]

In terms of the International Standard Classification of Education ('ISCED'), basic education comprises 'primary education (first stage of basic education) and lower secondary education (second stage). It also covers a wide variety of non-formal and informal public and private activities intended to meet the basic learning needs of people of all ages.'[415] The right to basic education for children is governed mainly by the South African Schools Act 84 of 1996. Although 'basic' education is not defined in the Act, the Act requires that children must attend school from the beginning of the year that the child reaches the age of seven years until the end of the year that the child turns fifteen or the ninth grade whichever occurs first,[416] and therefore appears to be in line with the ISCED above.

Churr indicates, however, that learners who have just completed grade nine are not 'properly equipped with the necessary knowledge, skills and experience to tackle the outside world. The consequence of this is that they will be unable to develop to their full potential, to live and work with dignity, pride and self-respect, and to improve the quality and virtues of their lives.'[417] Research by Fraser also suggests that over 40 percent of school learners do not complete matric with most of the drop-outs occurring in the senior grades.[418] Desai et al also indicate that youths (aged from 15 years to 24 years) make up 63.9 percent of the unemployed with 44 percent of these not having completed grade 12. Reasons for youths not

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[412] SAHRC 'The Right to Adequate Housing Fact Sheet' op cit note 406 at 5.

[413] As confirmed in by the Constitutional Court in the case of *Governing Body of the Juma Musjid Primary School v Essay* 2011 7 BCLR 651 (CC) at par 37.

[414] Section 29(1)(a) and (b) of the SA Constitution.

[415] UNESCO at https://uis.unesco.org/en/glossary-term/basic-education.

[416] Section 3(1) of the South African Schools Act 84 of 1996.

[417] Churr, C. 'Realisation of a child's right to a basic education in the South African school system: some lessons from Germany' (2015) 18.7 *Potchefstroom Electronic Law Journal* 2405 at 2411.

[418] Fraser, L. 'South Africa's shocking school dropout rate revealed' *Businesstech* 10 October 2023 available at https://businesstech.co.za/news/government/723902 last accessed on 13 March 2023.

completing grade 12 include a range of factors including social and economic reasons such as family needs and vocational aspirations.[419]

Apart from the concerns with the school dropout rate, the quality of basic education provided in South Africa is a cause for concern and is not covered by section 29 of the SA Constitution. The Centre for the Development of Education indicates that, considering the level of the spend on basic education, competitive learning levels and a large, trainable workforce should have been created. However, the standards have fallen below international benchmarks.[420] Churr lists a number of reasons for these circumstances including inequalities in the school environment, the lack of quality education in a safe environment, insufficient funds for the provision of basic education, inadequate buildings, a shortage of qualified and skilled educators, and the inability of the school system to cater for learning differences.[421]

vi. Social security

The right to social security is enshrined in section 27(1)(c) of the SA Constitution. The right to social security is applicable to all individuals, while the right to social assistance (being part of social security) is applicable to all individuals who are unable to support themselves and their dependants.[422] The right to social security including social assistance must be progressively realised by the state in line with its available resources.[423]

The social security legislation and programs implemented in South African are comprehensive with 3.3 percent of South Africa's Gross Domestic Product (GDP) being allocated to social assistance which makes it the fourth highest share in sub-Saharan Africa and the tenth highest share of all countries for which there is data. It also places it higher than its peers such as Brazil, Russia, Mexico, India and China. The framework consists of three main components being the social assistance schemes, certain statutory funds and certain voluntary funds.[424]

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[419] Desai, R., Magan, A. Ruiter, R., Reddy, P. and Mercken, L. "Understanding why youth drop out of school in South Africa' (2024) 14.1 *Sage Open* 1-5.

[420] Fraser, L op cit note 417 as cited.

[421] Churr, C op cit note 416 at 2406.

[422] Section 27(1)(c) of the SA Constitution.

[423] Section 27(2) of the SA Constitution.

[424] The World Bank 'Social Assistance Programs and Systems - Policy Review' (2021) at 12 available at https:// documents1. worldbank.org/curated/en/ 238611633430611402/pdf/South-Africa-Social-Assistance-Programs-and-Systems-Review.pdf last accessed on 25 June 2024.

Social assistance consists of social grants, the public works program and other programs such as the National School Nutrition program. Social grants are regulated by the Social Assistance Act 13 of 2004 and involve eight programs that are mainly aimed at those persons that cannot participate in the labour market with the main programs or grants being the older persons, child support and disability grants.[425] The exception to these grants is the Social Relief of Distress Grant of R350 per month that was introduced in 2020 in an attempt to offset the impact of the COVID-19 pandemic and is aimed at working-age individuals who are unable to access other forms of assistance.[426] In November 2023, the Government has extended this grant until March 2025 while it considers reforms to its social security policy and associated funding models.[427] StatsSA indicates that the percentage of the population that benefited from social grants has steadily increased from 13 percent in 2003 to approximately 31 percent between 2017 and 2019 before increasing sharply to 36 percent in 2021. Similarly, the percentage of households that received at least one social grant has grown from 31 percent in 2003 to 45 percent in 2019 and 51 percent in 2021.[428] With respect to the other social assistance programs, the public works program is intended to create temporary work opportunities for the unemployed, while the National School Nutrition program is intended to provide learners with a meal at schools.[429]

The statutory funds consist of the Unemployment Insurance Fund (UIF), the Compensation Fund and the Road Accident Fund (RAF). The UIF is designed to insure against unemployment, while the Compensation Fund is designed to insure against disability and death of the employee. Both funds are financed through contributions by employers and workers. The RAF is designed to protect victims of road accidents and is financed through a fuel levy paid for by road users.[430] The voluntary funds generally consist of retirement funds and medical schemes with medical schemes designed to protect against health risks, while

[425] Ibid.

[426] Ibid at 22.

[427] South African Government News Agency 'COVID-19 social grant extended until 2025' (1 November 2023) available at https://www.sanews.gov.za/south-africa/covid-19-social-grant-extended-until-2025#:~:text=Government%20has%20extended%20the%20COVID,during%20the%20COVID%2D19%20pandemic last accessed on 25 June 2024.

[428] Statistics South Africa 'General Household Survey 2021' op cit note 388 at 27.

[429] The World Bank 'Social Assistance Programs and Systems - Policy Review' op cit note 423 at 19.

[430] Ibid at 12.

retirement funds provide post-employment benefits. Both types of funds are financed through contributions by employers and workers.[431]

While the social security framework is a major intervention in alleviating poverty and inequality in South Africa, the World Bank indicates that the further expansion of social grants is expected to be a challenge going forward due to the current low economic growth and accompanying tapering of tax revenue.[432]

Social spending or the so-called 'social wage' has contributed significantly to the alleviation of poverty and inequality since 1994. However, the socioeconomic rights of a significant portion of the South African population remain unrealised as is evident from the discussion above.[433] The current level of spending which currently accounts for around 60 percent of the government's spend is also unsustainable and further expansion of these programs is limited as they depend on tax revenues which are being curtailed by the lack of growth in the economy.[434]

Although the economy grew by an average of 2.9 percent between 1994 and 2000 and accelerated to an average of 4.2 percent between 2001 and 2008, the growth in the economy fell to 1.6 percent between 2009 and 2017 following the fallout from the global financial crisis in 2008.[435] For 2023, the economy only grew at 0.6 percent.[436] Although the National Development Plan (NDP) indicates that raising employment levels should reduce the dependence of indigent communities on the social wage and to this end set a target of creating 11 million jobs by 2030, these plans were based on economic growth of 5 percent per annum.[437] The much slower economic growth rate has resulted in the government being able to create only less than half of the required jobs of 600 000 per annum in terms of the NDP.[438] Employment, of course, does

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[431] Ibid.

[432] World Bank Group 'Overcoming poverty and inequality in South Africa: An assessment of drivers, constraints and opportunities' op cit note 2 at xxvi of the 'Executive Summary'.

[433] Ibid at 6, 42 and 75.

[434] Ibid at 1 and 75

[435] Ibid at 1.

[436] Stats SA 'Economic growth muted as 2023 draws to a close' available at https://www.statssa.gov.za/?p=17053#:~:text=The% 20 economy%20grew%20by%200, GDP%20growth%20(Figure%204) last accessed on 15 June 2024.

[437] National Planning Commission (Department of the Presidency) 'National Development Plan 2030: Our future – make it work' at 39 available at https://www.gov.za/sites/default/files/gcis_document/201409/ndp-2030-our-future-make-it-workr.pdf last accessed on 13 July 2024.

[438] World Bank Group ibid at 3.

not in itself reduce poverty as many workers that employed earn very low wages as the so-called 'working poor'.[439]

b) Legislation aimed at advancing socioeconomic interests indirectly

Legislation dealing with the company's relationships with its stakeholders in promoting the SA Constitutional values of equality, dignity and freedom, and thereby advancing socioeconomic rights indirectly include legislation relating mainly to employees and society in general.

i. *Employees*

The legislation aimed at regulating the relationship between the company and its employees is comprehensive. The main statutes in this regard that serve to advance the interests of employees in the workplace are discussed briefly.

The *Basic Conditions of Employment Act 75 of 1997* ('BCEA') is intended to give effect to the right to fair labour practices as stated in section 23(1) of the SA Constitution and South Africa's obligations in terms of its membership of the International Labour Organisation by establishing and enforcing basic conditions of employment.[440] These provisions are aimed at preventing the exploitation of workers and thereby also advancing their right to dignity in terms of section 10 of the SA Constitution.[441] A basic condition of employment in terms of the Act effectively constitutes a term of the employee's contract of employment unless the condition has been amended in terms of the Act or the particular term in the employee's contract is more favourable than the minimum conditions of employment provided in terms of the Act.[442] The Act sets out the minimum conditions of employment and specifically deals with the working hours, leave, record-keeping and termination of employees, as well as the circumstances under which these conditions may be amended or revised for certain industrial sectors.

Studies suggest that the promotion of the right to dignity for workers flowing from the prescribed basic conditions is linked to an increase in worker productivity and consequently

[439] World Bank Group 'Overcoming poverty and inequality in South Africa: An assessment of drivers, constraints and opportunities' op cit note 2 at 101-103.

[440] Section 2 (a) of the BCEA.

[441] Tenza, M. 'Invoking the right to human dignity in the context of farm workers: liberating an oppressed group' (2016) 31.1 *Southern African Public Law* 140 at 148-150.

[442] Section 4 of the BCEA.

the improved performance of the business.[443] However, these conditions may not be the only conditions or aspects of their employment that workers are interested in. There may be other aspects which, if considered, would serve to improve their productivity even further.

The *Labour Relations Act 66 of 1995* is intended to give effect to and regulate the organisational rights of employees (and employers) as provided by section 23(2)-(6) of the SA Constitution and in terms of South Africa's obligations flowing from its membership of the International Labour Organisation.[444] The Act is also intended to promote workers' rights to dignity and equality as provided for in terms of sections 9 and 10 of the SA Constitution while also promoting the value of freedom enshrined in the SA Constitution. As such, the Act regulates the rights of employees and employers to join trade unions and employer organisations respectively, and the rights of employees and their trade unions (and employers and their employer organisations) to engage in collective bargaining to determine wages, terms and conditions of employment and other matters of mutual interest, as well as to formulate industrial policy.[445] The Act also regulates employee participation in decision-making at the workplace through workplace forums, the resolution of labour disputes and the institutions established in terms of the Act to deal with labour disputes.[446] In addition, the Act deals with what constitutes an unfair dismissal and an unfair labour practice, as well as the process an employer is required to take with respect to the retrenchment of employees due to operational requirements.[447]

Hayter and Pons-Vignon indicate that the provisions of the Act have delivered improvements and protection for millions of workers especially in light of the widespread restructuring and rising insecurity in employment at the time that the Act was introduced.[448] Specifically, the provisions concerned have led to an increase in the level of wages at the lower end of the wage distribution in companies as well as reducing inequality. They have also contributed successfully to promoting employment security including contract workers.

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[443] Sathyanarayanan, B. 'Dignity is a Timeless Currency in the Workplace' 18 July 2023 *Forbes* available at https://www.forbes.com/sites/forbeshumanresourcescouncil/2023/07/18/dignity-is-a-timeless-currency-in-the-workplace last accessed on 21 March 2024.

[444] Section 1(a) and (b) of the Labour Relations Act.

[445] Section 1(c) of the Labour Relations Act.

[446] Sections 78-94 of the Labour Relations Act.

[447] Sections 189(a) and 189A of the Labour Relations Act.

[448] Hayter, S. and Pons-Vignon, N. 'Industrial relations and inclusive development in South Africa: A dream deferred?' (2018) *Industrial Relations in Emerging Economies* at 74.

At the same time, however, these provisions have also reduced the flexibility of labour in the workplace. The participation of workers in decision-making through workplace forums has also been limited to highly innovative workplaces.[449] While the Act's labour dispute processes appear to have contributed to improved labour dispute resolution, these disputes have become less institutionalised in recent years with almost two thirds of strikes as recently as 2016 being unprotected. Dissatisfaction with pay remains the main trigger for strike action which is fuelled further by disproportionate increases in executive remuneration. As these issues threaten production and the continued investment in productive capacity, the sustainability of companies may be adversely impacted.[450]

The *National Minimum Wage Act 9 of 2018* is intended to improve the wages of the lowest paid workers and at the same time protect workers from unreasonably low wages.[451] The Act's provisions apply to all companies and their employees. As such all companies must pay wages to their employees that are no less than the national minimum wage and the national minimum wage must constitute a term of the worker's contract of employment unless that contract, a collective agreement or another law provides a wage that is more favourable to the worker.[452] The National Minimum Wage Commission established in terms of the Act is required to review the national minimum wage annually and make recommendations to the Labour Minister on any adjustment to the national minimum wage.[453]

Collier, Fergus, Cohen, Du Plessis, Godfrey, Le Roux and Singlee indicate that one of the main arguments advanced in support of this regulation is that the system of bargaining council agreements and sectoral determinations is fragmented leaving many vulnerable workers without any minimum wage protection. The variation in the levels of minimum wages in the different agreements and determinations has also not resulted in a noticeable improvement in workers' living standards, while enforcement is made difficult due to the different minimum wage rates prescribed by the agreements and determinations. Despite the intentions of the Act, however, the regulation of the minimum wage carries both risks and

[449] Ibid at 94-99.

[450] Ibid at 95-106.

[451] Section 2 of the National Minimum Wage Act.

[452] Section 4 of the National Minimum Wage Act.

[453] Sections 8 and 6(1) of the National Minimum Wage Act.

benefits. There is the risk that the wage set will not properly account for the circumstances of the particular sectors as intended which, if set too high, can result in job losses or at least constrain the creation of new jobs in certain sectors. The benefit of this regulation is that over time the improvement in wages will lead to an increase in the demand for consumer goods which should result in economic growth and growth in employment opportunities.[454]

The *Employment Equity Act 55 of 1998* ('EEA') is aimed at addressing the legacy of inequality created under the Apartheid. In particular, the Act attempts to advance the interests of those groups of people that were previously discriminated against in the labour market with respect to the distribution of jobs, occupations and incomes through legislation or social practices and thereby achieve equality in the workplace in line with section 9 of the SA Constitution. In line with this objective, the Act firstly deals with the prohibition of unfair discrimination on one or more grounds, including race, gender, sex, pregnancy, marital status and religion, in employment policies and practices unless in terms of affirmative action measures that are consistent with the Act, and applies to all employers and employees. Secondly, the Act deals with the implementation of affirmative action measures to redress the disadvantages in employment experienced by designated groups including black people (who are broadly defined as African, Coloured, and Indian people), women and people with disabilities in order to ensure their equitable representation in all occupational categories and levels in the workforce, and are only applicable to designated employers.[455] Designated employers are required to develop and prepare an employment equity plan that is intended to achieve reasonable progress towards employment equity in the employer's workforce, and report progress against this plan to the Director-General on an annual basis.[456] The 2023 amendment assented to by the President in April 2023 provides for the Minister of Employment and Labour to set employment equity targets for economic sectors as well as parts of sectors or regions within these sectors.[457] Employers are also required to submit an Income Differential report to the Employment Equity Commission.[458]

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[454] Collier, D., Fergus, E., Cohen, T., Du Plessis, M. C., Godfrey, S., Le Roux, R., and Singlee, S. *Labour Law in South Africa: Context and Principles* (2018) 37.

[455] Section 1 of the Employment Equity Act (definition of 'designated groups').

[456] Section 21 of the Employment Equity Act. Employers with less than 150 employees may submit the plan every 2 years.

[457] GG 48418 of 14 April 2023 Par 4 (insertion of section 15A) of into the EEA. These provisions had not yet been implemented as at 10 June 2024.

[458] Chapter 2.4.3 above.

Mayer, Oosthuizen and Tonelli indicate that while these measures have contributed toward a more inclusive, diverse and democratic workforce, these changes tend to be somewhat superficial in terms of organisational changes as opposed to bringing about real transformation. The implementation of employment equity plans in terms of the Act has also been faced with some negative responses from non-beneficiaries, while beneficiaries in terms of these plans have had to deal with marginalisation and their advancement in organisations being labelled tokenism amongst their peers.[459]

ii. Society

The legislation aimed at regulating the relationship between the company and the society within which it operates mainly relates to the economic empowerment of black people and the promotion of a sustainable environment. The main statutes in this regard are also discussed briefly.

The *Broad-based Black Economic Empowerment Act 53 of 2003* provides for the economic empowerment of black people (African, Coloured and Indian people who are South African citizens) by way of their participation in the economy of South Africa and thereby bringing about transformation in this area.[460] The Act therefore promotes the SA Constitutional rights to equality (and ultimately dignity) of the country's citizens that were previously disadvantaged under Apartheid.[461] In terms of the Act, the Minister of Trade, Industry and Competition may issue certain codes of good practice which are used to determine a company's Black Economic Empowerment ('BEE') rating.[462] The BEE Codes contain a BEE scorecard with five elements which each carry their own weighting relating to ownership, management control, skills development, enterprise and supplier development (including preferential procurement) and socioeconomic development.[463] In order to obtain a BEE rating, a company must implement certain black empowerment initiatives under the five elements of the BEE scorecard. A company is then measured against each element of the scorecard in order to determine its BEE score and therefore its rating level. The failure to

[459] Mayer, C. H., Oosthuizen, R. M. and Tonelli, L. 'Subjective experiences of employment equity in South African organisations' (2019) 17.1 *SA Journal of Human Resource Management* 1 at 3.

[460] Section 2(a) of the Broad-based Black Economic Empowerment Act 53 of 2003.

[461] Preamble to the Broad-based Black Economic Empowerment Act 53 of 2003.

[462] Section 9(1) of Act 53 of 2003. Code of Good Practice 2013 (GN 1019 GG 36928 of 11 October 2013). Par 8.2 of the code indicates the range from the lowest level of 8 to the highest level of 1.

[463] Par 8.1 of the code.

achieve at least a level 8 means that the company is non-compliant with the Act.[464] Norton Rose Fulbright, however, indicate that the failure to achieve a sufficiently high rating may also adversely impact the company's ability to secure licenses such as for mining activities and to tender for government business. As the company's customer may also be dependent on a favourable rating for preferential procurement, the company's customer may consider not procuring from the company where it has not achieved an appropriate rating.[465]

The intentions of the Act in advancing black economic empowerment appears constrained by various challenges. Shava indicates that these challenges include fraud, corruption and nepotism that has enabled powerful black individuals to manipulate the procurement systems at local levels of government to hand out tenders to their friends, peers and relatives. In addition, mismanagement, poor accountability and a lack of monitoring and evaluation of the tender processes have further contributed to the fraud and corruption experienced. As a result, BEE has done little to assist black South Africans as the tender processes appear to benefit the few individuals who have the human and financial resources to exploit big contracts.[466]

The *National Environment Management Act 107 of 1998* is intended to provide a general framework within which environmental management and implementation plans must be formulated. The provisions of the Act serve as guidelines or principles with regard to how any actions taken in terms of this Act or any other law relating to the protection of the environment should be pursued.[467] The Climate Change Bill was published in October 2021 and is intended to provide for a coordinated and integrated response to climate change and its impacts.[468] As with other environmental legislation, the provisions of this Bill should be read together with the National Environmental Management Act with regards to climate change.[469]

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[464] Par 8.2 of the code ibid.

[465] Norton Rose Fulbright 'Broad-based black economic empowerment – basic principles' July 2018 available at https://www.nortonrosefulbright.com/en/knowledge/publications/fe87cd48/broad-based-black-economic-empowerment---basic-principles#section3 last accessed on 22 March 2023.

[466] Shava, E. Black economic empowerment in South Africa: Challenges and prospects. (2016) 8.6 *Journal of Economics and Behavioral Studies* 161 at 165-168.

[467] Preamble to Act 107 of 1998.

[468] B9-2022 (Government Gazette No. 45299 of 11 October 2021). As at 1 June 2024, the bill is awaiting the President's assent. Section 2 of the Climate Change Bill.

[469] Section 5 of the Climate Change Bill.

> Although environmental law experts have welcomed the introduction of the bill, they have raised several concerns. Key amongst these concerns is the reliance that the draft legislation places on South Africa's 2015 climate change response as outlined in its nationally determined contribution (NDC) or commitment in terms of the United Nation's Framework Convention on Climate Change and its Paris Agreement to contribute to the global climate change effort.[470] Bega indicates that recent studies have shown that more urgent and rapid reductions in emissions are required by all countries in order to avoid dangerous climate change. In line with these concerns, South Africa's updated NDC proposes a significant reduction in greenhouse gas emissions to 2030. The 2030 targets are consistent with South Africa's fair share, and also an ambitious improvement on the current NDC target. The updated draft NDC also contains a section on South Africa's support requirements as a developing country.[471]

The legislative measures implemented to address the company's role in advancing the socioeconomic rights of its stakeholders indirectly have invariably improved the working conditions and remuneration levels of employees and provided them with equal access to economic opportunities, while also promoting a sustainable environment. Labour relations and the attempt by organised labour to improve wage levels is, however, impacted by the current slow economic growth, while the involvement of previously disadvantaged stakeholders appears to be frustrated by a new elite class of society. In addition, the company's relationship with its customers and suppliers is not addressed by similar legislation.

While these measures may contribute to increased productivity of employees, these measures may not capture other aspects of value that employees are looking for. They also do not consider the aspects of value that other stakeholders of the company may be looking for in their relationship with the company. The failure to consider these aspects in the company's operations, may ultimately compromise the financial performance and sustainability of the company.

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[470] The Nationally Determined Contribution is a country's self-defined national climate pledges under the Paris Agreement, detailing what they will do to help meet the global goal to pursue 1.5°C, adapt to climate impacts and ensure sufficient finance to support these efforts.

[471] Bega, S. 'Climate change bill: 'One of the most important draft laws to cross the desks of SA's lawmakers'' Mail& Guardian 19 May 2022 last accessed at https://mg.co.za/environment/2022-05-19-climate-change-bill-one-of-the-most-important-draft-laws-to-cross-the-desks-of-sas-lawmakers on 30 July 2023.

3.3.2 Facilitative measures to advance socioeconomic rights

The facilitative (or voluntary) measures suggested by the DTIC consist of the possibility of stakeholder representation on companies' boards, the traditional corporate social responsibility or investment initiatives, and the adoption of codes of best practice (as represented mainly by King IV currently).

a) Stakeholder board representation

The possibility of board representation by various stakeholders of the business may be useful from the perspective that the board would be able to acquire a direct insight into what these stakeholders want from their relationship with the company. This option would be a voluntary action by the company as there is no provision in South African corporate law, whether in the SA Companies Act or common law, to appoint directors from certain stakeholder groups.

The South African position differs substantially from the German approach in this regard. In terms of the Stock Corporation Act [472] ('German Stock Corporation Act'), the non-executive and executive functions of listed companies are separated by means of a two-tier board structure consisting of a supervisory board and a management board respectively.[473] The functioning of the supervisory and management boards is similar to that of listed companies in South Africa consisting of the statutory board and the executive management team (that sits beneath the board) as recommended by King IV. The distinction is that that executive directors do not sit on the supervisory board in Germany as they do on the statutory board in South Africa.[474]

Bottenberg, Tuschke and Flickinger indicate that the German board structure involves a clear separation between the control of decisions (the supervisory board) and decision-making (the management board) in Germany with a stronger focus on monitoring than Anglo-American governance systems. Apart from shareholder representation, up to half the membership of the supervisory board of listed companies is reserved for employee and union representatives and, as a result, employees have a say in the monitoring and advising of all relevant strategic decisions and governance decisions of the company. The presence of strong works councils further strengthens the co-determination rights of employees on the supervisory board. Where

[472] Stock Corporation Act of 6 September 1965 (Federal Law Gazette I, p. 1089).

[473] Sections 76(1) and 111(1) of the German Stock Corporation Act.

[474] Section 96(1) of the German Stock Corporation Act.

there is conflict between the shareholder and employee representatives on the supervisory board, the chairman may mediate these conflicting interests as legally mandated. [475]

However, while shareholders and employees are well represented on the (supervisory) boards of German companies, no provision is made for any other stakeholder representation such as key customers and suppliers under German corporate law. Such arrangements may, of course, not be practical in light of the board's independence requirements. Therefore, other than the interests of the shareholders and employees, it is unlikely that the interests of other stakeholders of the company would be advanced by these arrangements.

b) Charitable or social contributions

Corporate Social Responsibility (CSR) initiatives began to be seen in the 1970s, yet they appear to have only received attention in South Africa in the early 1990s after sanctions were lifted. This led to South Africa once again becoming a world trade partner with these CSR programs being either voluntarily or due to pressure by importing companies.[476] These essentially charitable donations are usually made to enhance the reputation and legitimacy of the company and thereby attract consumers, investors and employees.[477] Activities such as the donation of computers to a local school or sponsoring a local soccer team would usually be accompanied by some display of the company's corporate logo ensuring that the company's stakeholders are aware of their philanthropic efforts.

While indigent communities may benefit directly from these activities, they are typically insignificant in addressing the socioeconomic concerns of these communities as the company is confined to the dictates of common law requiring these activities to be reasonably incidental to the company's business.[478] Stakeholders may, however, benefit indirectly through the positive

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[475] Bottenberg, K., Tuschke, A., and Flickinger, M. 'Corporate Governance Between Shareholder and Stakeholder Orientation: Lessons From Germany' (2017) 26.2 *Journal of Management Inquiry* 165 at 169.

Oberfichtner indicates that works councils are an important part of the worker representation characterising Germany's system of industrial relations. This representation mainly consists of trade unions which represent workers at the sector level and the works councils which represent workers at the company level. The works council have substantial power via their co-determination rights in influencing the performance of the firm and the distribution of any resulting profits. Oberfichtner, M. 'Works council introductions in Germany: Do they reflect workers' voice?' (2019) 40.2 *Economic and Industrial Democracy* 301 at 302.

[476] Kloppers, H. and du Plessis, W. 'Corporate Social Responsibility, Legislative Reforms and Mining in South Africa' (2008) 26.1 *Journal of Energy & Natural Resources Law* 91 at 93-94.

[477] Carroll, A. B. and Shabana, K. M. 'The Business Case for Corporate Social Responsibility: A Review of Concepts, Research and Practice' (2009) 275 *International Journal of Management Review* 85 at 99.

[478] Chapter 3.2.1 (a)(ii) and the *Hutton*-case at note 328.

impact that these activities have on the company's reputation in society and thereby the sustainability of its operations.

c) Codes of best practice: King IV

As discussed in chapter 2, King IV is a corporate governance code aimed at achieving the benefits of good governance for companies being an ethical culture, good performance, effective control and legitimacy. Although these recommendations can give rise to legal consequences in that the Courts' would consider all relevant circumstances in determining the appropriate standard of conduct of the board and the executive, they are only required to be applied by companies listed on the JSE by virtue of the incorporation of the code's application and disclosure regime into the JSE Listings Requirements.[479] For unlisted companies and particularly large private companies, however, there are no regulatory instruments specifically requiring these companies to apply the recommended practices contained in the code.

With respect to remuneration reporting, the code recommends that the remuneration policy of the company should provide for the use of performance measures that support positive results in the economic, social and environmental (commonly referred to as the 'triple bottom line' or 'TBL') context within which the company operates, and/or the capitals that the company uses or affects in terms of integrated reporting ('IR Six capitals'). While not explicitly mentioned as an approach to non-financial performance measures, the position adopted by King IV with regard to Environmental, Social and Governance (ESG) principles is that ESG should be considered an alternative, complementary lens to the triple context approach through which sustainable development and the associated performance measures should be approached.[480]

The triple bottom line, IR six capitals and ESG approaches and their efficacy in advancing the interests of its stakeholders, and particularly the socioeconomic interests of indigent communities, are discussed briefly.

i. Triple bottom line (TBL)

TBL reporting was conceived by John Elkington in 1994 and was first adopted in the King Report on Corporate Governance for South Africa ('King II') as the basis for sustainability

[479] Ibid.

[480] IoDSA 'Guidance Paper – Responsibilities of governing bodies in responding to climate change' July 2021 at 6 available at https://cdn.ymaws.com/www.iodsa.co.za/resource/collection/04630F89-33B7-43E7-82B3-87833D1DC2E3/__King_Committee_Guidance_paper_on_the_responsib.pdf last accessed on 15 March 2024.

reporting.[481] The concept incorporates three dimensions of the company's performance, being the achievement of economic (or financial) performance measures that need to be balanced and integrated with social and environmental performance measures (which are considered to be non-financial). These three dimensions of performance are also commonly referred to as the three Ps: profits, people and planet.[482] While the economic or financial measures of performance largely coincide with the traditional reporting of a company's value, the concept requires directors to determine how the company can add value from the perspective of social and environmental interests and reflect this in their reporting.[483] The social dimension may include measurements of education, equity, health and well-being, while the environmental dimension may include measurements of natural resources and reflect potential influences to its viability such as air and water quality, energy consumption, natural resources, and solid and toxic waste.[484]

While there is no universal standard method for determining TBL measures, the Global Reporting Initiative (GRI) Standards provide a global framework for sustainability reporting which embraces the economic, social and environmental aspects of TBL reporting.[485] The GRI institute was founded in Boston (USA) in 1997 on the back of concerns stemming from the environmental damage of the Exxon Valdez oil spill which had occurred eight years previously, and their standards are arguably the largest and most widely accepted framework for corporate sustainability reporting. The intention of the institute was to create the first accountability mechanism to ensure companies adhere to responsible environmental practices. This culminated in the first version of what was then the GRI Guidelines (G1) published in 2000 providing the first global framework for sustainability reporting. These guidelines were followed by several updates in 2002 (G2), 2006 (G3) and 2013 (G4) before

[481] Elkington, John at https://www.johnelkington.com/archive/TBL-elkington-chapter.pdf last accessed on 15 March 2024. King II at 9 available at https://cdn.ymaws.com/www.iodsa.co.za/resource/collection/94445006-4F18-4335-B7FB-7F5A8B23FB3F/IoDSA_King_II_web_version.pdf last accessed on 15 March 2024.

[482] Section 4 Chapter 1.4 of King II ibid (at 97). Slaper, T. F. and Hall, T. J. 'The triple bottom line: What is it and how does it work' (2011) *86*.1 *Indiana business review* at 1.

[483] Section 4 Chapter 1.12 of King II ibid (at 100).

[484] Slaper, T. F. and Hall, T. J. ibid at 3-4.

[485] Section 4 Chapter 1.4 of King II ibid (at 100).

the GRI transitioned from providing guidelines to setting the first global standards for sustainability reporting (the GRI Standards) in 2016.[486]

Although the original objective of the GRI, being environmental accountability, was broadened to include social, economic and even governance issues, the standards appear to remain more environmentally focussed with employee and community interests, forming part of the social aspects of the standards, being also key focus areas of the standards. The standards for the economic aspects, however, are remarkably limited especially with regard to the operational finance aspects of companies. Furthermore, they do not provide a comprehensive overview of how companies can increase their value and measure the performance of their executives in this regard.

Sridhar and Jones also indicate that TBL suffers from three fundamental shortcomings. These relate to the measurement of TBL, the integration of the three aspects of TBL, and TBL being used simply as a compliance mechanism. With regard to the measurement of TBL, the GRI standards do not provide a means of determining the level of performance pertaining to the non-financial dimensions of TBL either from a qualitative or quantitative perspective.[487] While the economic dimension may be quantified fairly easily, Moneva, Archel and Correa indicate that different units are typically used for the measurement of these non-financial dimensions either by index calculations or by the expression of various indicators in monetary terms. However, these can result in significant distortions.[488] Van Zyl and Mans-Kemp also indicate that these considerations are very challenging to apply from a practical point of view, especially with respect to the value added to the triple context, and that King IV should have provided more guidance on how to apply these considerations.[489] The lack of integration across the three dimensions of TBL is, as Sridhar and Jones indicate, possibly due to people being trained to be experts in each of the three dimensions and not across all three of them. TBL also focusses on the co-existence of the three bottom lines, as opposed to considering their interdependence, such that the three dimensions are often seen

[486] GRI mission and history available at https://www.globalreporting.org/about-gri/mission-history last accessed on 14 August 2023.

[487] Sridhar, K. and Jones, G. 'The three fundamental criticisms of the Triple Bottom Line approach: An empirical study to link sustainability reports in companies based in the Asia-Pacific region and TBL shortcomings' (2013) 2 *Asian Journal of Business Ethics* 91 at 94-97.

[488] Moneva, J. M., Archel, P. and Correa, C. 'GRI and the camouflaging of corporate unsustainability' (2006) 30 *Accounting Forum* 121 at 128-134.

[489] Van Zyl, M. and Mans-Kemp, N. op cit note 13 at 13.

as conflicting and not potentially complementary.[490] As a compliance mechanism, Sridhar and Jones indicate that TBL is often used as a vehicle by companies to adopt a set of criteria that enables them to obtain recognition on various sustainability indexes. Government pressures, regulatory standards and stakeholder pressures contribute to TBL being used to simply meet demands for sustainability reporting as opposed to companies adopting TBL as a more holistic approach to sustainability.[491]

ii. IR Six capitals

The 'IR six capitals' approach forms part of the fundamental concepts of integrated reporting. The primary purpose of integrated reporting is to explain to providers of financial capital how a company creates, preserves or erodes value over time. The International Integrated Reporting Framework (referred to as the '<IR> Framework'), issued by the International Integrated Reporting Council ('IIRC'), governs the preparation, presentation and content of integrated reports in explaining to users the company's ability to create value. To this end, the <IR> Framework has established 'Guiding Principles' upon which the preparation and presentation of integrated reports should be based, and 'Content Elements' that deals with the overall content of an integrated report.[492]

The creation, preservation and erosion of value that the company makes for itself is manifested in the increases, decreases or transformations of the various forms of capital that the company depends on for its success. The forms of capital are encompassed by the six capitals consisting of 'financial capital' being the pool of funds available to the company from lenders or generated from its activities, 'manufactured capital' being the manufactured physical assets used by the company in the production of its goods and services, 'intellectual capital' being the company's knowledge-based intangible assets, 'human capital' being the

[490] Sridhar, K. and Jones, G. op cit note 486 at 98.

[491] Ibid at 98-99.

[492] IIRC 'International Integrated Reporting Framework' (July 2021) available at https//:www.integratedreporting.org/ last accessed on 19 December 2023 at 6-8. The IIRC was a global coalition of regulators, investors, companies, standard setters, the accounting profession, academics and non-government organisations. As of August 2022, the IFRS Foundation assumed responsibility for the <IR Framework> with the intention that the IFRS Foundation's International Accounting Standards Board (IASB) and the International Sustainability Standards Board (ISSB) should build on and integrate the IR Framework into their standard setting projects and requirements. The continued adoption of the IR Framework by the preparers of Integrated Reports, however, is still actively encouraged by the IFRS Foundation. The IASB has also issued two standards based on the <IR> Framework. These standards are the 'IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information' and 'IFRS S2 Climate-related Disclosures'. These standards have incorporated concepts from the framework and build on the definitions of sustainability and the resources or relationships (or capitals) that company the depends on or affects.

competencies, capabilities and experience of its employees, 'social and relationship capital' being the institutions and relationships between various stakeholders, and 'natural capital' being the various environmental resources and processes upon which the company depends for its sustainability. These capitals are increased, decreased or transformed through the activities and outputs of the company. For example, financial capital is increased when it makes a profit, and the quality of its human capital is improved when employees become better trained. The value that the company makes for itself, in turn, affects the financial returns to providers of financial capital (or its shareholders) and its other stakeholders (including society in general). The shareholders are assumed to be interested in both these aspects as the ability of the company to create value is considered to be linked to the value it creates for these other stakeholders.[493]

Oll and Rommerskirchen indicate that the fundamental concepts have, however, been subject to much criticism by academics and practitioners. While reference is made to stakeholders other than shareholders, the emphasis of integrated reporting appears to be on the value from the perspective of shareholders (the financial providers of capital). There also appears to be some uncertainty as to the terminology associated with the capitals in that the prevalent definitions leave much room for interpretation. As a consequence of this uncertainty, the focus of integrated reports appears to be more on financial capital.[494] There are also challenges with the reporting of trade-offs amongst the various capitals. For example, trade-offs between financial and natural capitals can present an opportunity for companies to justify negative impacts on the environment while engaging in self-promotion. Furthermore, the reporting of trade-offs requires consistent and comparable measurement in order to realise the fundamental objectives of integrated reporting. Yet, due to a lack of guidance provided by the IIRC in this this area, companies have resorted to measuring these trade-offs subjectively. This subjectivity has also resulted in the negative trade-offs being obscured or diminished.[495] As a consequence of these shortcomings, integrated reporting does not appear to be contributing to the sustainability of companies as intended. This is particularly due to the predisposition of preparers of integrated reports to financial capital, as indicated above,

[493] Ibid at 16-19.

[494] Oll, J. and Rommerskirchen, S. 'What's wrong with integrated reporting? A systematic review' (2018) 26 *Sustainability Management Forum* 19 at 22-27.

[495] Ibid at 27-28.

such that social and environmental reporting may not attain the standing it requires with respect to corporate accountability and stakeholder empowerment.[496]

iii. *Environmental, Social and Governance (ESG)*

ESG refers to the three categories of risks, practices, and policies that a company must carefully consider, after taking into account its specific circumstances, with a view to achieving long-term sustainability and value creation for all of its stakeholders. The environmental and social components of ESG largely correspond with the non-financial components of TBL and include environmental aspects such as the reduction of greenhouse gases, recycling plastics and treating waste to avoid pollution, and social aspects such as health and safety, diversity or wage levels of employees and the company's relationship with its community within which it operates. The governance component, on the other hand, relates to the relationships among the company's shareholders, directors and management.[497] ESG may, therefore, be used as a basis for the setting of non-financial performance measures in terms of King IV's recommendations as it is considered to be consistent with the approaches recommended by the code.[498]

The prominence of ESG as essentially an investment consideration rose during the latter half of the last decade following pressure on companies to implement sustainable business practices.[499] In South Africa, the JSE Sustainability and Climate Change Disclosure Guidance was issued in June 2022. It is aligned with the various global initiatives on sustainability and climate change disclosure and is not intended to replace any of these initiatives but rather seeks to help companies navigate the landscape of reporting standards, and to specifically provide for the South African context.[500] While there are no regulatory bodies for the enforcement of ESG measures, the JSE Responsible Investing Indices ('JSE RI'), however, does provide a level of encouragement to companies to adopt ESG measures. The JSE RI is a means by which investors can assess a company's compliance with ESG

[496] Ibid at 28-31.

[497] Lipton, M., Emmerich, A. O., S Schwartz, K., V Niles, S. and D'Ginto, A. M. 'Understanding the Role of ESG and Stakeholder Governance Within the Framework of Fiduciary Duties' (2022) 29 November *Harvard Law School Forum on Corporate Governance* 1 at 3-4.

[498] IoDSA 'Guidance Paper – Responsibilities of governing bodies in responding to climate change' op cit note 479 ibid.

[499] Deloitte 'Director and Prescribed Officer remuneration at JSE listed companies' op cit note 288 at 28.

[500] JSE Limited 'Leading the way for a better tomorrow – JSE Sustainability Disclosure Guidance' June 2022 at 4 available at https://www.jse.co.za/sites/default/files/media/documents/JSE%20Sustainability%20Disclosure%20 Guidance% 20 June%202022.pdf last accessed on 10 January 2024.

practices.[501] Certain regulation such as section 36 of the Pensions Fund Act 24 of 1956 has also been a key driver of the adoption of ESG principles.[502]

ESG as an approach to advancing the interests of stakeholders, however, has been criticised on several fronts. Edmans indicates that ESG factors are extremely important from the perspective of driving long-term value for the company, yet in this regard there are several concerns as to their effectiveness. He emphasises that ESG is nothing special in that it should not be put on a pedestal compared to other value drivers. At least since the introduction of the 'balanced scorecard' by Kaplan and Norton in 1992, the management of companies have been aware that their companies' value depends on more than just financial factors. Many value drivers, however, do not fall under the narrow ambit of ESG. Companies should, therefore, avoid the noise created by reporting frameworks and stakeholder demands and rather seek to establish what the measures of performance for the company are as drivers of value. These could include ESG metrics but there may be others such as customer satisfaction. ESG would then move from being a tick box exercise to a value creation tool.[503]

In addition, Edmans indicates that most ESG metrics capture measures that relate to doing no harm to others such as water usage and worker injuries. Although these are important, creating long-term value is much more about whether a company 'actively does good' and uses the example of Unilever which measures how many people it reaches through its hygiene campaigns. He also suggests that incorporating quantitative ESG metrics into performance frameworks for executives because they are easy to measure, such as employee turnover, as opposed to qualitative measures such as respect, fairness and pride that employees value, may result in long-term value not being created. At the same time, he notes that ESG rating agencies cannot agree as to what factors are relevant to the long-term value potential of the company, how to assess these factors and the relative weight to attach to each factor.[504] Similar to the triple context measures recommended by King IV above, reliably quantifiable ESG measures appear difficult to define.[505]

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[501] Deloitte 'Director and Prescribed Officer remuneration at JSE listed companies' op cit note 288 at 29.

[502] Section 36 states: '[a] fund and its board must at all times apply the following principles…before making an investment in and while invested in an asset consider any factor which may materially affect the sustainable long term performance of the asset including, but not limited to, those of an *environmental, social and governance* character.'

[503] Edmans, A. 'The end of ESG' (2023) 52.1 *Financial Management* 3 at 6.

[504] Ibid at 7, 8 and 13.

[505] Deloitte 'Director and Prescribed Officer remuneration at JSE listed companies' ibid at 31.

> With respect to the South African experience specifically, Chemaly and Paschalides indicate that due to international initiatives to deal with climate change and promote sustainability, the environmental aspect of ESG appears to have become the main focus by companies listed in South Africa. As a result, companies are not addressing the social sustainability aspect of ESG which should enjoy at least, if not more, attention in the South African context. Although environmental concerns are important to South African communities, the extreme levels of poverty and high unemployment should be the main focus of ESG by companies.[506] Mokgonyana also indicates that businesses may be promoting themselves incorrectly as responsible corporate citizens in that the ESG scoring methodology typically tends to focus on how well companies manage their internal processes as opposed to the impact that their products or services have on communities. There appear to be instances where companies have achieved high ESG scores while adversely impacting the communities that they form part of such as the displacement of communities, degradation of land and discrimination against gender and race.[507]

The facilitative measures suggested by the DTIC to advance stakeholder interests have merit but, ultimately, they lack real effectiveness in achieving these ends.

While optional board representation for employees may be a useful means of garnering the views of these stakeholders as to how to advance their interests, the views of other stakeholders such as customers and suppliers are also important and board representation for these stakeholders may not be practical. Corporate social investment initiatives are also an important means of advancing stakeholder interests by directly addressing their socioeconomic concerns directly and enhancing a company's reputation in indigent communities thereby contributing to its long-term sustainability and as such benefitting the local economy and these interests indirectly. However, the value of these initiatives needs to remain compliant with the common law and may therefore remain relatively insignificant in addressing socioeconomic concerns in these communities.

The bases of the nature of performance measures recommended by King IV, being the TBL or the IR6C (and the ESG approach with respect to non-financial measures) are well-intentioned and may certainly improve the financial performance of companies while advancing the interests

[506] Chemaly, S. and Paschalides, A. 'ESG: a shift in focus' (April 2023) *Financial Institutions Legal Snapshot* available at https://www.financialinstitutionslegalsnapshot.com /2023/04/esg-a-shift-in-focus last accessed on 6 July 2023.

[507] Mokgonyana, K. 'What is ESG and where does it fall short' (May 2023) *Mail & Guardian* available at https://mg.co.za/thoughtleader/opinion/2023-05-10-what-is-esg-and-where-does-it-fall-short last accessed on 6 July 2023.

of all the company's stakeholders including the socioeconomic interests of its indigent stakeholder communities. Yet the critical issue with King IV is that while the recommendations are mandatory for JSE listed companies, they essentially remain voluntary for large private companies that may also have large financial and social footprints. Concerns as to the complexity and lack of guidance provided in respect of non-financial performance measures with respect to their application also tend to discourage their effective use, while the bases themselves have also been shown to be fraught with concerns as to their effectiveness.

3.4 A new approach to advancing stakeholder interests

In light of the limitations in advancing the socioeconomic interests of indigent communities under the SA Constitution and company law, as well as the legislative and facilitative measures in terms of the DTIC's original approach, consideration must be given to exploring a new approach to the role of companies in advancing these interests. The recently enacted amendments to the SA Companies Act relating to the disclosure of wage differentials in remuneration reports appears to represent a departure from the DTIC's original approach to advancing stakeholder interests taken two decades ago. These amendments are intended to promote the constitutional right of equality and effectively the advancement of socioeconomic rights by means of the Act. Although, incentive-linked performance measures are not addressed by these amendments, they may have opened the door to pursuing additional reforms to the SA Companies Act that specifically deal with this area of executive remuneration in advancing socioeconomic interests.

Therefore, it is proposed that a new approach to the advancement of stakeholder interests is explored in terms of which the nature of incentive-linked performance measures, as complemented by certain corporate governance measures that serve to protect stakeholders (discussed in Chapter 4), is legislated in terms of the SA Companies Act. As discussed earlier, the path to alleviating poverty and inequality, and thereby advancing the socioeconomic rights of indigent stakeholders, is largely dependent on growing the economy, and creating and filling high paying positions.[508] These reforms would need to ensure that companies are managed to drive their optimal performance and thereby support the state's interventions in addressing the socioeconomic concerns in South Africa. Apart from widening the fiscal base and reducing the demands on the state to meet the social wage, the opportunity of well-paid employment would also provide its recipients with dignity and be instrumental in reducing the rampant crime experienced in this country. This can only be achieved

[508] Chapter 3.2.3 above.

where companies are allowed to flourish while, at the same time, being cognisant of the current socioeconomic environment within which they operate in the interests of their long-term sustainability.

These reforms would require those companies that have either avoided addressing socioeconomic concerns in their performance measures, or merely addressed them to be compliant with the JSE Listings Requirements or in response to shareholder demands, to ensure that these concerns are now addressed in compliance with SA Companies Act. While the nature and governance of incentive-linked performance measures would be regulated, the executive would not be obligated to pursue these incentive-linked performance measures and he or she would only do so if the activities involved were pursued in good faith, in the best interests of the company and the costs of doing so can be considered to be reasonably incidental to the company's business in line with his or her fiduciary duties in terms of the SA Companies Act and the common law pertaining to companies. Yet as executives are assumed to be motivated by pecuniary incentives, one would expect that they would pursue the incentive targets linked to these measures whether in the genuine interest of the company and its stakeholders or for their own benefit while at the same time staying within the confines of the law. Either way, these reforms are likely to contribute to achieving more protection and especially advancement for the stakeholders of the company than is being achieved currently.

However, the legislation of incentive-linked performance measures through the SA Companies Act requires a new approach to advancing stakeholder interests upon which the provisions concerned need to be based. The TBL and the IR Six Capitals approaches (and the ESG approach with respect to non-financial measures) are not feasible as a basis for these legislative reforms in light of the challenges that these approaches present. Therefore, a new approach is introduced that draws from developments in modern stakeholder theory which recognise the value that the company can generate for its stakeholders and in turn creates value for the company thereby driving its optimal and sustainable financial performance. At the same time, this approach meets the imperatives of the SA Constitution and the executive's fiduciary duties under the SA Companies Act and the common law pertaining to company law. For the sake of ease of reference, this approach is simply termed the 'stakeholder value' approach.

The point of departure in developing this approach is the efficient stakeholder approach suggested by Magill, Quinzii and Rochet. They suggest that the recognition of key stakeholder interests and the incentivisation of the executive in this regard involve the identification of well-defined stakeholders of the company, the assignment of well-defined values to these stakeholders,

the assignment of relative weights to each performance measure to obtain a well-defined objective for the company, the provision of incentives to the executive to maximise these objectives and the linking of the incentive to the performance measure.[509] Similar to Magill et al, the IoDSA suggests a process which involves defining the ultimate objective in clear and precise terms, identifying the value drivers, defining metrics to measure the value drivers, establishing target levels of performance, developing narrative statements and linking short- and long-term executive remuneration to purpose-related metrics. The suggested process for the applying the stakeholder value approach incorporates elements of both the approaches suggested by Magill et al and that by the IoDSA.

3.4.1 Establishing a well-defined objective for the company

Freeman, Phillips and Sisodia indicate that stakeholder management requires all stakeholders to align around a shared purpose. Where this shared purpose has not been articulated, companies tend to default to the objective of 'profit maximisation'. Consequently, all stakeholders then enact their own version of profit maximisation drawing from a limited pool of available profit. Hence, 'employees want to work as little as possible while getting paid as much as possible, customers will seek to maximise their margins by cutting corners, investors will become speculators and will exit at the first sign of a profit downturn, and society will see to tax and regulate as much as possible'.[510]

As such, the executive needs to understand and communicate the 'interconnectedness and interdependence' of all stakeholders and ultimately achieve 'balance, fairness and harmony within the whole system of stakeholders'.[511] The IoDSA indicates that the objective of the company should, therefore, be to create sustainable value for all the company's stakeholders who in turn create value for the company. The creation of stakeholder value ultimately drives the value of the company.[512] Similarly, Freeman et al indicate that a more humanistic conception of business as a

[509] Magill, M., Quinzii, M. and Rochet, J. C. 'A theory of the stakeholder corporation' (2015) 83.5 *Econometrica* 1685 at 1688.

[510] Freeman, R. E., Phillips, R. and Sisodia, R. op cit note 339 at 220.

[511] Ibid at 221.

[512] IoDSA 'Linking Executive Pay to Organisational Purpose – Remuneration Committee Guidance' July 2020 at 13 available at https://cdn.ymaws.com/www.iodsa.co.za/resource/collection/57F28684-0FFA-4C46-9AD9-EBE3A3DFB101/Paper_10_Linking_executive_pay_to_organisational purpose.pdf last accessed on 30 March 2024.

vehicle for human cooperation enables the company to realise outcomes or results that are not otherwise attainable.[513]

In establishing this objective, Donaldson and Preston suggest that normative considerations should be central to the company's approach to stakeholders i.e. what managers should be doing along moral lines as to the obligations that companies have towards their stakeholders.[514]

3.4.2 Identification of stakeholders of the company

As discussed earlier, a stakeholder of a company is 'any group or individual who can affect or is affected by the achievement of the organisation's objectives' including shareholders, employees, customers, suppliers, the government and the community at large.[515] Freeman indicates that for a large company, stakeholders can also include unions, trade associations, customer advocate groups, competitors, activist groups, political groups and the financial community. To fully appreciate the extent of the stakeholders of the company, one would need to draw a comprehensive stakeholder map.[516] At the same time, Donaldson and Preston indicate that one must also be careful to distinguish between 'stakeholders' and 'influencers'. Although some entities may impact the activities of the company, they may have no specific stake in the company in that they do not benefit from the successful operation of the company. Competitors and the media would typically fall into the category of influencers. Competitors, for example, would stand to lose whatever the company gains.[517]

As to how to determine which stakeholders of the company should be considered, Magill, Quinzii and Rochet first indicate that the stakeholders concerned need to be sufficiently close to the company in order to evaluate their interest in the company and to be considered in the governance of the company.[518] King IV also indicates that these stakeholders should be material 'based on the extent to which they affect, or are affected by, the activities, outputs and outcomes of the organisation'.[519] Benson and Davidson then indicate that once these stakeholders have been identified, the question is how to prioritise their competing interests. They suggest that the

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[513] Freeman, R. E., Phillips, R. and Sisodia, R. op cit note 339 at 219,221.

[514] Donaldson, T. and Preston, L. E. 'The stakeholder theory of the corporation: Concepts, evidence, and implications.' (1995) 20.1 *Academy of management Review* 65 at 87-88.

[515] Chapter 3.2. (notes 310 and 311).

[516] Freeman, R. E. op cit note 310 at 24-25.

[517] Donaldson, T. and Preston, L. E. ibid at 86.

[518] Magill, M., Quinzii, M. and Rochet, J. C. op cit note 508 at 1689.

[519] Part 5.5 par. 4(b) of King IV (at 71).

'stakeholder salience' theory proposed by Mitchell, Agle and Wood deals with this question comprehensively.[520]

Mitchel's stakeholder salience theory considers the relative importance (or salience) of the stakeholders classifying them according to the number of the following attributes each stakeholder possesses: the stakeholder's power to influence the firm, the legitimacy of the stakeholder's relationship with the company and the urgency of the stakeholder's claim on the firm. The stakeholder's 'power' is considered to exist where the stakeholder can cause the company to do something it would not otherwise have done and can be coercive, utilitarian or normative. Coercive power exists where the stakeholder uses physical means to control the behaviour of the company, while utilitarian power exists where the stakeholder uses material means such as goods, services or money to control the behaviour of the company. Less common perhaps is normative power which exists where the stakeholder uses symbols associated with prestige and acceptance for purposes of control. The stakeholder's 'legitimacy' flows from Suchman's definition of legitimacy being 'a generalised perception or assumption that the actions of an entity [the stakeholder] are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions'. Lastly, the stakeholder's 'urgency' is the degree to which stakeholder claims call for immediate attention and is based on the time sensitivity and criticality of the claim. Time sensitivity refers to the degree to which managerial delay in attending to the claim or relationship is unacceptable to the stakeholder, while criticality refers to the importance of the claim or the relationship to the stakeholder.[521]

Mitchell's stakeholder salience theory produces a comprehensive typology of stakeholders to whom managers should pay attention time, energy, and other resources to track stakeholder behaviour and to manage relationships. The stakeholder's importance or salience will be positively related to the cumulative number of attributes (power, legitimacy and urgency) that the manager considers the stakeholder to possess. The stakeholder that possess all three attributes is termed a 'definitive stakeholder'.[522] Examples of these stakeholders are those that most companies would be familiar with and include employees, key customers and key suppliers (including lenders). These stakeholders typically possess power (in the form of utilitarian power in that the provision

[520] Benson, B.W. and Davidson, W. N. 'The relation between stakeholder management, firm value, and CEO compensation: A test of enlightened value maximization' (2010) 39.3 *Financial Management* 929 at 932.

[521] Mitchell, R. K., Agle, B. R. and Wood, D. J. 'Toward a theory of stakeholder identification and salience: Defining the principle of who and what really counts' (1997) 22.4 *Academy of management review* 853 at 865-868.

[522] Ibid at 872-879.

of goods, services or money controls the behaviour of the company), legitimacy (flowing from either their contractual relationship with the company or some or other socially constructed belief of what is fair with respect to both parties) and urgency (due to the time sensitivity and criticality of the relationship in that any delay in tending to their interests would have adverse consequences for their interests).

While the determination by the executive as to who 'definitive stakeholders' are is a matter of judgement, the decision to disregard a certain attribute that the stakeholder has may have adverse consequences for the company. For example, where the executive does not consider an impatient indigent community picketing outside the gates of the company's operations to be a definitive stakeholder on grounds that they do not believe that the community has a legitimate relationship with the company, the executive may ignore the interests of this community. The community may then resort to its coercive power including damaging the company's premises and threatening its employees in order to get the company's attention. These actions may in turn adversely impact the performance of the company and the interests of its other stakeholders, and thereby the long-term sustainability of the company.

3.4.3 Determination of value for the stakeholders of the company

The <IR> Framework indicates that 'the ability of an organisation to create value for itself is linked to the value it creates for others.'[523] In this sense, that value has been broadly defined as anything that has potential to be of worth or merit to the company's stakeholders.[524] Parmar et al indicate that businesses can be seen as a set of relationships among its various stakeholders which interact to jointly create and trade value. The executive is expected to manage and develop these relationships in order to create as much value as possible for the stakeholders and manage the distribution of that value. Where the interests of the various stakeholders conflict with each other, the executive would be required to establish how the needs of each stakeholder should be addressed optimally. Should trade-offs between stakeholders have to be made, the executive would need to determine how to achieve these trade-offs and ensure that the interests of all stakeholders are ultimately advanced.[525]

The IoDSA suggests that there are four forms of value which are expected by the company's stakeholders. These are financial value, human value, consumer value and societal value. Financial

[523] IIRC 'International Integrated Reporting Framework' op cit note 491 at 16.

[524] Harrison, J.S. and Wicks, A. C. op cit note 158 at 100-101.

[525] Parmar, B. L. at al op cit note 337 at 406.

value is the value the company creates for its stakeholders such as the growth in the company's revenue, the management of its working capital, costs and cash flows. Human value is the value that the company creates when it provides employment and invests in the development of people. Consumer value is the value that the company creates for its stakeholders by producing goods and services that are aligned with the customer's needs. Societal value is the value created for stakeholders through the relationships that the company has with all of its external stakeholders including its environmental, social and economic impacts.[526]

While these forms of value offer a useful insight into the different dimensions of value, they are perhaps too limited. There are other forms of value such as the value to the supplier of goods, services or money to the company of the company meeting the supplier's payment or repayment terms. Even the shareholder may be looking for value, in addition to the returns on his or her shares, from the company such as the manner of his or her engagements with the executive. It is suggested, therefore, that a distinction should simply be made between the *financial value* that the company generates for its stakeholders comprising the company's financial performance, and the *social value* that the company generates for its stakeholders comprising the intrinsic value that the stakeholders acquire from their relationship with the company. This value should be considered from the perspective of the stakeholder. It is assumed that all stakeholders are interested in the financial value generated by the company as determined from the company's financial statements (which usually translates into returns for shareholders and economic stability for the interests of other stakeholders), while it is also assumed that all stakeholders are interested in the social value generated by the company which is determined by assessing whether certain non-financial needs of the stakeholders are met.

Schaltegger, Hörisch and Freeman state that identifying the needs and expectations of stakeholders helps to understand the core purpose of a specific business.[527] The executive would therefore need to engage with stakeholders and understand the value that their companies are creating from a stakeholder perspective. As the UK Corporate Code recommends, the board should obtain an understanding of the interests of its key stakeholders.[528] King IV also recommends that the formal mechanisms for engagement and communication with stakeholders should be

[526] IoDSA 'Linking Executive Pay to Organisational Purpose – Remuneration Committee Guidance' op cit note 511 at 14.

[527] Schaltegger, S., Hörisch, J., Freeman, R.E. 'Business Cases for Sustainability: A Stakeholder Theory Perspective' (2019) 32.3 *Organisation and Environment* 191 at 205.

[528] Chapter 3.2.2 above (provision 5 of the UK Corporate Code at note 349).

established with the intention of measuring the quality of material stakeholder relationships.[529] These engagements could be both formal and informal and include focus groups, workshops, surveys and roadshows.[530]

The financial value and social value concepts represent the types of outcomes that would form the basis of performance measures pertaining to the incentive-linked variable components of the executive remuneration package and as such are discussed briefly.

a) Financial value

All stakeholders of the company have interests in the company being operated effectively by their executive management teams in order to drive their optimal performance, and thereby, being able to sustain and ultimately grow themselves which in turn contributes to the overall growth of the economy. Apart from providing an investment vehicle to shareholders including institutional investors, they are typically significant providers of employment, meet the needs of consumers for goods and services and support a network of suppliers for goods, services and funds to the company. They are large contributors to the tax revenues of the state and thereby assist the state to discharge its duty to advance various socioeconomic rights and as such contribute to various socioeconomic initiatives aimed at alleviating poverty and inequality in South Africa. They may also contribute directly to advancing socioeconomic interests in the communities they form part of by providing employment opportunities to local residents and supporting the local municipality with respect to various infrastructure needs. It is imperative, therefore, that companies are managed to achieve their optimal performance while ensuring that this performance is sustainable in the long-term.

Consequently, the financial value of a company as the outcome of these efforts is important to all stakeholders, and it is essential for the executive to properly appreciate what this value entails. While traditional financial management is associated with maximising the financial value of the company which in turn translates to maximising shareholder value and ultimately the maximisation of profit, the focus on profitability including the growth thereof are incomplete actions with respect to the financial management of a business and may lead to poor decision-making.[531] Other financial aspects of the company that impact its financial

[529] Part 5.5 par. 49(d) and (e) of King IV (at 71).

[530] IoDSA 'Value Creation and Executive Pay - Remuneration Committee Guidance' (2016 – revised in 2020) at 11 available at https://cdn.ymaws.com/www.iodsa.co.za/ resource/collection/ 57F28684-0FFA-4C46-9AD9-EBE3A3DFB101/Paper_5_Value_creation_and_executive_pay.pdf last accessed on 15 June 2023.

[531] Chapter 2.3.2. (b)(i) above.

performance and consequently its financial value include the company's cashflows, operating efficiency, liquidity and solvency. They also include aspects such as the company's cost of capital and its risk exposure. As such the executive needs to focus on all aspects of the company's financial performance in order to promote its optimal financial value including its long-term sustainability for all its stakeholders.[532]

i. Profitability

The profitability of the company generally relates to the consistency of the company's ability to generate profits being the excess of its income less its expenses. Profitability is also referred to in the context of the company's profits relative to its turnover. The profit of the company and therefore its profitability exist at different levels. For example, gross profit consists of the company's revenue less its cost of sales (being the cost of the goods or services used to manufacture the goods, and other direct production-related costs). Operating profit consists of the company's gross profits less its operating overheads, and net profit would consist of the company's operating profit less its finance costs and taxation charge. The factors or drivers of the company's profitability include efforts to increase volumes and selling prices, while reducing raw material costs and production inefficiencies. They also involve efforts to reduce overheads such as labour, maintenance and energy costs, reduce financing costs and ensure that the taxation charge on profit before tax is efficient.

ii. Cash flows

A company's cash flow is crucial to its sustainability in that inadequate cash flow may result in the company being unable to meet its obligations as they fall due. While a company may be profitable at any level of the statement of profit or loss (income statement), all cash generated in its operations may be absorbed in increasing its working capital to maintain these levels due to its working capital being poorly managed. Working capital may be poorly managed where the trade debtors of the company have payment terms that are longer than the payment terms of its trade creditors or its trade debtors are not collected within their terms. Working capital may also be poorly managed where inventory levels are maintained at higher levels than is reasonably required for the company's level of operations. Cash flow from operations may also be over utilised in investing activities such as the purchase of businesses, plant and machinery, and other capital assets, while insufficient cash may be

[532] Correia, C. op cit note 134 1-10 – 1-13.

generated from financing activities to support both operational and investing activities. The factors or drivers of the company's efficient or optimal cash flows in addition to driving the profitability of the company, therefore, involve the executive's efforts to ensure that working capital and capital expenditure are managed appropriately, and that financing decisions are appropriate.

iii. Operating efficiency

Operating efficiency relates to how well a company is using its assets and, therefore, whether the company's level of investment in its assets is justified in relation to the company's turnover.[533] These assets may relate to its operating assets such as property, plant and equipment, and working capital, as well as its human assets being its employees. Operating efficiency is therefore the consideration of the company's inputs, being its assets, compared to its outputs, such as its turnover, in the production process.[534] The factors or drivers of the company's operating efficiency are the executive's efforts to ensure that the company's assets are utilised efficiently in this process. Inefficient use of the company's assets may ultimately put pressure on the company's profitability and cash flows.

iv. Liquidity

Liquidity is the ability of the company to meet its short-term obligations or liabilities as and when they fall due.[535] These liabilities may relate to loans (including the liability relating to the payment of interest on these loans), trade creditors and other accounts that are payable in the ordinary course of the company's operations. The ability to settle these liabilities flows from the level of liquid assets that it has on hand (including inventory, trade receivables and cash) relative to its short-term liabilities, as well as its level of unutilised call or revolving credit facilities that may be drawn down to meet its obligations as they fall due. The latter includes meeting any reasonably foreseeable expenditure, or bridging any periods where the company experiences challenges or delays in converting its liquid assets to cash.[536] The factors or drivers of the company's liquidity include monitoring the quality of its current assets and the level of its facilities.

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[533] Ibid at 5-16.

[534] Ibid.

[535] Ibid at 5-15.

[536] Refer section 4 of the SA Companies Act regarding the solvency and liquidity test that must be applied by the company in certain circumstances and its determination.

v. Solvency

Similar to liquidity, the solvency of the company is its ability to meet its long-term obligations as and when they mature. The long-term debt of the company generally consists of all its interest-bearing financial liabilities such as loans from lending institutions that are repayable over a period of more than one year. A company is considered solvent where its assets exceed its liabilities or, in other words, where its equity consists of a positive balance on its statement of financial position (or balance sheet).[537] The net equity of the company is calculated as the total net equity of the company (such as share or stated capital, reserves and retained earnings) and is equal to the difference between the company's assets and its liabilities. Negative equity is indicative, therefore, of the company's liabilities exceeding its assets and it being factually insolvent. The factors or drivers of the company's solvency are the executive's efforts to ensure that the company's assets continuously exceed its liabilities by managing the acquisition and use of its assets while managing its debt and other liability levels.

b) Social value

While the financial value generated by the company is generally important for all the company's stakeholders, Harrison and Wicks indicate that it is not the only aspect of value that is important to them. The sole or dominant focus on financial value may lead the executive to pursue actions in this regard while reducing other types of value that stakeholders are interested in. Where this reduction in stakeholder value results in a loss of support for the company from their stakeholders, the long-term sustainability of the company's financial performance may be jeopardised.[538] Therefore, they suggest that most stakeholders consider other aspects of their relationship with the company to be essential. These aspects involve how the company treats them and manages their interests in line with the central premise of much of stakeholder theory.[539]

As far back as the King Report on Corporate Governance 1994 ('King I'), the importance of recognising the interests of employees, customers and the communities within which their operations were located was emphasised. Employees should feel entitled to be motivated and led, while also being as fully informed about their company as is possible. The latter would

[537] Ibid. The assets and liabilities of the company should be fairly valued.

[538] Harrison, J.S. and Wicks, A. C. op cit note 158 at 99, 102.

[539] Ibid at 101.

include regular communication as to their rights, benefits and obligations as well as their company's plans, targets and policies.[540] Customers should feel entitled to products that conform to the description and standards of quality agreed as well as clearly worded and reliable warranties.[541] Local communities should expect companies to see themselves as residents in a particular area and act in a spirit of good neighbourliness reaching out to and being sensitive to the needs of their local communities.[542]

Harrison and Wicks indicate that the executive's appreciation of these factors can prove critical to understanding why some firms are more successful than others, why stakeholders are drawn to the company and why they are retained by them. [543] They, therefore, suggest that the social value that the company creates for its stakeholders should be based on the perceived value or utility that the stakeholders receive from the company as indicated by their level of 'happiness' in this regard. They suggest that there are four factors which drive this value (or outcome): the quality of the goods or services received, the manner in which they are treated, the affiliation with the company's philosophy (or ethos) and the opportunity cost associated with each factor (which impacts how well a company can retain the stakeholder).[544]

i. Quality of the goods or services supplied

The value that the stakeholder derives from the quality of the physical goods or services supplied involves the company aspiring to provide goods or services that have the best possible value to the stakeholder for the value received by the company.[545]

Examples of this factor relating to shareholders include the clarity and comprehensiveness of information provided in interim and annual financial statements and presentations, as well as various engagements with the executive. For employees it could include aspects of the various components of their employment contracts such as the level and structure of their salary, benefits and perquisites as well as working hours and conditions. For suppliers it could include aspects such as the payment of amounts due within the agreed terms and length of supply contracts. For society in general, this factor could relate to drivers

[540] Chapter 16 paragraph 2.1 of King 1.

[541] Chapter 16 paragraph 2.3 of King 1.

[542] Chapter 16 paragraph 3.1 of King 1.

[543] Harrison, J.S. and Wicks, A. C. op cit note 158 at 98.

[544] Ibid at 103. Also see Jones, T. M. and Felps, W. 'Stakeholder Happiness Enhancement: A Neo-Utilitarian Objective for the Modern Corporation' (2013) 23.3 *Business Ethics Quarterly* 349 at 364 for example.

[545] Harrison, J.S. and Wicks, A. C. ibid at 104.

such as the contributions to local infrastructure, schools and housing.[546] The 'Social, Economic and Environmental' (SEE) program of *Standard Bank Group Limited* with respect to sustainability and social bonds are encouraging examples of the drivers of this social value. These bonds are designed to raise funds to provide finance for environmental projects and low-income housing, and thereby play a useful role in addressing socioeconomic concerns in South Africa.[547]

ii. The manner in which they are treated

The utility associated with how well stakeholders are treated involves perceptions as to how the stakeholders perceive the fairness of the rules and procedures that relate to decisions impacting them and the respect shown towards them in their interactions with the company.[548]

Examples of this factor relating to shareholders include aspects such as how quickly the executive responds to their requests for meetings and feedback on queries relating to financial reports. For employees, it could include aspects such as fairness in decision-making, treatment in the workplace, promotion opportunities and development plans. For customers, it could include the treatment they experienced during the transaction and any after sales service such as the way in which complaints are dealt with. For society in general, this factor could include aspects such as the hiring of local residents and protecting the environment.[549]

iii. The affiliation with the company

The utility that stakeholders derive from their affiliation with a company relates to how the stakeholders tend to identify with the company's philosophy flowing from the company's practices being consistent with the things that they value. Typically, these companies provide stakeholders with feelings of connectedness, esteem and empowerment and thereby encourages stakeholders to reciprocate by contributing more value to the company. This

[546] Harrison, J.S. and Wicks, A. C. op cit note 158 at 115. IoDSA 'Value Creation and Executive Pay - Remuneration Committee Guidance' op cit note 530 at 11.

[547] Standard Bank Group Ltd Governance and Remuneration Report for the year ended 31 December 2022 at 96 available at https://thevault.exchange/?get_group_doc=18/1680198968-SBG2022GovernanceandRemunerationReport.pdf last accessed on 9 July 2024.

[548] Harrison, J.S. and Wicks, A. C. ibid at 104-106.

[549] Harrison, J.S. and Wicks, A. C. op cit note 158 at 115. IoDSA 'Value Creation and Executive Pay - Remuneration Committee Guidance' op cit not 530 at 11.

includes employees being motivated to invest more time and effort and customers acquiring more of the company's goods or services.[550]

Examples of this factor relating to shareholders, employees, customers and suppliers include aspects such as the company's position on environmental and other societal issues.[551]

iv. The opportunity cost associated with each factor

The utility associated with perceived opportunity costs relates to how much value the stakeholder believes he or she is getting from the company compared to what they feel they could derive from their competitors and therefore how well a company can retain the stakeholder.[552]

In exchange for the value created or provided to the stakeholder, as driven by the quality of the goods or services supplied, the treatment received by them, their affiliation with the company and the opportunity cost associated with each factor, the company could expect to derive value from the stakeholder in return. The value derived by the company could manifest in several ways. Shareholders may be inclined to forego dividends and not withdraw their investments when the company is under duress, and to take up rights offers where the company needs to raise capital. Employees may be more engaged and motivated leading to increased productivity and the retention of key skills for the company. Customers may want to continue doing business with the company leading to revenue growth, while suppliers may ensure that the quality and price of their goods and services supplied contribute beneficially to improving productivity at reasonable margins thereby leading to increased profits. For society in general, the company's efforts in addressing socioeconomic interests, even though insignificant, may improve its standing or reputation in society and thereby contribute to its increased sustainability.[553]

3.4.4 Establishing measures of value for stakeholders of the company

Once the aspects of financial and social value generated by the company have been established, the next step in the process of setting the remuneration policy for the incentive-linked variable components of executive remuneration packages involves establishing performance measures for these aspects of value or outcomes. The IoDSA also indicates that performance measures should

[550] Harrison, J.S. and Wicks, A. C. ibid at 106-107.

[551] Ibid at 115.

[552] Ibid at 107-108.

[553] IoDSA 'Value Creation and Executive Pay - Remuneration Committee Guidance' op cit note 530 at 11-12.

be based on the drivers of these aspects of value or outcomes, as opposed to outcomes only.[554] As discussed, examples of these drivers may include efforts to increase volumes or reduce production costs thereby driving the profitability aspect of financial value, or ensuring that their employees' performance and developments plans are properly carried out each year thereby driving their employees' sense of 'happiness' or social value. Their reasons for suggesting that performance measures should not be based on outcomes alone include concerns that outcomes may be manipulated and that they do not provide an indication of management's actions or the company's strategy that is required to achieve them.[555] While there may be merit in these views, the payment or award of incentives based on drivers may lead to the executive being rewarded in circumstances where the outcome is not achieved. For example, an increase in volumes may not lead to an increase in profitability due to the poor margin achieved on these additional volumes thereby contributing to the possibility of performance risk. The executive should also retain the flexibility to achieve the desired outcomes by taking whatever action he or she needs to in the circumstances concerned. Therefore, it is submitted that performance measures should be based on outcomes alone.

a) Financial measures of performance

Bussin suggests that certain studies indicate that the company's financial performance should be measured by market-based measures such as the company's share performance, due to accounting-based measures such as earnings levels and return on assets being too susceptible to manipulation.[556] In particular, accounting-based measures may involve financial statement line items being manipulated through creative accounting or management practices. However, he indicates that accounting-based measures are more informative of the managerial efforts than market-based measures as they are not affected by the noise of the market.[557] It is also submitted that appropriate corporate governance measures and verification by external audit of the implementation report should alleviate concerns with respect to the manipulation of accounting-based measures.

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[554] Ibid at 9.

[555] Ibid 8-9.

[556] Bussin, M. op cit note 27 at 236.

[557] Ibid. In this regard, the 'Total Shareholder Return' (TSR) measure calculated as the sum of the movement in the share price and dividends paid during the financial year divided by the share price at the beginning of the year is a commonly used incentive-linked performance measure. Ultimately the TSR measure is a consequence of the financial value generated by the company and may be a useful measure of this value yet can be impacted by the 'noise of the market'. It is also considered more of an investor measure than an incentive measure. See IoDSA 'Value Creation and Executive Pay - Remuneration Committee Guidance' op cit note 530 at 9-10.

As such, it is suggested that financial performance measures should be based on either the absolute measures of the company's financial value as reflected by the elements of the company's financial statements, formulated in terms of alternative performance measures based on adjusted financial information flowing from these financial statements, or formulated in terms of various financial ratios that are based on elements of the financial statements or these alternative financial performance measures. Naturally, a combination of these measures could also be implemented. In addition, the IoDSA indicates that an appropriate balance between short-term and long-term incentive-linked performance measures should be achieved as these measures are important for the retention of executives and the sustainable performance of the company respectively, yet these measures should ideally not be duplicated as this would lead to a double incentive award or payment.[558]

Elements of financial statements include measures of the company's financial performance such as 'revenue', 'attributable profit or loss', 'earnings per share' and 'cash flow from operating activities' are specifically defined measures of the financial performance of the company for the period concerned in terms of International Financial Reporting Standards ('IFRS') and upon which financial measures may be based. Although 'operating profit' is not a defined subtotal in the profit or loss statement in terms of IFRS, an exposure draft is currently under deliberation to make this a recognised term.[559] Headline earnings per share ('HEPS') is another important financial measure that is defined in terms of the Headline Earnings Circular to exclude certain capital gains and losses, such as the profit on disposal of plant and equipment, and is required to be disclosed for companies listed on the JSE.[560]

Adjusted financial information flowing from the financial statements upon which alternative financial performance measures are based is often disclosed in the notes to the financial statements. This financial information may include or exclude certain income or expense items from defined IFRS elements of the financial statements to communicate the executive's view of profit or loss, or other aspects of the company's financial performance. Alternative financial performance measures based on such adjusted information include 'normalised profit', 'pro forma earnings', 'cash earnings', 'earnings before interest, tax, depreciation and amortisation' (EBITDA), 'adjusted earnings', and 'earnings before non-

[558] IoDSA 'Linking Pay with Performance – Remuneration Committee Guidance' op cit note 130 at 15.

[559] ED/2019/7 General Presentation and Disclosure par 60. Per par 46, all income and expenditure relating to investing, financing, associates and joint venture, income tax and discontinued operations must be excluded from this category.

[560] Circular 1/2023 available at https://www.saica.org.za/resources/179364 last accessed on 9 July 2024.

recurring items'.[561] Such measures can play an important role in communicating to investors the measures that are used to hold management to account and explain certain values for companies that are not encompassed by IFRS based measures. They can also assist investors to understand the financial effect of unusual events that impacted the company.[562]

Examples of these financial performance measures pertaining to the different aspects of financial value are discussed briefly.

i. Profitability

Performance measures relating to the profitability of the company include the growth year-on-year of certain line items in the statement of profit or loss (or income statement) such as revenue, gross profit, operating profit and earnings per share, as well as other performance measures which may be disclosed in the notes of the financial statements such as EBITDA and HEPS. Various profitability ratios based on gross profit, operating profit, net profit and EBITDA relative to the company's revenue also provide further insight into the profitability of the business. The margin ratios are calculated by dividing the absolute measure concerned, such as gross profit, by revenue.[563]

For the purposes of establishing whether the company has created or destroyed value as measured by the company's Economic Value-add (EVA), the company would calculate the return on invested capital (ROIC) and compare this to its weighted average cost of capital (WACC). This measure is especially relevant where the executive has substantially increased the company's debt position in acquiring businesses or other assets. It may also serve to prevent the risk adverse executive from acquiring risky assets at excessive prices that place the company's sustainability at risk and should, therefore, be a standard feature of all remuneration policies. The return on invested capital is usually calculated as the net operating profit after tax (by applying the statutory tax rate to the operating profit of the company) divided by the total funds employed by the capital (consisting of the total equity and total interest-bearing liabilities of the company). The weighted cost of capital is the weighted

[561] IFRS Foundation 'Principles of disclosure – Alternative performance measures' February 2015 *IASB meeting staff paper* par 4 available at https://www.ifrs.org/content/dam/ifrs/meetings/2015/february/iasb/disclosure-initiative/ap11b-pod-alternative-performance-measures.pdf last accessed on 2 August 2024.

[562] Deloitte 'Alternative performance measures' July 2016 *IFRS in Focus – A practical guide* 1 available at https://www.iasplus.com/en/publications/global/other/apm last accessed on 2 August 2024.

[563] Correia, C. op cit note 134 at 5-21 – 5-22.

average cost of issuing equity and the cost of debt. The difference between the ROIC and the WACC of the company is the company's EVA.[564]

ii. Cash flows

Performance measures relating to the cash flow of the company would usually be determined with reference to the absolute measures of the company's statement of cash flows (cash flow statement). While EBITDA (especially if based on operating profit before net impairment losses) is closely aligned to cash flows from operations before working capital movements, cash flow from operations provides a useful measure of the quality of the EBITDA in that it takes the absorption or release of working capital into account in achieving that EBITDA.

iii. Operating efficiency

Efficiency ratios provide an indication of how well a company is using its assets and, therefore, whether the company's level of investment in its assets is justified in relation to its turnover. Typical performance measures in this area include the various asset turn over ratios and the company's level of investment in the working capital of the company. The inventory turnover ratio is usually calculated as the cost of sales divided by the average level of the company's inventory.[565] The company's investment in working capital is the net working capital level divided by turnover. This measure can also be calculated as the number of days invested in working capital by dividing the net working capital by net revenue and multiplying this result by 365 days.[566] This measure, however, can be manipulated by creative management practices of holding back creditors or running inventory levels down towards the end of the measurement period. To prevent these practices, the use of a 13-month average working capital should be considered in the determination of this measure.

iv. Liquidity

Performance measures relating to the company's liquidity include the 'current ratio' and the 'quick ratio'. The current ratio is calculated by dividing current assets by current liabilities. Current assets normally consist of inventories, trade and other receivables and cash, while current liabilities normally consist of trade and other payables, short-term portions of loans

[564] Correia, C. op cit note 134 at 5-23 – 5-24.

[565] Ibid at 5-16 – 5-18.

[566] Ibid.

and overdrafts.[567] The quick ratio or acid test ratio is calculated by dividing current assets, excluding inventory, by current liabilities. The reason for excluding inventory is that it normally takes longer to convert inventory to cash and therefore the ratio is a useful measure of the company's ability to settle its short-term obligations without having to rely on the turn of inventory.[568] Liquidity may also be measured on the basis of maintaining sufficient headroom in the company's available facilities.

v. *Solvency*

The solvency performance measures are linked to the management of the company's debt obligations. These performance measures include the net debt equity ratio (or net gearing ratio) calculated as dividing the net debt of the company by the net equity of the company.[569] Net debt consists of all interest-bearing financial liabilities such as loans from lending institutions less interest-bearing financial assets such as cash. Performance measures relating to debt-management may include the net debt to EBITDA ratio and the interest cover ratio. The net debt to EBITDA ratio is usually calculated as the net interest-bearing debt of the company divided by the EBITDA of the company. It provides an indication of the company's ability to repay its interest-bearing debt and measures the number of years the company would effectively need to repay this debt.[570] The interest-cover ratio is usually calculated as the company's EBITDA divided by the net interest incurred by the company on its interest-bearing financial assets and liabilities. It provides an indication of the company's ability to meet its interest obligations.[571]

b) Social measures of performance

Social performance measures relate to the value generated by the company for its stakeholders through their association and interaction with the company. The level of this value is measured with reference to the construct of 'happiness' i.e. how happy or satisfied are stakeholders with the value received from the company. Harrison and Wicks suggest that the measurement of this value should be through self-report questionnaires, informant reports and the observed data

[567] Correia, C. op cit note 134 at 5-15.

[568] Ibid at 5-16.

[569] Ibid at 5-19 – 5-20.

[570] Ibid at 5-20.

[571] Ibid at 5-21.

memory recall of positive and negative incidents. They also indicate that the use of multiple sources of data would be better than relying on one source of information.[572]

i. Shareholders

Shareholder 'happiness' or satisfaction may be measured with reference to written feedback following the publication of the company's financial statements and the presentation of these results at the interim and year-end, as well as following constructive engagement with shareholders who may have raised concerns with the executive on certain matters. This feedback may be both initiated by the company or provided without a request in this regard.

ii. Employees

Employee 'happiness' or satisfaction may be measured with reference to various employee satisfaction surveys. In South Africa, these could include engagement, climate and culture surveys designed by consulting companies such as DMSA and PureSurvey. The DMSA indicates that these surveys are conducted with respect to aspects such as trust, work life balance, management style, values, work environment, training, career opportunities and communication.[573] As PureSurvey indicates, the responses to these surveys provide an indication of the rational and emotional commitment of employees, their morale, their attitudes relating to employment practices, and how aligned employees are with the company's mission.[574]

iii. Customers

Similar to employees, customer 'happiness' or satisfaction with the goods or services supplied by the company may be measured with reference to various customer satisfaction indices. In South Africa, these include the South African Customer Satisfaction Index (SAcsi) and the recently released South African Retail Sentiment Index (SArsi). The SAcsi is maintained by the marketing research company Consulta and measures customer satisfaction according to several criteria including price, quality and fair treatment including complaint incidence and handling.[575] Similarly, the SArsi developed by PriceWaterhouseCoopers in collaboration with DataEQ measures customer satisfaction or

[572] Harrison, J.S. and Wicks, A. C. op cit note 158 at 114-116.

[573] DMSA 'Employee Engagement, Climate & Culture Surveys' internet landing page at https://www.dmsa.co.za/surveys-overviewemployee-engagement-culture-climate-survey last accessed on 1 April 2024.

[574] PureSurvey 'Employee Surveys & Insights' internet landing page at https://www.puresurvey.co.za/solutions/employee-engagement-surveys last accessed on 1 April 2024.

[575] Moonstone Information Refinery 'Which medical scheme has the most satisfied members' available at https://www.moonstone.co.za/which-medical-scheme-has-the-most-satisfied-members last accessed on 1 April 2024.

sentiment across certain customer satisfaction ratings including price, service and the product offering.[576]

In addition, the 'customer churn' and 'net promotor score' measures, as used by the *MTN Group Limited* in their remuneration policy, can be considered complementary measures to determine customer satisfaction. 'Customer churn' is defined in their policy as the 'percentage or number of subscribers to a service who discontinue their subscriptions to the service within a given period'.[577] The relative Net Promotor Score (NPS) in their policy is defined as 'the willingness of customers to recommend MTN's products or services to others'.[578] The NPS, developed by Bain and Co, typically measures this outcome on a scale of 0 to 10 with 0 being 'not likely' and 10 being 'likely'.[579] While both these measures provide a useful indication of customers satisfaction, the company would need to establish what has led or driven the customer to being unsatisfied or 'unhappy' with the goods or service supplied where the result is less than satisfactory. The customer satisfaction indices, therefore, provide more comprehensive insight into any issues that customers may have with a company's goods or services.

iv. Suppliers

The 'happiness' or satisfaction that the company generates for its suppliers can be measured along the lines of what the supplier expects from its interaction with the company. Survio, for example, is a company that assists companies in setting up online surveys for gauging supplier satisfaction. Questions can relate to how satisfied suppliers are with payments being made within their agreed payment terms, communication of planned orders being placed properly in advance and their interactions with the company's procurement teams.[580]

v. Society

Social performance measures relating to communities or the society within which the company operates would be based on positive feedback in response to the contributions that

[576] PriceWaterhouseCoopers 'South African Retail Sentiment Index 2023' available at https://www.pwc.co.za/en/publications/south-african-retail-sentiment-index.html last accessed on 1 April 2024.

[577] MTN Group Ltd Integrated Report for the year ended 31 December 2023 op cit note 224 at 117.

[578] Ibid.

[579] BizCommunity 'Applying Net Promoter Score to South African 'state of the company' February 2016 available at https://www.bizcommunity.com/Article/196/19/141091.html last accessed on 1 April 2024.

[580] Survio 'Measuring your supplier's satisfaction available at https://www.survio.com/en/use-cases/how-to-create-a-supplier-survey last accessed on 12 August 2024.

the company has made to addressing socioeconomic concerns either directly such as access to food, water, healthcare and housing or indirectly through the advancement of the rights to equality and dignity. Examples of these measures could include the positive feedback of community leaders and government departments (especially in the environmental aspects) as well as those that measure the promotion of equality in the workplace such as the diversity and inclusion performance measure in *Naspers Limited's* remuneration policy which targets a certain percentage of favourable responses to the question 'I feel respected at my company' in the annual engagement survey.[581]

Social performance measures could also relate to government departmental feedback on the compliance with environmental requirements that support South Africa's contribution to the 2030 target range for the reduction of greenhouse gas (GHG) emissions. These requirements include reducing certain scoped in emissions and moving to renewable energy sources such as solar power and green hydrogen energy where the renewable sources contribute a certain percentage of the total electricity consumption. [582]

For both financial and social performance measures to be effective in providing proper measurements of the company's performance and protecting the company's stakeholders, it is critical that certain corporate governance measures must be adopted to support these measures. These corporate governance measures are comprehensively discussed in the following chapter.

3.4.5 Establishing weighting of financial and social performance measures

There is a dearth of literature as to what the ideal weighting of financial performance measures versus social performance measures should be. King IV simply recommends that performance measures should cover both the financial and social (including environmental) perspectives of the business, while the King IV Guide simply indicates that a balance should be achieved between financial and non-financial measures. It would appear that companies are tending towards favouring a much heavier weighting for financial performance measures with measures relating to profitability being overly dominant in their remuneration policies.[583]

Ideally, a much higher weighting should be allocated to social performance measures than appears to be provided currently considering their complementary importance to financial performance measures and the company's sustainability. As discussed, an overemphasis on

[581] Naspers Ltd Integrated Annual Report 2023 op cit note 223 at 150.

[582] Chapter 3.3.1 (b)(ii) above.

[583] Chapter 2.4.2(c)(ii) above.

financial performance measures may lead executives to focus too heavily on maximising the financial value of the company which in the long-term may ultimately end up impacting these stakeholders adversely.[584] It is, therefore, suggested that further research is conducted in this area to establish what the appropriate ratio between financial and social performance measures should be and to this end what may be constraining the weighting of social performance measures.[585] It may be that current surveys that measure the social value or outcomes that the company contributes to its stakeholders are not properly developed such that remuneration committees do not have confidence in the ability of these surveys to measure this value appropriately. In order for these surveys to be effective as a measurement tool, they need to be tailored for the drivers of this value after a process of engagement with the company's various stakeholders as opposed to being generic. The executive should also be made aware of what these drivers are at the beginning of the performance period.

With respect to the weighting of the financial performance measures relative to the various financial aspects of the company that impact its overall financial health and consequently its financial value, consideration should be given to what is considered appropriate for the company in its organisational context.[586] It is submitted that all aspects of the company's financial value should be adopted as performance measures for the variable components of executive remuneration with a minimum set at say 12.5 percent for each aspect. The remuneration committee should have the flexibility to allocate more weighting to the measures that relate to those aspects of the business that are under pressure. As such, each aspect of financial value (including profitability) could still enjoy up to 50 percent of the total weighting for financial performance measures. Factors that need to be considered include the company's level of profitability and opportunities for growth in the market it serves, as well as its financial position (including its solvency and liquidity risks) and its ability to expand. A company with higher liquidity and solvency risks may allocate a higher weighting to the financial performance measures pertaining to these aspects.

With respect to the weighting of the social performance measures as they relate to the value provided to the various stakeholders of the company, the weighting should ensure that the interests of all definitive stakeholders of the company are considered while providing some flexibility in the

[584] Chapter 3.4.3(b) above.

[585] Clearly, where social performance measures are not allocated a sufficiently high weighting, they may be ineffective in advancing stakeholder interests. Consideration should possibly be given to an initial split of 70:30 between financial and social performance measures similar to the Naspers Limited remuneration policy for 2023 (see note 230 above).

[586] Chapter 2.2.3(c)(ii) above.

weighting for the relative importance of stakeholders in the context of the company's operations. It is therefore submitted that these measures should be split evenly between shareholders, employees, customers and suppliers (including lenders) on the one hand, and society (including the environment) on the other. These respective groupings would thereby effectively be weighted 50 percent each of the total social performance measures. Within the first grouping it is submitted that employees are allocated 40 percent of the weighting with the remaining 60 percent allocated between shareholders, customers and suppliers based on their relative significance to the company's operations. Similarly, within the second grouping, it is suggested that performance measures relating to non-environmental and environmental socioeconomic interests are each allocated a minimum of 40 percent of the weighting with the remaining 20 percent of the weighting being allocated to the performance measures relating to either the non-environmental or environmental interests dependent on the type of industry that the company is part of. A company involved in the extraction of minerals would therefore allocate this weighting to measures relating to environmental interests in light of the significance of their operations to these interests.

3.4.6 Establishing targets for financial and social performance measures

The final step in the process involves assigning the incentive to the performance measure, including an attainable range or percentage of the incentive, that the executive can achieve. Once again there does not appear to be any literature on what the ideal thresholds or attainable ranges should be. Therefore, although setting the minimum threshold too low would defeat the purpose of the performance measure, the threshold and attainable range should be within the discretion of the company concerned.

3.5 Summary

Despite the DTIC appearing to lean towards a stakeholder approach to the fiduciary duties of the executive in bringing about transformation, they ultimately refrained from changing the common law position due to several concerns with the stakeholder or pluralistic approach. Instead, they suggested that there were other means by which the company's role in advancing stakeholder interests and thereby addressing the socioeconomic concerns in South Africa could be achieved including specific legislation and various facilitative means. Changing the common law in favour of the stakeholder approach would in any event probably not add any meaningful change to the protection or especially the advancement of stakeholder interests. This is due to both approaches requiring the executive to balance the competing interests of the company's various stakeholders

and the executive may or may not act in the best interests of the company, whether represented by the shareholders or all the company's stakeholders, even where the socioeconomic rights of indigent communities are involved. Similarly, codifying either approach in the SA Companies Act would also not bring about any meaningful improvement to the protection or advancement of the company's stakeholders.

While state interventions in advancing socioeconomic interests have contributed significantly to the alleviation of poverty and inequality since 1994, the socioeconomic rights of a significant portion of the South African population remain unrealised. The current level of social spending is also unsustainable as they depend on tax revenues which are being curtailed by the lack of growth in the economy. The path to alleviating poverty and inequality, therefore, is largely dependent on growing the economy, and creating and filling high paying positions. Companies must, therefore, be managed to drive their optimal and sustainable performance while being cognisant of their role in advancing the socioeconomic interests of indigent communities within the confines of the common law and thereby support the various state interventions in this regard.

Although the recently enacted amendments to the SA Companies Act do not address incentive-linked performance measures, the pay differential disclosure provisions addressing the inequality in South Africa possibly represent a change to the DTIC's approach to the role of the SA Companies Act in advancing stakeholder interests in South Africa. While their original approach advocated methods outside the SA Companies Act to address socioeconomic concerns in South Africa, these amendments would conceivably be a move towards addressing these concerns now also through the Act. Further reform measures to the SA Companies Act that deal specifically with incentive-linked performance measures (as well as associated corporate governance measures) that aim to drive the optimal financial performance of the company in manner that is sustainable would strengthen these efforts to address socioeconomic concerns in South Africa and would not require any changes to the current common law approach to stakeholders. Yet, the introduction of further reforms in this area needs to be based on a properly grounded approach to stakeholder interests which the triple bottom line, IR six capitals and ESG approaches do not provide. The 'stakeholder value' approach, on the other hand, represents a superior approach for recognising and measuring the financial and social value generated by the company for its stakeholders, and upon which these reforms should be based to drive the optimal and sustainable financial performance for the company and ultimately advance the interests of all its stakeholders and especially address the socioeconomic concerns prevalent in South Africa.

Chapter 4

Proposed reforms to the regulation of executive remuneration

4.1 Background

The 'stakeholder value' approach to the determination of incentive-linked performance measures for the executive, discussed in the previous chapter, as complemented by certain corporate governance measures has the potential to improve the protection and especially the advancement of stakeholder interests in South Africa. This approach offers a comprehensive, practical and efficient method to advance these interests and should be considered as the platform upon which financial and social performance measures should be based in order to generate real value for the company's stakeholders and the company itself, and thereby contribute more constructively to addressing the socioeconomic concerns prevalent in this country.

In this chapter, consideration is given to how the 'stakeholder value' approach, as well as appropriate corporate governance measures in selected jurisdictions that are aligned with this approach, should be incorporated into a revised corporate governance code for South Africa and, particularly, the SA Companies Act (including the SA Companies Regulations). It is intended that the revised code and amended legislation will serve to guide and enforce the regulation of incentive-linked performance measures pertaining to executive remuneration in line with this approach as supported by the corporate governance measures concerned. To this end, the corporate governance codes and legislation, where applicable, of the European Union, United Kingdom, Germany, United States, Canada and Australia are first discussed briefly as to how executive remuneration in these jurisdictions are regulated with respect to their determination, approval and disclosure. This discussion also touches on the reasons for selecting these jurisdictions and the recent developments that have taken place in the regulation of executive remuneration in these jurisdictions.

Consideration is then given to the reforms that are considered necessary to King IV (with respect to the sections dealing with executive remuneration) in developing a revised corporate governance code in this area for South Africa. In this regard, the question of what the purpose of the code should entail, the principles contained currently in King IV compared to those in the selected jurisdictions and what the code should ultimately look like are discussed. Attention is also given to those measures that are currently in King IV and the corporate governance codes of these

jurisdictions that would be better suited in legislation pertaining to executive remuneration in South Africa.

Consideration is lastly given to the reforms that are considered necessary to the SA Companies Act (and the supporting SA Companies Regulations), in addition to the recently enacted amendments, with regard to the regulation of executive remuneration. In establishing what these reforms should be, the current regulation of executive remuneration in South Africa (as largely contained in King IV) and the enacted amendments to the SA Companies Act, and their attendant deficiencies, that were discussed in Chapter 2 are briefly revisited. An analysis of the corporate governance codes (specifically for measures that are better suited to legislation) and the legislation of the selected jurisdictions is then performed taking note of the measures that these jurisdictions have adopted in strengthening the governance of executive remuneration, where applicable, that could be applied in South Africa. These measures are then adapted to complement the aspects of the 'stakeholder value' approach and suggested as reforms to the SA Companies Act and SA Companies Regulations.

4.2 Comparative corporate governance codes and legislation

The recommendations and directive of the European Union, and the corporate governance codes and legislation relating to the United Kingdom, Germany, United States, Canada and Australia, are briefly analysed from the perspective of the how executive remuneration in these jurisdictions are regulated with respect to their determination, approval and disclosure. The recommendations and especially the revised shareholder directive of the European Union are analysed due to its impact on the member states of the European Union.[587] The regulatory approaches in the United Kingdom, United States and Australia were specifically selected for comparison due to their remuneration structures being similar to that in South Africa with their emphasis on the payment of performance-based incentives.[588] Germany's approach was selected as it is often considered as a comparative to that in the United Kingdom due to its two-tier board structure and its more pluralistic approach to the governance of executive remuneration that emanates from this structure,[589] while the Canadian approach was selected due to its approach being largely similar to that of the United States in their

[587] The United Kingdom left the European Union on 31 January 2020. The revised shareholder directive was required to be legislated by member states by 10 June 2019.

[588] Massie, K., Collier, D. and Crotty, A. *Executive salaries in South Africa: Who should get a say on pay?* (2015) 31–35.

[589] See, for example, Conyon, M. J. and Schwalbach, J. 'Executive compensation: Evidence from the UK and Germany' (2000) 33(4) *Long Range Planning* 504.

regulation of executive remuneration through securities exchange regulation and may therefore offer further insight into this approach. Although the approach in Japan was considered due to its culture of lower salaries, fundamental amendments to their legislation recently with regard to executive remuneration have not been officially translated and. therefore, their approach was not analysed.[590]

4.2.1 European Union

Following the corporate scandals of the 1990s which included the likes of Enron, the European Commission published two recommendations, being Commission Recommendation 2004/913/EC ('EC Recommendation 2004') and Commission Recommendation 2005/162/EC ('EC Recommendation 2005'), which were aimed at strengthening the corporate governance in companies with regard to executive remuneration.[591] The 2004 recommendation sought to strengthen controls with respect to the remuneration policy including its separate presentation in the remuneration report, the disclosures that are to be contained in the policy and its approval by shareholders. The recommendation also sought to deal with the disclosures pertaining to executive remuneration actually paid or awarded that are contained in the implementation report of the remuneration report, as well as the prior approval of the shareholders relating to share-based payment schemes.[592] The 2005 recommendation, on the other hand, sought to strengthen controls with respect to the board's role in setting and approving executive remuneration amongst other matters, including their independence, qualifications, experience and commitment, as well as their appointment, evaluation and removal.[593] Although member states could implement these recommendations either through company law reforms or corporate governance codes subject to the 'comply or explain' principle, the latter route was predominant.[594]

The financial crisis in 2008 highlighted the need for the European Commission to consider additional corporate governance measures relating to the structure of executive remuneration and the performance measures relating to the variable components thereof amongst other concerns with

[590] Nikkei staff writers 'Japan to update English translations of business laws by FY2022' last accessed at https://asia.nikkei.com/Politics/Japan-to-update-English-translations-of-business-laws-by-FY2022 on 24 August 2023.

[591] Ferrarini, G. and Moloney, E. N. 'Executive Remuneration in Crisis: A Critical Assessment of Reforms in Europe' (2010) *Journal of Corporate Law Studies* 73 at 74.

[592] Points 3-6 of EC Recommendation 2004.

[593] Points 3-11 of EC Recommendation 2005.

[594] Ferrarini, G. and Ungureanu, M. C. 'Executive Remuneration. A Comparative Overview' (2014) Law Working Paper no. 268/2014 at 21 available at http://ssrn.com/abstract=2509968 last accessed on 5 April 2024. Reference is made to 'director' throughout the recommendations. In paragraph 2.1 of the 2004 Recommendation, a 'director' is defined as 'any member of the administrative, managerial or supervisory bodies of a listed company'.

executive remuneration.[595] In response to these concerns, the Commission published Commission Recommendation 2009/385/EC ('EC Recommendation 2009') which sought to complement the 2004 and 2005 recommendations and was published in parallel with recommendation 2009/384/EC which relates to the remuneration policies in the financial sector. The 2009 recommendation sought to strengthen controls relating to the variable components of executive remuneration including share-based remuneration, the performance measures to which these components are linked, and termination payments. The recommendations also sought to expand on the disclosure pertaining to these matters, while also addressing the shareholder vote on executive remuneration and the composition, role and functions of the remuneration committee.[596] As with the 2004 and 2005 recommendations, member states could implement this recommendation either through company law reforms or corporate governance codes subject to the 'comply or explain' principle.

Possibly due to the low uptake of these recommendations (with only six member states adopting the measures set out in these recommendations),[597] the European Commission amended the 2007 Shareholder Rights Directive (Directive 2007/36/EC) ('EC Directive 2007') by way of the insertion of articles 9a and 9b in 2017 which dealt with the corporate governance measures pertaining to the remuneration policy and the remuneration (or implementation) report respectively. This amendment, commonly known as the Revised Shareholder Rights Directive,[598] was introduced in May 2019 and the provisions of the directive were required to be implemented by member states specifically in their legislation by 10 June 2019 (applicable to companies with year-ends beginning after this date).[599] Article 9a requires member states to legislate the requirement of a remuneration policy, the content of the policy especially with regard to variable remuneration, the approval of the policy by the shareholders, and the results, implications and frequency of the shareholders' vote.[600] Article 9b, on the other hand, requires member states to legislate the requirement of a remuneration (or implementation) report, the disclosures in the report and the

[595] Ferrarini, G. and Moloney, E. N. op cit note 590 at 22. Preamble (3) of the Commission Recommendation 2009/385/EC.

[596] Points 4-9 of EC Recommendation 2009.

[597] Ahern, D. 'The mythical value of voice and stewardship in the EU Directive on long-term shareholder engagement: rights do not an engaged shareholder make' (2018) 20 *Cambridge Yearbook of European Legal Studies* 88 at 97.

[598] European Directive 2017/828/EC.

[599] Telfer, S. 'New Companies Reporting Requirements – Directors' remuneration' 19 June 2019 *Institute of Chartered Accountants Scotland* available at https://www.icas.com/news/corporate-and-financial-reporting/financial-reporting/new-company-reporting-requirements-directors-remuneration last accessed on 30 July 2024.

[600] Article 9a par's 1-6 of EC Directive 2007.

approval of the report by the shareholders.[601] As Ahern indicates, the provisions of the directive with respect to the remuneration policy and the implementation report are aimed at promoting transparency. The focus of the policy is particularly on how it contributes to the long-term interests and sustainability of the company as opposed to prescribing the content of either.[602]

4.2.2 United Kingdom

The 'Study Group on Directors Remuneration' headed up by Sir Richard Greenbury, the chairman of Marks & Spencer plc, was set up in January 1995 in response to public and shareholder concerns about the remuneration of company directors in the United Kingdom ('UK'). These concerns specifically related to large pay increases and large gains on share options in the recently privatised utility industries, as well as termination payments made to directors leaving the company. The pay increases had also often coincided with retrenchments and restrictions on pay for other employees.[603] The final report, typically referred to as the 'Greenbury Report', was published in July 1995 and dealt with the main themes of accountability, responsibility, full disclosure, alignment of directors and shareholder interests and improved company performance.[604] The recommendations have largely been incorporated in the UK Corporate Governance Code ('UK Corporate Code') which is administered by the UK's Financial Reporting Council with the current version having been issued in July 2018,[605] while the substantive provisions were ultimately incorporated into statutory law by way of a 2013 amendment to The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations of 2008 ('UK Companies Regulations') which support the Companies Act 2006 (c46) ('UK Companies Act').[606] The

[601] Article 9b par's 1-6 of EC Directive 2007.

[602] Ahern, D. op cit note 596.

[603] Confederation of British Industry 'Greenbury Report (Study Group on Director's Remuneration)' at 9 available at https://www.ecgi.global/code/greenbury-report-study-group-directors-remuneration last accessed on 4 April 2024.

[604] Ibid at 5 and 7.

[605] The latest version of the code was issued in January 2024 and is applicable to companies with financial periods beginning on or after 1 January 2025. The 2024 version is substantially similar to the current 2018 version with respect to remuneration with no change to the principles. The latest version does, however, includes additional disclosure requirements relating to malus and claw back provisions while the six principles relating to the remuneration policy have been removed. The 2024 version of the code can be accessed at https://media.frc.org.uk/documents/UK_Corporate_Governance_Code_2024 and was last accessed on 4 April 2024.

[606] Harvey, C., Maclean, M. and Price, M. 'Executive remuneration and the limits of disclosure as an instrument of corporate governance' (2020) 69 *Critical Perspectives on Accounting* at 3.

amendments to the regulations included the detailed disclosures that companies are required to make in their directors' remuneration reports in terms of the UK Companies Act.[607]

The UK Corporate Code mainly provides for the establishment, composition, role and operation of the remuneration committee, as well as certain principles and controls that should be incorporated into the remuneration policy for executive directors and senior management (defined as the executive committee or the first layer of management below board level including the company secretary). It also deals with the notice or contract periods of directors.[608] Similar to the South African framework, the Financial Conduct Authority ('FCA') requires all premium listed companies (on the London Stock Exchange) to apply the principles and measures set out in the UK Corporate Code on a comply and explain basis.[609] Apart from the principles and controls relating to remuneration in the UK Corporate Code, the code also provides for engagement with key stakeholders, including employees, and the disclosure of how their interests and the matters in section 172(1) of the UK Companies Act have been considered by the board in their decision-making.[610]

In terms of the UK Companies Act, the directors of a listed company are required to prepare a directors' remuneration report for each financial year of the company.[611] The report is typically part of the annual report of the company which also includes the company's financial statements. Schedule 8 of UK Companies Regulations, as provided for by section 421(1) of the UK Companies Act, requires that the directors remuneration report must be divided into three parts being the statement by the remuneration committee chairman, the remuneration policy and the annual remuneration report (or implementation report).[612] The schedule also sets out comprehensive disclosures that are required to be taken up in these parts of the remuneration report. These requirements include presenting the disclosures in a prescribed format including written explanations or descriptions, tables and graphs.[613] A key difference between the disclosure required

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[607] Section 421(1) of the UK Companies Act (the detailed disclosures are set out in Schedule 8 of the UK Companies Regulations).

[608] Provisions 32-41 and footnote 4 (page 8) of the UK Corporate Code.

[609] LR 9.8.6 (5)-(6) of the FCA Listing Rules February 2024 available at https://www.handbook. fca.org.uk/handbook/LR.pdf last accessed on 4 April 2024.

[610] Provision 5 of the UK Corporate Code. The matters referred to in section 172(1) of the UK Companies Act relate to those matters that must be considered by the directors in exercising their fiduciary duties to act in the best interests of the company and include the interests of the company's stakeholders. Chapter 3.2.2 above.

[611] Section 420(1) of the UK Companies Act.

[612] Par 1(1) of Schedule 8 of the UK Companies Regulations. Parts 2-4 relate to the three parts of the remuneration report.

[613] Parts 2-4 of the UK Companies Regulations.

by the UK Corporate Code (and King IV) and that in the UK Companies Regulations is that the latter only applies to directors who are formally appointed as such in terms of the UK Companies Act. Members of senior management forming part of the executive committee are excluded.[614] Several reforms to the UK Companies Act were introduced in terms of The Enterprise and Regulatory Reform Act of 2013 (c. 24) with one of the fundamental changes being the introduction of the binding vote of shareholders by means of an ordinary resolution on the directors' remuneration policy.[615] The implementation report remains subject to a non-binding vote of the shareholders by means of an ordinary resolution.[616] Key amendments to the UK Companies Regulations include the introduction of pay ratio's for UK-based employees in terms of The Companies (Miscellaneous Reporting) Regulations of 2018,[617] and the introduction of a prescribed format (by means of a table) for the disclosure of the various components of directors remuneration and the average increase each year over the last five years for directors and for other full time employee separately in terms of The Companies (Directors' Remuneration Policy and Directors' remuneration Report) Regulations of 2019.[618]

4.2.3 Germany

Executive remuneration, being that of the management board, in Germany is regulated mainly by the German Corporate Governance Code ('Deutscher Corporate Governance Kodex' or 'German Corporate Code'), the German Commercial Code ('Handelsgesetzbuch') and the Stock Corporation Act of 1965 ('Aktiengesetz' or 'German Stock Corporation Act').

The German Corporate Code sets out three governance principles with respect to the remuneration of the management and supervisory boards. These principles relate to the characteristics, objectives and shareholder involvement pertaining to the remuneration policy for the management board members as well as the implementation report relating to both the

[614] Department for Business, Energy & Industrial Strategy 'Corporate governance: The Companies (Directors' Remuneration Policy and Directors' Remuneration Report) Regulations 2019 – Frequently Asked Questions' June 2019 at 9 available at https://assets.publishing.service.gov.uk/media/5d02799de5274a3d2bcecccb/corporate-governance-directors-renumeration-policy-renumeration-report.pdf last accessed on 2 August 2024.

[615] Section 79(4) of The Enterprise and Regulatory Reform Act 2013 (c. 24) (introduced Section 439A of the UK Companies Act).

[616] Section 439 of the UK Companies Act.

[617] Regulation 17(b) of The Companies (Miscellaneous Reporting) Regulations of 2018 (introduced paragraphs 19A-19G to Schedule 8 of the UK Companies Regulations dealing with pay ratios).

[618] Regulations 31(4) and 31(8)(b) of The Companies (Directors' Remuneration Policy and Directors' remuneration Report) Regulations 2019 (introduced paragraphs 5(1) and 19(1)(a) and (b) to Schedule 8 of the UK Companies Regulations dealing with the directors' remuneration table and remuneration increases respectively).

management and supervisory boards.[619] The recommendations under these principles deal with the establishment of the remuneration policy of the management board as well as the determination of amounts actually awarded and/or paid to the management and supervisory boards.[620] Noticeably, remuneration committees do not feature amongst these recommendations. The recommendations set out in the code are not mandatory as such. However, any deviations from the recommendations have to be explained and disclosed with the annual declaration of conformity pursuant to section 161 of the German Stock Corporation Act.[621]

The German Commercial Code requires listed companies to set out the total remuneration of the management and supervisory boards respectively in the notes to the consolidated financial statements of the company.[622] The Act on the Disclosure of Compensation of Corporate Executives (the 'Vorstandsvergütungs-Offenlegungsgesetz') of 2005 supplemented these disclosures by requiring listed companies to disclose the remuneration of the management board on an individual basis with the remuneration of the management board members broken down into its various components in the notes to the financial statements.[623] These requirements have now been superseded by the disclosures now required in terms of the separate implementation report in terms of the German Stock Corporation Act (discussed below) such that the disclosure requirements in the notes to the financial statements only relate to the total remuneration paid to the management and supervisory boards respectively.[624]

The German Stock Corporation Act requires listed companies to prepare a separate remuneration policy and implementation report.[625] While the remuneration policy and implementation report appear to be published separately from the annual report (containing the management report and the consolidated financial statements), there appears to be a fair degree of flexibility as to how the policy and the report may be published as part of a company's annual reporting requirements. They may be separately published under its suite of corporate governance

[619] Principles 24-26 of the German Corporate Code.

[620] G.1-G.18 of the German Corporate Code.

[621] Landing page of the 'Regierungkomission: Deutscher Corporate Governance Kodex' at https://www.dcgk.de/en/ code last accessed on 7 April 2024.

[622] Section 314(1) 6 of the German Commercial Code.

[623] Beck, D., Friedl, G. and Schäfer, P. 'Executive compensation in Germany' (2020) 90.5 *Journal of Business Economics* 787 at 791-792.

[624] Heuking 'Remuneration of the Board Members of a Listed Company according to ARUG II – Overview and Timetable for the Implementation of the New Regulations' available at https://www.heuking.de/en/news-events/newsletter-articles/detail/ last accessed on 7 April 2024.

[625] Sections 87a (1) and 162(1) of the German Stock Corporation Act.

reports,[626] or even as part of its shareholder information for the annual general meeting.[627] The remuneration policy for the management board is required to be established in terms of the principles set out in both the German Corporate Code and the Act,[628] while it must also meet certain minimum requirements in terms of the Act.[629] The Act also prescribes the details that the implementation report must contain in respect of the remuneration pertaining to the management and supervisory board members.[630] The Act then sets out the requirements relating to shareholder approval consisting of a non-binding vote on both the remuneration policy and the implementation report.[631]

Apart from various amendments to the German Corporate Code,[632] the German Stock Corporation Act has also undergone several key reforms in the last two decades with the aim of strengthening corporate governance over executive remuneration. Following the fallout from the 2008 financial crisis, the Act on the Appropriateness of Management Board Compensation (Gesetz zur Angemessenheit der Vorstandsvergütung) of 2009 amended the German Stock Corporation Act by introducing further principles that the supervisory board needed to observe in establishing the remuneration policy of the management board.[633] These amendments were aimed at ensuring that the level and structure of executive remuneration are appropriate specifically with respect to that of similar companies, other employees in the company and the company's financial position, as well as being aligned with the company's sustainability.[634] In response to the 2017 amendment to the EC Directive 2007 which Germany adopted in terms of its Act Implementing the Second Shareholder Rights Directive (Gesetz zur Umsetzung der zweiten Aktionärsrechterichtlinie or 'ARUG II') of 2019, the German Stock Corporation Act was amended by introducing further

[626] See for example the remuneration policy and implementation report for Telefonica Deutschland (for the year ended 31 December 2023) available at https://www. telefonica.de/investor-relations-en/corporate-governance and the Merck Group (for the year ended 31 December 2023) available at https://www.merckgroup. com/en/investors/corporate-governance last accessed on 7 April 2024.

[627] See for example the remuneration policy and implementation report for Hannover Re (for the year ended 31 March 2023) available at https://www. hannover-re.com/ 1989207/2023-annual-general-meeting last accessed on 7 April 2024.

[628] Recommendations G.1 – G.14 of the German Code of Corporate Governance and Section 87 of the German Stock Corporation Act.

[629] Section 87a (1) of the German Stock Corporation Act.

[630] Section 162(1) preamble of the German Stock Corporation Act.

[631] Section 120a of the German Stock Corporation Act.

[632] The most recent version of the Code as published in the Federal Gazette 27 June 2022 contains all amendments to the code up to 28 April 2022.

[633] Section 87 of the German Stock Corporation Act.

[634] Beck, D. et al op cit note 622 at 792.

requirements that the supervisory board has to meet with respect to the remuneration policy of the management board. These include setting the maximum remuneration that may be paid to them, stating the fixed and variable components of their remuneration package and the respective proportions of these components relative to each other, the financial and non-financial performance measures relating to the variable components, and the ability and criteria for temporarily deviating from the policy.[635] The implementation report was also amended to include the reporting of remuneration paid to the supervisory and management boards individually, the average increase each year over the last five years for directors and for other full time employee separately and the extent of the use of claw-backs.[636] Lastly, the amendment also introduced certain requirements relating to the shareholder vote on the remuneration policy including how often the policy must be approved and the steps to follow where the policy is rejected, as well as certain requirements relating to the implementation report.[637]

4.2.4 United States

Executive remuneration in the United States ('US') is mainly regulated by the Securities Exchange Act of 1934 ('US Securities Exchange Act') which deals with, amongst other matters, the financial disclosures that public companies are required to make in documents issued by them. These include a listed company's proxy statement and information material. A proxy statement describes matters up for shareholder vote and may include the disclosure of executive remuneration if the shareholders are voting for the election of directors.[638] The Act is supported by the Code of Federal Regulations ('US Federal Regulations') which prescribes the detailed information that must be disclosed in, amongst other documents, the proxy statement. This information includes the 'Compensation Discussion and Analysis' which requires the company to provide details as to the remuneration policy for executives,[639] and the 'Summary Compensation Table' which requires the company to provide details of all remuneration actually paid and awarded to its executives.[640] The executives for whom these disclosures are required relate to the so-called 'named executive

[635] Section 87 and 87a of the German Stock Corporation Act per Heuking op cit note 623.

[636] Section 162 of the German Stock Corporation Act per Heuking ibid.

[637] Section 120a of the German Stock Corporation Act per Heuking ibid.

[638] US Securities and Exchange Commission 'Annual meetings and proxy requirements' last accessed at https://www.sec.gov/education/smallbusiness/goingpublic/annualmeetings on 3 May 2023.

[639] Title 17 Part 229.402 par (b) of the US Federal Regulations.

[640] Title 17 Part 229.402 par (c) of the US Federal Regulations. The paragraph deals specifically with the disclosure of executive remuneration including how the prescribed disclosures should be set out in a tabular format.

officers' being the principal executive officer, principal financial officer and the three highest paid executive officers (other than the principal executive and financial officers), as well as two additional individuals for whom disclosure would be required but for the fact that they were not executive officers at the end of the financial year concerned.[641]

In response to the financial crisis of 2008, the US government responded by enacting three critical pieces of legislation. These were the Emergency Economic Stabilisation Act of 2008 which made funds available for the purchase of poor quality mortgage assets held by financial institutions, the American Recovery and Reinvestment Act of 2009 which was aimed at stimulating the economy and thereby stemming job losses, and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the 'Dodd-Frank Act') which was aimed at preventing future financial crises.[642] The Dodd-Frank Act introduced a number of measures that were aimed at strengthening the corporate governance over executive remuneration and have been implemented progressively since 2011. These included the reinforcement of the powers and independence of remuneration committees (and the independence of remuneration consultants appointed by the committee),[643] the introduction of a mandatory clawback provision relating to incentive-based remuneration paid to executives in certain circumstances,[644] and the introduction of a non-binding or advisory vote on executive remuneration disclosed in the proxy statement.[645] In addition to these measures, the Act also amended the required disclosures that companies were required to make in their proxy statements by introducing two specific disclosure provisions. These provisions dealt with the

[641] An 'executive officer' is defined in terms of US Federal Regulations as used in reference to the registrant (being the issuer with respect to whom the security disclosures relate) as being 'its president, any vice president of the registrant in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy making function or any other person who performs similar policy making functions for the registrant' (Title 17 Part 240.3b-7 of the US Federal Regulations).

[642] Murdock, C.W. 'The Dodd-Frank Wall Street Reform and Consumer Protection Act: What Caused the Financial Crisis and Will Dodd-Frank Prevent Future Crises' (2011) 64.4 *SMU Law Review* 1243 at 1244-1246.

[643] Section 10C of the US Securities Exchange Act as introduced by Section 952 of the Dodd-Frank Act. The final version or rule was adopted on 20 June 2012 (compliance by no later than 25 September 2012) See final rule at https://www.sec.gov/files/rules/final/2012/33-9330.pdf last accessed on 27 May 2024.

[644] Section 10D of the US Securities Exchange Act as introduced by Section 954 of the Dodd-Frank Act. The final version or rule was adopted on 26 October 2022 (compliance from 27 January 2023). See final rule at https://www.sec.gov/files/rules/final/2022/33-11126.pdf last accessed on 27 May 2024. A similar measure is contained in section 304(a)(1) of the Sarbanes-Oxley Act of 2002.

[645] Section 14A of the US Securities Exchange Act as introduced by Section 951 of the Dodd-Frank Act. The amendment requires companies to conduct a separate shareholder vote on the remuneration of executives as well as the so-called 'golden parachute' arrangements. The final version or rule was adopted on 25 January 2011 (compliance from 4 April 2011). See final rule at https://www.sec.gov/files/rules/final/2011/33-9178.pdf last accessed on 27 May 2024.

relationship between executive remuneration and the performance of the company (the so-called 'pay-versus-performance' disclosure rules),[646] as well as the pay-ratio between the remuneration of executives and that of mid-tier employees (the so-called 'pay-ratio' disclosure rule).[647]

4.2.5 Canada

The remuneration relating to the executives of Canadian companies is mainly regulated by each Canadian province's or territory's securities' or other related legislation together with 'national instruments' which serve to standardise this legislation across all of Canada's thirteen provinces and territories.[648] The national instruments, in particular, set out the required disclosures for listed companies relating to any management information circular involving the solicitation of proxies by management for the election of directors, or in the issuer's annual information form.[649] Further regulatory requirements with respect to executive remuneration are contained in the Canadian Business Corporations Act R.S.C. 1985 c. C-44 ('Canadian Business Corporations Act') as supported by the Canadian Business Corporations Regulations 2001 (SOR/2001-512) ('Canadian Business Corporations Regulations'). The Canadian Coalition for Good Governance ("CCGG") has also published various forms of guidance on recommended pay practices, including a model say-on-pay policy for boards for directors and 'executive compensation principles'.[650]

National Instrument 58-101 Disclosure of Corporate Governance Practices (and in particular Form 58-101F1) requires listed companies to disclose the process by which the board determines their executive remuneration and certain disclosures with respect to its remuneration committee including its responsibilities, powers and functions.[651] The remuneration committee's responsibilities, powers and functions are also supported by the National Policy 58-201 Corporate

[646] Section 14(i) of the US Securities Exchange Act (and Title 17 Part 229.402 par (v) of the US Federal Regulations for the detailed disclosure) were introduced by Section 953(a) of the Dodd-Frank Act. The final version or rule was adopted on 25 August 2022 (compliance for financial years ending on or after 16 December 2022). See final rule at https://www.sec.gov/files/rules/final/2022/34-95607.pdf last accessed on 27 May 2024.

[647] Title 17 Part 229.402 par (u) of the US Federal Regulations as introduced by Section 953(b) of the 'Dodd-Frank Act'. The final version or rule was adopted on 5 August 2015 (compliance for financial years beginning on or after 1 January 2017). See final rule at https://www.sec.gov/files/rules/final/2015/33-9877.pdf last accessed on 27 May 2024.

[648] Canadian Securities Administrators 'CSA National and Multilateral Instruments' available at https://www.securities-administrators.ca/resources/csa-national-and-multilateral-instruments/ last accessed on 27 May 2024. The CSA is an umbrella body representing Canada's provincial and territorial securities commissions.

[649] Stikeman Elliott LLP 'Executive Compensation Guide for Canadian Officers and Directors' (May 2014) at 17-19 available at https://www.stikeman.com/-/media/files/kh-guides/ last accessed on 9 April 2024.

[650] Stikeman Elliott LLP ibid.

[651] Par 7 of Form 58-101F1.

Governance Guidelines.[652] National Instrument 51-102 Continuous Disclosure Obligations (and in particular, Form 51-102F6 Statement of Executive Compensation) prescribes the detailed disclosures that companies are required to set out in their annual management proxy circulars with respect to the remuneration of their executive being the Chief Executive Officer ('CEO'), the Chief Financial Officer ('CFO') and the three most highly compensated executive officers executives.[653] These disclosures include the 'Compensation Discussion and Analysis' which requires the company to provide details such as its remuneration policy regarding the different elements of compensation paid to the company's executive, the company's remuneration trends and its shareholder returns,[654] as well as the 'Summary Compensation Table' which requires the company to provide details of all non-equity remuneration actually paid to its executives in a tabular format.[655] These disclosures must be complemented by separate tables for equity-based remuneration and pension plan benefits accruing to its executives amongst other disclosures.[656]

The current provisions in the Canadian Business Corporations Act relating to executive remuneration are, in contrast to the national instruments, extremely light.[657] Proposed amendments in the Budget Implementation Act of 2019 ('Bill C-97'),[658] however, introduce several measures relating to executive remuneration that are more substantial. These include the requirement for the company to develop a remuneration policy (or 'approach'),[659] disclosure relating to the claw back of executive incentives paid where this is included in the policy,[660] and the submission of the policy to each annual general meeting for a non-binding vote by the shareholders.[661] The group of employees for whom disclosure in terms of these amendments would be required differs somewhat

[652] Part 3.15-17 of National Policy 58-201 Corporate Governance Guidelines.

[653] Items 1.1 and 1.2 of Form 51-102F6.

[654] Item 2 of Form 51-102F6.

[655] Item 3 of Form 51-102F6.

[656] Items 4-7 of Form 51-102F6.

[657] Section 125 of the Canadian Business Corporation Act simply indicates that 'subject to the articles, the by-laws or any unanimous shareholder agreement, the directors of a corporation may fix the remuneration of the directors, officers and employees of the corporation.'

[658] No. 1 SC 2019 c29.

[659] Section 142 of the Budget Implementation Act proposes the introduction of Section 125.1 into the Canadian Business Corporations Act.

[660] Section 143(1) of the Budget Implementation Act proposes the introduction of Section 172.3 into the Canadian Business Corporations Act.

[661] Section 143(1) of the Budget Implementation Act proposes the introduction of Section 172.4 into the Canadian Business Corporations Act.

from that in terms of the national instruments above. The disclosures in terms of these amendments would be required for 'members of senior management' as defined in the Canadian Business Corporations Regulations which includes a wider group of people. While this term would still include the CEO and CFO, the term also includes any person who performs a policy-making function at the company.[662]

4.2.6 Australia

Executive remuneration in Australia is regulated mainly by the Corporate Governance Principles and Recommendations of Australia ('Australian Corporate Code'), and the Corporations Act 50 of 2001 ('Australian Corporations Act') as supported by the Corporations Regulations of 2001 ('Australian Corporations Regulations'). The Australian Corporations Act and the supporting regulations refer to the executive management of the company as the 'key management personnel' for the purpose of the provisions dealing with executive remuneration. 'Key management personnel' are defined by reference to the Australian Accounting Standards as being 'those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity'.[663] As Pyburne and Murphy indicate, the 'key management personnel' of the company relates to the statutory directors and generally the most highly remunerated executives of the company.[664] This definition is therefore similar to that of 'prescribed officers' in terms of the SA Companies Regulations.[665]

The principle contained in the Australian Corporate Code dealing with executive remuneration states that the remuneration should be fair and responsible and sets out three recommendations under this principle. These recommendations involve the appointment of a remuneration committee by listed companies including the composition and various disclosures relating to the committee, the disclosure by a listed company of its remuneration policy and practices relating to executives and non-executives, and the disclosure of certain details of any equity-based remuneration scheme maintained by a listed company.[666] The code also contains

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[662] Regulation 72.2 (3) of the Canadian Business Corporations Regulations.

[663] Par 9 of AASB 124: Related Party Disclosures.

[664] Pyburne, P. and Murphy, J. 'Executive Remuneration: a quick guide' September 2022 Parliament of Australia – Department of Parliamentary Services (Laws and Digest Section) available at https://parlinfo.aph.gov.au/parlInfo/download/library/prspub/8778457/upload_binary/ last accessed on 8 April 2024.

[665] Refer note 23.

[666] Recommendations 8.1 – 8.3 (pages 29-30) of the Australian Corporate Code.

suggested guidelines for executive and non-executive remuneration including aspects such as the composition of packages, the fixed, performance-based and equity components of the packages, and termination payments.[667]

The Australian Corporations Act requires the remuneration policy and implementation report to be set out in a separate section of the directors' report headed the 'remuneration report'.[668] Unlike the SA Companies Act requirements, the directors report does not form part of the financial statements of the company but is a separate annual report that is required to be prepared.[669] The Act sets out the disclosures that must be provided in the remuneration policy and the implementation report, including certain details with regard to the results of the vote on the remuneration report, the use of remuneration consultants and the relationship between the remuneration policy and the company's performance. The disclosures in the implementation report relating to the remuneration paid or awarded to key management personnel during the year are expanded by the Australian Corporations Regulations.[670]

The Australian Corporations Act also sets out the process for the shareholder vote on the remuneration report at the annual general meeting,[671] as well as the consequences for a significant vote against the resolution.[672] These consequences involve the so-called 'two strikes rule' which was introduced by the Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Act of 2011 to strengthen the accountability and transparency of Australia's executive remuneration framework, and to provide shareholders with more power over the remuneration of companies' directors and executives.[673]

In summary, the approaches to the regulation of executive remuneration in the United Kingdom, Germany, United States, Canada and Australia are similar in many respects. There are, however, also key differences.

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[667] Box 8.2 (page 31) of the Australian Corporate Code.

[668] Section 300A (1) and (1A) of the Australian Corporations Act.

[669] Section 30(3) of the SA Companies Act and Section 295 of the Australian Corporations Act. Australian companies typically prepare an 'annual report' which includes the financial report (financial statements) and the directors report as separate sections. See, for example, the annual report of the Woolworths Group for 2022 accessible at https://www.woolworthsgroup.com.au/content/dam/wwg/investors/reports/2022/full-year.

[670] Regulation 2M.3.03 of the Australian Corporations Regulations (as prescribed per section 300A (1)(c) of the Australian Corporations Act).

[671] Sections 249(L)(2) and 250R(2)-(3) of the Australian Corporations Act.

[672] Sections 250U to 250Y of the Australian Corporations Act.

[673] Pyburne, P. and Murphy, J. op cit note 663 at 3.

The United Kingdom, Germany and Australia regulate executive remuneration through their company legislation as supported by detailed company regulations and corporate governance codes. The United States and Canada, on the other hand, regulate executive remuneration mainly through their securities legislation as supported respectively by their federal code and national instruments. Noticeably, most of the corporate governance measures addressing the level and structure of executive remuneration (including incentive-linked performance measures) are encompassed by the legislation of these jurisdictions with the corporate governance codes of these jurisdictions, where applicable, containing mainly high-level principles and recommendations.

Of the jurisdictions selected, only Germany does not legislate or advocate a remuneration committee for the governance of executive remuneration and rather places its reliance in this regard on the supervisory board. There are also differences in the way executive remuneration is reported to the public being either the annual report, a separate corporate governance report, or securities-related information reports. While the legislated provisions (and the principles and recommendations supported by the listings authorities) relating to executive remuneration are typically only mandatory for listed companies, the United Kingdom also requires disclosures for unlisted companies in certain circumstances. The United Kingdom also only requires disclosure for the remuneration of its statutory executive directors compared to other jurisdictions that require disclosure for other members of senior management. Furthermore, the United Kingdom is also the only jurisdiction selected that requires a binding vote by the shareholders on the executive's remuneration policy, while Australia's process involves significant consequences for directors where the shareholders reject successive remuneration reports.

The detailed principles and recommendations set out in the corporate governance codes of the selected jurisdictions, as well as the detailed provisions set out in their legislation, are analysed and compared to the South African regulatory framework in the next two sections with a view to their adoption where this would strengthen the South African framework as it pertains to the protection and advancement of the company's stakeholders.

4.3 Proposed reforms to the corporate governance code of South Africa

The enacted amendments to the SA Companies Act with respect to the remuneration report including the background statement, remuneration policy and implementation report, and the shareholder vote on both the remuneration policy and the implementation report, suggest that the current recommendations contained in King IV relating to the remuneration report and accompanying

shareholder vote may become redundant on the implementation of these amendments. This would especially be the case where the detailed content of the remuneration report was eventually taken up in the SA Companies Regulations. The content and purpose of King IV pertaining to executive remuneration should therefore be considered with a view to understanding what its continued relevance would be. These aspects are discussed before considering the principles contained in the King IV, as explained in the King IV Guide, and the corporate governance codes (and legislation) of the selected jurisdictions above before proposing reforms to King IV that would support its continued relevance after the implementation of the enacted amendments.

4.3.1 Purpose of the corporate governance code

As the enacted amendments do not cover the format and detailed content of the remuneration report, it may be assumed that at least the content would continue to follow the recommendations contained in King IV. Ideally, however, the format and detailed content of the remuneration report should be taken up in the supporting SA Companies Regulations in line with the jurisdictions of the United Kingdom and Australia, as well as that of the United States and Canada that employ similar regulatory instruments for the format and detailed content of their executive remuneration disclosures. The question would then be: what content should the code continue to contain? To answer this question, consideration should be given to properly understanding the purpose of a corporate governance code. The international Corporate Governance Institute perhaps best expresses this purpose succinctly:

> 'A corporate governance code is a guide for board members and directors, setting out how they should approach governance in their organisation'[674]

Applied to executive remuneration, therefore, a clear distinction should be made between the principles that the remuneration committee should apply in its approach to the governance of executive remuneration on the one hand, and the measures that they should consider in giving effect to these principles on the other. Ideally, the code should be a set of principles that are emphasised and elaborated upon as to the manner in which executive remuneration should be approached. The measures that should be applied in giving effect to these principles should then be incorporated into the SA Companies Act and supporting SA Companies Regulations as 'hard law'.

Applying this distinction would prevent some of the confusion that appears to exist in the corporate governance codes and legislation of the United Kingdom and Germany, for example.

[674] Byrne, D. 'What is a corporate governance code?' available at https://www.thecorporategovernanceinstitute.com/insights/lexicon/what-is-a-corporate-governance-code last accessed on 3 June 2024.

The new corporate governance code of the United Kingdom applicable from 2025 has unfortunately removed some very useful elaborations of their principles while now also incorporating a measure relating to claw backs that would be more suited to legislation such as in the United States.[675] Germany on the other hand includes measures in both their corporate governance code and their legislation by way of section 87 of the German Business Corporations Act which is aptly titled 'principles applying to the emoluments of the members of the management board'.[676]

4.3.2 King IV and other corporate governance codes compared

King IV provides that remuneration in companies should embrace the principles of 'fairness', 'responsibility' and 'transparency'. While King IV contains general definitions of these principles in the glossary of terms, there is no indication of how these principles relate to executive remuneration other than recommending that executive remuneration should be fair and responsible in the context of overall employee remuneration. The principle 'transparency' is also not addressed in this regard. Instead, it is left to the King IV Guide and the various guides issued by the IoDSA to elaborate on these principles. Further insight into these principles can be obtained from the European Union's Commission Recommendations, and the corporate governance codes of the United Kingdom, Germany and Australia.

In terms of the King IV Guide, the principle of 'fairness' applies both from the perspective of all employees in that the level of executive remuneration relative to the remuneration of other employees in the company is equitable, and from the perspective of the executives in that they should be able to influence the achievement of performance measures for incentive-linked remuneration.[677] The principle 'responsibility' includes aspects such as financial performance measures being appropriate for the stage of the business cycle that the company is positioned. For example, performance measure focussed more on growth such as market share and revenue would be more appropriate for early-stage companies as opposed to focussing solely on returns such as return on equity.[678]

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[675] Refer par 37 of the UK Corporate Governance Code 2024 available at https://www.frc.org.uk/library/standards-codes-policy/corporate-governance/uk-corporate-governance-code/#uk-corporate-governance-code-2024-effective-2025-16c7508e last accessed on 3 June 2024, and section 10D of the US Securities Exchange Act.

[676] Refer paragraph G.4 of the German Corporate Code, for example, with regard to the measures that Supervisory Board should consider in order to ensure that the levels of remuneration in the workplace are fair in relation to each other.

[677] King IV Guide op cit note 201 at 4.

[678] IoDSA 'Linking Pay with Performance – Remuneration Committee Guidance' op cit note 130 at 5.

The principle 'fairness' as suggested by EC Recommendation 2009 requires that the remuneration of executives should be proportionate with respect to each other and that of other employees in the company.[679] The principle 'responsibility' is evident in their recommendation that performance criteria relating to variable components of executive remuneration should promote the long-term sustainability of the company and include non-financial criteria that are applicable to the company's long-term value creation.[680] In addition, the level of fixed components should be sufficient for the company to withhold variable components of remuneration where performance measures are not met.[681] The principle 'transparency' is also apparent in their recommendation that executive remuneration, including share-based remuneration, should only be awarded in line with predetermined and measurable performance criteria.[682] A further principle appears to be suggested in EC Recommendation 2009 and EC Directive 2007 in their recommendation that the remuneration policy should be 'clear and understandable'.[683]

The UK Corporate Code incorporates the principles 'fairness', 'responsibility' and 'transparency' with regard to executive remuneration, while also incorporating the principle of 'simplicity'. The principle 'fairness' (relating to the executive) is evident in the recommendation that the range of the possible values of the awards at the different performance levels and any limits or use of the committee's discretion are explained to the directors at the time the policy is approved.[684] The principle 'responsibility' appears in the code's overriding principles relating to executive remuneration in that the remuneration design should support the strategy and long-term sustainable success of the company, and should be aligned to the company's purpose.[685] Furthermore, the code recommends that reputational risks and other risks associated with excessive awards, as well as behavioural risks associated with inappropriate performance measures, should be identified and mitigated against.[686] The principle of 'transparency' also appears in the code's overriding principles in that the procedure for developing the policy and determination of executive remuneration should be formal and should promote engagement with shareholders and the

[679] Point 9.3 of EC Recommendation 2009.

[680] Point 3.2 of EC Recommendation 2009.

[681] Point 3.1 of EC Recommendation 2009.

[682] Point 3.2 of EC Recommendation 2009.

[683] Point 5.1 of EC Recommendation 2009. Article 9a par 6 of the EC Directive 2007.

[684] Provision 40 (the factor 'predictability') of the UK Corporate Code.

[685] Principle Q and provision 40 (the factors 'proportionality' and 'alignment to culture') of the UK Corporate Code.

[686] Provision 40 (the factor 'risk') of the UK Corporate Code.

workforce.[687] Lastly, the principle 'simplicity' is referenced by the code indicating that remuneration structures should not be overly complex, and their operation should be capable of being easily understood.[688]

The German Stock Corporation Act and the German Corporate Code incorporate the principles of 'fairness' and 'responsibility' in their provisions and recommendations respectively. The principle 'fairness' is implied by the Act in that it provides for the Supervisory Board to ensure that the remuneration relating to the Management Board is appropriate in relation to the tasks and performance of the board member concerned.[689] The code recommends that the Supervisory Board should take into account the relationship of the Management Board's remuneration and the remuneration of senior managers and the workforce as a whole, and how their remuneration has developed over time.[690] The principle 'responsibility' is evident in the Act in that it provides that the remuneration relating to the Management Board should be aimed at promoting the long-term sustainability of the company, and in particular, that their remuneration should be appropriate with regard to the financial circumstances of the company and that their remuneration does not exceed the customary level for that position unless particular reasons require this.[691] The code attempts to clarify what is meant by the 'customary' level by indicating that the Supervisory Board should ensure that the level of the Management Board's remuneration is in line with other companies, yet should also ensure that this does not result in an automatic upward trend in their remuneration level.[692] The principle 'simplicity' is also suggested by the Act in that it states that the Supervisory Board should ensure that the remuneration policy of the Management Board is 'clear and understandable'.[693]

The Australian Corporate Code incorporates the principle 'responsibility' in its recommendations with regard to the characteristics of executive remuneration. The code recommends that the level and structure of executive remuneration should be sufficient to attract,

[687] Principle Q and provision 40 (the factor 'clarity') of the UK Corporate Code.

[688] Provision 40 (the factor 'simplicity') of the UK Corporate Code.

[689] Section 87(1) of the German Stock Corporation Act.

[690] Recommendation G.4 of the German Corporate Code.

[691] Section 87(1) of the German Stock Corporation Act. Also see Principle 24 and Recommendation G.2 of the German Corporate Code.

[692] Recommendation G.3 of the German Corporate Code.

[693] Section 87a (1) preamble. Also see Principle 24 of the German Corporate Code.

motivate and retain high quality executives.[694] At the same time, the code indicates that the company needs to be mindful of the impact that excessive levels of remuneration can have on its reputation and its profitability in light of the company's legal obligations, market conditions and the scale of the company's operations.[695] Incentive-linked remuneration should also be consistent with its circumstances, purpose, strategy, values and risk appetite. In particular, incentives should encourage executives to pursue the growth and success of the company without compromising its values and risk appetite.[696]

4.3.3 Recommended reforms to the South African Corporate Governance Code

The importance of an effective corporate governance code that sets out the approach that the remuneration committee should apply in its governance of executive remuneration cannot be overemphasised. An effective code establishes the principles upon which corporate governance measures relating to the setting, approval and disclosure of executive remuneration should be based, and ultimately the incorporation of these measures into legislation ensures that executive remuneration is consistent with these principles.

The principles 'fairness', 'responsibility' and 'transparency' relating to executive remuneration in King IV are consistent with the corporate governance codes of the other jurisdictions selected as discussed above. The principle 'simplicity' as evident in these jurisdictions, however, should also be added to our current corporate governance code. While this principle appears to be incorporated into the principle of 'transparency' as defined in King IV, it is suggested that this principle stands alone as a separate principle underpinning executive remuneration, and in particular, the remuneration policy and implementation report, in order to better facilitate the board's and shareholders' approval process relating to executive remuneration, as well as the work of analysts in this regard, thereby improving accountability.[697]

Each principle should then be explained comprehensively such that the user can understand the context of the corporate governance measures that have been adopted. The corporate governance measures that are evident in the recommended practices of King IV and the jurisdictions selected, however, should not be part of the code. These measures should be

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[694] Recommendation 8.1 (commentary) of the Australian Corporate Code.

[695] Ibid, and Box 8.2 (suggested guidelines for executive remuneration) of the Australian Corporate Code.

[696] Ibid.

[697] King IV 'Glossary of Terms' at 18. Refence is made to the '*unambiguous*…exercise of accountability such that decision-making processes and business activities, outputs and outcomes (both positive and negative) are *easily able* to be discerned' [my italics].

incorporated into legislation that is aimed at ensuring that executive remuneration is aligned with these principles. It may be useful for the principles and supporting explanations in the code to reference the applicable legislative provisions that give effect to the principles concerned in a separate annexure to the code or incorporate this cross-referencing in a revised guide to the code.

The corporate governance code should be reformed in such a way, therefore, that each of the four principles, 'fairness', 'responsibility', 'transparency' and 'simplicity', are set out and explained comprehensively.

a) Fairness

The principle 'fairness' should emphasise that it relates to the relationship between the remuneration of members of the executive and between that of the executive and other employees of the company concerned, while also relating to the executive personally with respect to his or her remuneration.

As such, the level and structure of executive remuneration should be appropriate between members of the executive and between the executive and other employees of the company. Executive remuneration should also be appropriate in relation to the nature of the functions and the performance of the executive member concerned. The process of establishing the policy for executive remuneration and the policy itself should be formerly defined. Aspects of the policy concerned include the performance measures set, the process for determining how the targets set for the performance measures are met, any changes to the policy during the performance period and the discretion of the remuneration committee in deviating from the policy in certain prescribed circumstances. Performance measures established should also be controllable by the executive in that they should be able to influence the achievement against the measure concerned.

b) Responsibility

The principle 'responsibility' should be explained with reference to how the level and structure (and specifically, the nature of performance measures) of executive remuneration are in the best interests of the company concerned. As such, the level and structure (and the incentive-linked performance measures applicable) should be sufficient to attract, motivate and retain high quality executives, and drive the strategy and purpose of the company including its sustainable and long-term development.

At the same time, the remuneration committee should be mindful of reputational and other risks associated with executive remuneration including behavioural risks associated with

inappropriate performance measures. The level of remuneration and the incentive-linked performance measures relating to the variable components of the remuneration should, therefore, be appropriate for the financial circumstances of the company including its stage of the business cycle, while also being appropriate relative to similar positions at other companies that are comparable to the company with respect to its size and the industry it participates in. Fixed components of remuneration should also be sufficient for the company to withhold variable components of remuneration where performance measures are not met. Variable components of remuneration should be contingent on meeting predefined targets related to performance measures and should correlate with the performance of the company in creating value for its stakeholders and thereby the company. The performance measures should measure the value creation for all definitive stakeholders of the company both indirectly from a financial perspective and more directly from a social perspective in line with the stakeholder value approach.

c) Simplicity

The principle 'simplicity' should deal with the level and structure of executive remuneration in terms of its formulation in the remuneration policy. Aspects of the policy covered should include the performance measures and associated targets relating to the variable components, as well as the determination of the amounts actually paid or awarded. The remuneration policy should avoid complexity, and the rationale, operation and effect of performance measures and their associated targets at the various performance levels should be easily understandable and comparable to companies in similar industries. In particular, the link between the potential awards of incentive- linked remuneration and the different levels of the company's performance should be clearly apparent.

The methods of determining how financial and social measures of performance have been achieved should be set out clearly in the remuneration policy such that one can fairly easily understand how the actual payments and awards at the targets achieved for the performance measures concerned were determined and how they compare to the company's actual performance. As share-based payments forming part of the variable remuneration of executives specifically can be material on vesting dates, the amounts vesting in each year and the conditions of vesting should be easily understandable while multiple schemes should not operate in parallel with each other.

d) Transparency

The principle 'transparency' should address the information requirements of the users with respect to the process of setting the remuneration policy and the determination of the actual amounts paid or awarded. The remuneration philosophy of the company and the objectives relating to the various components of executive remuneration should be apparent. Similarly, the relative importance of the various components in achieving the company's purpose and driving its strategy including its long-term growth and sustainability should be evident.

As such, users should be able to establish that a formal process exists for the development of the remuneration policy, including consultations with definitive stakeholders, and how the remuneration actually paid or awarded is determined. They should be able to confirm that these consultations have occurred and have been responded to, while also being able to establish how the performance measures for incentive-linked remuneration operate including what the effect of achieving the performance targets at the different thresholds are. They should also be able to confirm that the amounts actually paid and awarded, or withheld, meet the provisions of the remuneration policy or are a deviation from the policy including the reasons for the latter. In particular, the reasons and conditions for awarding non-standard remuneration components such as sign-on bonuses, retention payments and termination payments should be capable of being attained without undue effort. Certain trends such as whether the level of fixed remuneration components of the executive have increased year-on-year, what the reasons for the increase in these components are and how this increase compares to that of other employees and the performance of the company over the performance period concerned, should also be capable of being established fairly easily.

4.4 Proposed reforms to the corporate legislation of South Africa

An effective corporate governance code establishes the principles upon which corporate governance measures relating to the setting, approval and disclosure of executive remuneration should be based. These measures need to be incorporated into appropriate legislation to ensure that they are capable of being efficiently enforced and that executive remuneration is thereby consistent with these principles. The enacted amendments to the SA Companies Act apply only to public (and state-owned) companies for which the King IV recommendations are in any event mandatory in terms of the JSE Listings Requirements. However, they remain essentially voluntary for private (or non-listed) companies including those that may still require an audit due to their significance from a public interest perspective. In light of the decline in companies listed on the JSE over the last two

decades from around 470 listings in 2003 to 287 currently with some one hundred delistings having occurred in the past five years,[698] it would appear that there is an increasing number of companies that have a significant economic and social impact on South African society that are only subject to voluntary measures with regard to the governance of their executive remuneration. Constructing these amendments to be applicable to all companies that require an audit (due to their significant public interest score as determined in terms of the 2011 SA Companies Regulations) and incorporating the King IV recommendations, as complemented or substituted by the 'stakeholder value' approach introduced in the previous chapter and the measures suggested in the ensuing section, into the Act as further reforms applicable to all companies would improve the protection and advancement of these companies' stakeholders.[699] Where additional measures are required for listed companies in light of their generally higher public interest, these measures would need to be specifically indicated as such.

The approach to the reforms suggested in this section is to incorporate the 'stakeholder value' approach and relevant substantive corporate governance measures adopted from King IV and the jurisdictions selected into further reforms to the SA Companies Act. Detailed disclosures applicable in these jurisdictions that would serve to support the 'stakeholder value' approach and these measures are adopted as reforms suggested to the SA Companies Regulations. This approach would largely be consistent with the regulatory approaches of the jurisdictions selected. Only those measures and disclosures contained in the corporate governance codes, legislation and supporting regulations of the jurisdictions that are considered specifically relevant to the issues raised in chapter 2 are considered for their possible adoption. These measures and disclosures should also be applicable to all companies that require an audit unless specifically indicated as being only applicable to listed companies.

These suggested reforms are discussed as they specifically pertain to the definitions of 'remuneration' and the 'executive', the composition and functioning of the remuneration committee and the use of remuneration consultants, the structure and content of the remuneration report (including the background statement, remuneration policy and implementation report), and the shareholder vote on the remuneration report.

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[698] Gouws, J. op cit note 12.

[699] This construct would need to be supported by the implementation of section 4(d) and (e) of the enacted amendments which introduce the right of anyone, in addition to shareholders as provided currently by section 26(c) of the SA Companies Act, to access reports presented at annual meetings of companies requiring an audit.

4.4.1 Definition of 'remuneration'

Section 30(6) of the SA Companies Act lists some of examples of 'remuneration' that must be disclosed in the annual financial statements of the company.[700] However, the term 'remuneration' is not specifically defined in the Act and, as such, certain payments that are not listed may be called into question as to whether they are required to be disclosed in terms of section 30(4) of the Act. The term is also not defined in either King IV or the JSE Listing Requirements. The SA Companies Act should therefore be amended to introduce the definition of 'remuneration' in terms of the enacted amendments to the SA Companies Act.[701] Consideration should also perhaps be given to moving the definition to section 1 of the Act dealing with definitions used in the Act.[702]

4.4.2 Definition of 'executive management'

The reference in the SA Companies Act and the enacted amendments to the Act to 'prescribed officers' in relation to the required disclosures for executive remuneration is too broad. The definition of 'prescribed officers' would include both executive directors, members of the executive management board or committee and other senior managers of the company.[703] King IV also appears to recommend that the current SA Companies Act disclosures should be applied for all prescribed officers and then limits certain disclosures to only those prescribed officers that are members of 'executive management' (defined as being the highest decision-making authority after the board). Consequently, confusion is created as to the applicability of these disclosures with some companies clearly bending the rules.[704]

This position is similar to the Australian Corporations Act which prescribes the disclosure of executive remuneration for all the 'key management personnel' of the company. The term 'key management personnel' is defined in terms of the Australian Accounting Standard AASB 124 which defines 'key management personnel' as 'those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity'.[705] The Australian Department of

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[700] Chapter 2.4.1 (b) above.

[701] Chapter 2.4.4 (b) above.

[702] The definition is included in section 6 (section 30B of the SA Companies Act) of the SA Companies Amendment Act and specifically refers to the term being applicable to that section, yet the term is also referred to in the current section 30 of the SA Companies Act and the enacted Section 30B of the Act.

[703] Chapter 2.2.1 above.

[704] Chapter 2.4.2(d)(iii) above.

[705] Par 9 of AASB 124.

Finance indicates that remuneration disclosures need to be provided for 'executive' key management personnel, yet sets out only several vague criteria for determining which employees fall into this category. These include whether they are members of the governing board or the executive management board that has decision-making authority, and whether they have delegation and/or authority to make decisions relating to the planning, directing and controlling of significant aspects of the company's operations.[706]

It is therefore suggested that the SA Companies Act should be amended to contain a definition of 'executive management' in Section 1 of the Act that is similar to that contained in King IV's glossary of terms and incorporates aspects of the definitions of 'executive directors' set out in King III,[707] and 'key management personnel' set out in the Australian accounting standards, above. The term should therefore relate to 'employees of the company who are members of the highest decision-making authority in the company that are tasked with planning, directing and controlling the operational activities of the company'.

However, while there may be some merit in disclosing all details relating to the remuneration of each executive, consideration should be given to limiting disclosures in the remuneration policy and implementation report to that of only the statutory directors, as required in terms of the UK Companies Act,[708] or at the most only the Chief Executive Officer, Chief Financial Officer and the next three highest paid members of executive management, as provided in terms of the US and Canadian securities disclosure requirements.[709]

4.4.3 Roles and responsibilities of the Remuneration Committee (and Remuneration Consultants)

King IV recommends that the oversight of executive remuneration (as well as that of other employees) be allocated to the remuneration committee (or other dedicated committee) consisting of non-executive directors of the company's board with the majority of the committee members, including the chairperson, being independent. While the remuneration committee and its composition are intended to ensure that there are no conflicts of interest with regard to the governance of executive remuneration, the committee's effectiveness in constraining the levels of

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[706] Australian Government – Department of Finance 'Commonwealth Entities Executive Remuneration Reporting Guide for Annual Reports' available at https://www.finance.gov.au/government/managing-commonwealth-resources/ commonwealth-entities-executive-remuneration-reporting-guide-annual-reports-rmg-138/key-management-personnel last accessed on 8 June 2024.

[707] Chapter 2.2.1 above.

[708] Chapter 4.2.2 above. The recent remuneration reports of Naspers Ltd and Shoprite Holdings Ltd only disclose information about executive remuneration of their executive directors. Refer note 255 above.

[709] Chapter 4.2.4 and Chapter 4.2.5 above.

executive remuneration and setting appropriate measures with respect to the variable components thereof can be compromised by various factors, such as the committee's lack of real independence and skills in this area, with adverse consequences for the company's stakeholders. Although the latter may be addressed through the use of remuneration consultants, the independence of these consultants may also be compromised.[710]

The current regulatory requirements pertaining to remuneration committees appear to be ineffective in several respects. No provision is made in the code for a formal assessment regarding the independence and skills level of the committee members before being appointed. Where consultants are used, the code also provides no guidance with respect to assessing the consultant's ability to act independently and objectively from the influence of management, who should appoint the consultant in the first place, or the remuneration committee's discretion with regard to the consultant's recommendations.[711]

a) Composition and attributes of the remuneration committee

The European Union's Recommendations and the Directive do not regulate the composition of the remuneration committee. They also do not require that members of the committee should be independent, other than to indicate that the members of the committee should exercise independent judgement and integrity when exercising its functions.[712] The EC Recommendation 2009, however, does touch on the requirement that members should be skilled in remuneration-related matters in that it provides that at least one member of the remuneration committee should have knowledge and experience with regard to establishing remuneration policies.[713] While this recommendation has merit, it is submitted that it is somewhat vague as to the level of and how contemporary the knowledge and experience is required to be.

The UK Companies Act and the Australian Corporations Act make no provision for remuneration committees. The requirements in this regard, including the committee's composition, are set out in the corporate governance codes of these jurisdictions and are largely similar to that of King IV. The German Corporate Code and Stock Corporation Act, on the other hand, make no provision for the appointment of remuneration committees. The UK Corporate Code requires that the committee should be constituted entirely of independent non-executive

[710] Chapter 2.4.2(b) above.

[711] Chapter 2.4.2(b) above.

[712] Point 9.1 of EC Recommendation 2009.

[713] Point 7.1 of EC Recommendation 2009

board members with the minimum number of committee members being three (or two in the case of smaller companies), while the chair of the committee should have served on the committee for at least 12 months prior to being appointed.[714] The UK Corporate Code also recommends that the chair of the board can only be a member of the remuneration committee if they were independent on appointment and cannot chair the committee.[715] Similar to the UK Corporate Code, the Australian Corporate Code recommends that listed companies should have a remuneration committee with a minimum of three members, with the majority being independent, and should be chaired by an independent director.[716] Neither of these codes, however, provide for an assessment of the skills level of committee members before their appointment to the committee.

The US Securities Exchange Act requires listed companies to appoint a remuneration committee consisting of independent directors of the company's board. The Act then indicates that the factors for determining the independence of the committee members include a consideration of the source of the members' income including any consulting, advisory or other fees paid to the member by the company, and whether the member is associated with the company itself, its subsidiaries or an associate of the company or its subsidiaries.[717]

b) Use of remuneration consultants

The EC Recommendation 2009 recommends that where a remuneration consultant is appointed to advise the remuneration committee, the consultant should not at the same time advise the human resources department or the executive members.[718]

The UK Corporate Code also recommends that it is the responsibility of the remuneration committee to appoint remuneration consultants where required, while the committee should also exercise independent judgement when evaluating the advice of these consultants as with that of other parties including the executive.[719] The UK Companies Regulations require the disclosure of whether consultants were used and the name(s) of the consultants, as well as details of other work performed, who appointed the consultant and the manner of appointment, whether the

[714] Provision 32 of UK Corporate Code 2018 (at 13).

[715] Ibid.

[716] Recommendation 8.1 of the Australian Corporate Code (at 29).

[717] Section 10C (1)- (2) of the US Securities Exchange Act.

[718] Point 9.2 of EC Recommendation 2009.

[719] Provision 35 of the UK Corporate Code (at 13).

remuneration committee is satisfied that the consultant's advice is independent and objective, and the amount of the fees charged by the consultant and the basis thereof.[720]

The Australian Corporations Act provides that the appointment of a remuneration consultant (in terms of a 'remuneration consultancy contract') must be approved either by the company's board of directors or the remuneration committee.[721] The remuneration recommendation must be made directly by the remuneration consultant to the company's board of directors (excluding executive directors) and/or the remuneration committee,[722] and must be accompanied by a declaration by the consultant that the recommendation is made free from undue influence by the members of the executive (the 'key management personnel') to whom the recommendation relates.[723] Similar to the UK Corporate Code, certain details relating to the consultant and his or her work are required to be disclosed in the remuneration report including the name of the consultant, the remuneration advice and any other advice provided to the company, the amount and nature of the fee charged for the remuneration and other advice and a statement that the board is satisfied that the advice was free from undue influence including the board's reasons for being satisfied and the arrangements that the company made in this regard.[724]

The US Securities Exchange Act provides that the remuneration committee is directly responsible for the appointment, fees and oversight of the remuneration consultant concerned, and has the sole discretion to obtain or retain the advice of the consultant.[725] The remuneration committee, however, may only appoint the consultant after taking into account all the factors that could impact the independence of the advisors concerned including the provision of other services to the company by the consultant, the proportion of the fees received by the consultant from the company in relation to his or her total income, the policies and procedures of the consultant that are aimed at preventing conflicts of interest, any business or personal relationship between members of the remuneration committee and the consultant, and any shares held by the consultant in the company.[726] The company is also required to disclose in its shareholder notice

[720] Regulations 22(2) of the UK Companies Regulations.

[721] Section 206K (1)-(2) of the Australian Corporations Act.

[722] Section 206L (1)-(2) of the Australian Corporations Act.

[723] Section 206M (2) of the Australian Corporations Act.

[724] Section 300A(1)(h) of the Australian Corporations Act.

[725] Section 10C (c)(1) (A) - (C) and section 10C (e)(1) of the US Securities Exchange Act. These provisions emphasise that the remuneration committee is not compelled to act on the advice of the consultant.

[726] Section 10C (b)(1) and (2) of the US Securities Exchange Act.

('proxy or consent material') for the annual general meeting whether it used a remuneration consultant and whether the consultant's work raised any conflict of interest and if so, how it was resolved.[727]

c) Recommended reforms to the SA Companies Act and SA Companies Regulations

Consideration should be given to strengthening the measures that address the independence and skills requirements of the remuneration committee especially with respect to companies registered in South Africa that are listed on the JSE. Consideration should also be given to adapting these requirements to other companies that require an audit including large private companies.

The SA Companies Act should be amended to provide for the composition of the remuneration committee as set out in King IV for public and large private companies, yet all committee members should be required to be independent in line with the comparative provisions in the UK Corporate Code and the US Securities Exchange Act. The Act should also be amended to list the minimum factors for determining the independence of the directors including those provided by the US Securities Exchange Act and those included in the King IV definitions in this regard such as the director's business and personal relationship with executives, any income for services provided to the company other than as director and any interest in or other association with the company concerned. The SA Companies Act should also be amended to provide that remuneration committee members must undergo remuneration-related skills training especially with regard to the 'stakeholder value' approach to the setting of incentive-linked performance measures. Such training could include official courses in this regard that are administered by the IoDSA or SARA. The SA Companies Regulations must also set out the disclosures that would assist users in assessing, amongst other objectives, the independence and skills levels of the committee members which take into account the suggested reforms to the Act.

With respect to the use of remuneration consultants, consideration should be given to strengthening measures that address the independence of the consultant in light of the concerns in this regard. The SA Companies Act should be amended to provide that the consultant may only be appointed by the remuneration committee and the Act should set out the factors that the remuneration committee should at a minimum take into account in assessing the independence of the consultant before the consultant's appointment by carrying out the necessary

[727] Section 10C (c)(2)(A) and (B) of the US Securities Exchange Act.

investigations to this effect. These factors could include those provided by the US Securities Act as well as any further factors that are considered relevant. The SA Companies Act should also be amended to provide that the consultant must advise the remuneration committee directly, while stressing that the committee is not obligated to accept the advice. The advice provided should be accompanied by a statement by the consultant indicating that the advice was provided without undue influence of the executive. The SA Companies Regulations must also set out the disclosures that would assist users in assessing, amongst other objectives, the independence of the consultant which should at a minimum include the consultant's name, that the consultant was appointed by the remuneration committee, the nature of the remuneration advice and other services provided to the company, the fees charged for these services, and a statement indicating that the remuneration committee is satisfied that the consultant's advice is independent and objective.

4.4.4 Remuneration report

King IV recommends that executive remuneration should be set out in a standalone remuneration report consisting of a background statement, the remuneration policy and the implementation report.[728] The enacted amendments to the SA Companies Act incorporate these recommendations by requiring public and state-owned companies to prepare a remuneration report consisting of these same three parts. While the format of the report is similar to that contained in King IV, there are no provisions dealing with the content of the report other than the required disclosures pertaining to relative employee remuneration levels and pay ratio information at a high-level. A previous version of the enacted amendments (as contained in the Companies Amendment Bill of 2021) provided for the report to be set out in a 'prescribed manner' which appeared to suggest that the detailed disclosures required in the report could be set out in the SA Companies Regulations at some stage. In light of there being no reference to this aspect of the report in these amendments, it is assumed that the disclosures in the report will continue to adopt the King IV recommendations in this regard.[729]

a) Background statement

King IV recommends that the background statement should briefly provide the context for the considerations and decisions made in regard to executive remuneration for the year concerned

[728] Chapter 2.4.2 (d) above.

[729] Chapter 2.4.4 (b) above.

with reference to the various aspects listed in the code.[730] This recommendation is similar to the requirement in the UK Companies Regulations for the remuneration report to contain a statement by the remuneration committee chair which summarises the major decisions on directors' remuneration, any discretion exercised in the award of directors' remuneration, any substantial changes relating to the directors' remuneration that were made during the year concerned and the context in which the decisions were taken and changes occurred.[731]

It is suggested that the recommended disclosures relating to the background statement in King IV are incorporated into the SA Companies Regulations supporting the enacted amendments to the SA Companies Act. These disclosures should also include a discussion as to how the principles fairness, responsibility, simplicity and transparency were applied in protecting and advancing stakeholder interests with respect to the remuneration policy and implementation report, and include aspects such as whether any discretion was exercised in the award of executive remuneration as provided by the UK Companies Regulations.

b) Remuneration policy

King IV recommends that the remuneration policy should be designed to attract, motivate and retain suitable individuals and should promote the achievement of the company's strategic objectives, while at the same time promoting an ethical culture within the company and reinforcing the company's role as a corporate citizen in society. In doing so, the company should specifically address the level and structure of executive remuneration, and the incentive-linked performance measures relating to the variable components of their remuneration. The code also recommends certain disclosures that should be included in the remuneration report which set out the various components of executive remuneration forming part of the policy, as well as certain other disclosures relating to these components. While the enacted amendments to the SA Companies Act provide for the disclosure of the remuneration policy in the remuneration report, no indication is provided as to what substantive provisions or disclosures should be included in the policy such that the recommendations of King IV in this regard would continue to be applicable.[732]

[730] Chapter 2.4.2(d)(i) above.

[731] Par 3 of Schedule 8 of the UK Companies Regulations.

[732] Chapter 2.4.4(a) above.

i. *Level of executive remuneration*

King IV recommends that the differential between the level of executive remuneration and that of employees at the lower remuneration levels of the company should be addressed, yet there is no indication as to how the level of executive remuneration and especially the remuneration differential should be addressed. Consequently, it would appear that this recommendation is merely being paid lip service as suggested by the remuneration reports of the JSE-listed companies selected with possible adverse consequences for these companies' sustainability.[733]

While excessive or disproportionate levels remain a cause for concern both in South Africa and abroad, there do not appear to be any instances amongst the codes and legislation of the jurisdictions selected where the overall remuneration of executives or the fixed components thereof are required to be limited or capped. The EC Recommendation 2009 does, however, recommend that the company should set limits on variable components of remuneration in the remuneration policy,[734] yet these recommendations do not provide any indication of what this limit should be. The European Unions' Capital Requirements Directive IV issued by the European Banking Authority, on the other hand, prescribes that member states must regulate that the limit pertaining to variable components should be set at 100 percent of the fixed components (although member states may set a lower percentage limit).[735] The limit may also be lifted to 200 percent of the fixed components where this increase is agreed to by either 66 percent of the shareholders of the company with at least 50 percent of the shareholders represented, or 75 percent of the shareholders of the company where less than 50 percent of the shareholders are represented.[736] Colonnello, Koetter and Wagner indicate, however, that evidence suggests that banks in Europe have simply increased the fixed portion of their executives' remuneration to compensate them for the cap and thereby ensure that they retain talented executives. This in turn may have led to risk-adverse executives taking on more risk in line with agency theory.[737]

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[733] Chapter 2.4.2 (c)(i) above.

[734] Point 3.1 of EC Recommendation 2009.

[735] Article 94.1 (g)(i) of the European Parliament's Capital Requirements Directive 2013/36/EU.

[736] Article 94.1 (g)(ii) of the European Parliament's Capital Requirements Directive 2013/36/EU.

[737] Colonnello, S.; Koetter, M.; Wagner, K. 'Effectiveness and (in)efficiencies of compensation regulation: Evidence from the EU banker bonus cap' (2020) IWH Discussion Papers 7/2018 *Halle Institute for Economic Research (IWH)* at 40 available at https://www.econstor.eu/bitstream/10419/227086/1/iwh-dp2018-07rev.pdf last accessed on 20 July 2024.

The EC Recommendation 2009 also recommends that termination payments provided in terms of executive remuneration policies should not exceed a fixed amount or a fixed number of years of annual remuneration. In either case, the payment should not be more than the sum of two years of the fixed component of remuneration.[738] The Australian Corporations Act requires shareholder approval for termination payments made that exceed one year's fixed remuneration (or 'base pay') of the executive concerned.[739]

As the issue with the level of executive remuneration perhaps relates more to the disparity between the levels of executive remuneration and other employees, which the enacted amendments to the SA Companies Act with respect to relative employee remuneration including the pay ratio disclosures are intended to address, it is suggested that executive remuneration should not be limited or capped through legislation. The level of executive remuneration, as with all employees, should continue to largely be determined in line with market forces and guided by the principles of 'fairness' and 'responsibility'. The focus of the remuneration committee should be on efforts to reduce the gap between the remuneration of executives and that of other employees.

ii. *Structure of executive remuneration*

King IV recommends (indirectly) that the executive remuneration package should be structured between fixed and variable components, yet there is no indication in the code as to what the weighting between the fixed and variable components of the executive remuneration package should be with JSE-listed companies evidently moving towards a greater component of their remuneration being fixed. There is also no indication in the code as to how components that are not subject to performance criteria or otherwise enhance risk-taking should be regulated. The latter specifically include termination payments discussed below.[740]

Consideration should be given to setting the minimum split between fixed and variable components based on the level of the fixed components and the level of the variable components that would be paid or awarded at the on-target levels in line with the remuneration policy of *Naspers Limited*. Their policy provides for the short-term incentive targets to be set at 100 percent of the executive's base salary. Effectively this would be a

[738] Point 3.5 of EC Recommendation 2009.

[739] Section 200B and G of the Australian Corporations Act.

[740] Chapter 4.4.4 (b)(iv) below.

50/50 split between the fixed and short-term variable components if the executive met his or her targets. Although similar targets are not provided for the long-term incentives, this arrangement would at least ensure that the variable components exceed the fixed components where the target level is met for short-term incentive and at least a part of the long-term incentive is paid or awarded.[741]

iii. *Incentive-linked performance measures (and related corporate governance measures)*

King IV recommends that the variable components should be based on the achievement of both financial and non-financial performance measures across the economic, social and environmental contexts and/or the six capitals that the company uses or effects.[742] However, the code does not indicate what the weighting between the financial and non-financial performance measures relating to the variable components should be such that financial performance measures can be overwhelmingly dominant as is apparent in the remuneration reports of the JSE-listed companies selected. With respect to financial performance measures, the code does not indicate what aspects of financial performance should be measured with the possibility that certain aspects of their financial health are not being measured. With respect to non-financial performance measures, the code does not contain any recommendations as to the identification of key or definitive stakeholders such that the value contributed by some of these stakeholders may not be measured, while these measures may also be too generalised to understand the drivers of the performance concerned, thereby impacting the company's long-term sustainability.[743] Certain corporate governance measures relating to performance measures and other aspects of the variable components of executive remuneration that are aimed at protecting the interests of the company's stakeholders are also not contained in the code.

It is suggested that the SA Companies Act should be amended to require all companies that are registered in South Africa and that require an audit in terms of the current regulations to implement the 'stakeholder value' approach as discussed in the previous chapter.[744] This approach should form the basis upon which the performance measures relating to the variable components of executive remuneration should be set, and therefore the basis for the

[741] See the *Naspers Ltd Integrated Report* for 2023 op cit note 223 at 140.

[742] Chapter 2.4.2 (c) above.

[743] Chapter 2.4.2 (c)(ii) above.

[744] Chapter 3.4 above.

recognition and measurement of the financial value and the social value generated by the company for its stakeholders. The recognition and measurement of this value would in turn drive the optimal and sustainable financial performance for the company and ultimately advance the interests of all its stakeholders including the interests of indigent stakeholder communities.

The 'stakeholder value' approach should be carried out in a systematic fashion by addressing each step of the approach. As such, a well-defined objective for the company should be determined behind which all stakeholders are aligned, before the definitive stakeholders of the company are identified based on the stakeholder's possession of the power to influence the company, the legitimacy of its relationship with the company and the urgency of its claim on the company. The financial and social value that the company generates for its stakeholders should then be determined. The financial value should relate to all aspects of the company's financial health including its profitability, cashflows, operating efficiency, liquidity and solvency, while the social value of the company should relate to the stakeholders' sense of 'happiness' or satisfaction as determined with reference to the quality of the goods or services received by them, the manner in which they are treated, the affiliation that they have with the company's philosophy and the opportunity cost associated with each factor. Once the company's financial value and social value have been determined, financial performance measures drawn from the company's financial statements and social performance measures drawn mainly from surveys and incidence reports should be established. The final steps of the process involve setting the weighting for these performance measures and the setting of targets for these measures.[745]

In addition, certain corporate governance measures relating to these performance measures and other aspects of the variable components to which these measures relate should be considered to ensure the protection of stakeholder interests.

- *Fraud and creative accounting (or management) provisions*

  The corporate governance codes and legislation of the jurisdictions selected do not directly provide for measures that would otherwise prevent or discourage incentives

[745] Ibid. Per 3.4.4(a)(i) above, consideration should be given to making the Economic Value Add (EVA) financial performance measure mandatory. EVA measures the value created or destroyed by comparing the return on invested capital against the cost of funding utilised with respect to that capital invested and is particularly important for the sustainability of the company for all its stakeholders.

being awarded on the basis of financial information that was manipulated through fraudulent or creative accounting (or management) practices.

Consideration should be given to incorporating a statement by the remuneration committee chairman in the SA Companies Act that procedures have been undertaken to ensure that the financial (and even social) performance measures in terms of the policy have not been manipulated through these practices. These procedures can include a specific audit sign-off of the implementation report with reference to these practices.

- *Malus and clawback provisions*

  The EC Recommendation 2009 recommends that executive contracts should include provisions that permit the company to reclaim variable components of remuneration that were awarded on the basis of data that was subsequently found to be misstated.[746] Similarly, the UK Corporate Code recommends that executive remuneration policies should include provisions that would enable the company to recover and/or withhold amounts or share awards and specify the circumstances in which it would be appropriate to do so.[747] On the other hand, the US Securities Exchange Act provides that the executive remuneration policy must contain a provision which requires the company to recover any incentive-based remuneration which was awarded on the basis of an accounting misstatement within three years preceding the date that the company is required to prepare the accounting restatement. The recovery is limited to the amount of the excess of what would have been paid to the executive had the accounting information been stated correctly.[748]

  In light of the protection that malus and clawback provisions provide to protecting the interests of the company's stakeholders, consideration should be given to incorporating these measures in the SA Companies Act. While Madlela suggests, clawback provisions should be triggered by the award of variable remuneration that is based on any data that is subsequently found to be misstated in line with the EC Recommendation 2009,[749] these provisions would not be triggered on the basis of unrealised gains that culminate in realised losses on settlement of the underlying

[746] Point 3.4 of EC Recommendation 2009.

[747] Provision 37 of the UK Corporate Code.

[748] Section 10D of the US Securities Exchange Act.

[749] Madlela, V. op cit note 233 at 72.

financial instrument. It is therefore suggested that these measures should apply at a minimum whenever data upon which the measures are based is materially misstated due to fraud or error, or are based on unrealised gains or profits which culminate in realised losses in the following measurement period.[750]

- *Discretion with respect to variable remuneration*

  The UK Corporate Code recommends that the remuneration policy should provide for the board to exercise its discretion in overriding 'formulaic outcomes' with respect to awards and thereby ensuring that the awards are in line with the performance of the company and the individual concerned, as well as 'wider circumstances'.[751] Similarly, the Australian Corporate Code recommends that discretion should be retained to prevent performance-based remuneration rewarding conduct that is contrary to the entity's values or risk appetite.[752] The UK Companies Regulations then provide that where the policy provides for the directors to exercise their discretion in respect of any part of the policy, the policy must clearly set out the extent of that discretion.[753]

  It is suggested that the SA Companies Act should be amended to provide for the exercise of discretion by the board as a requirement for the variable components of executive remuneration in terms of the policy. The extent of the exercise of this discretion must be restricted to circumstances where the award of variable component of remuneration would not be linked to the performance of the company or the individual concerned, or would be insensitive to any particular socioeconomic event in which the company is exposed to. Circumstances relating to the latter event would include pandemics and natural disasters which impact the company's earnings in a particular measurement period.

- *'Gatekeeper' or modifier provisions*

  The corporate governance codes and legislation of the jurisdictions selected do not directly provide for 'gatekeeper' or 'modifier' provisions in remuneration policies.

[750] Chapter 2.4.2(c)(ii): this would cover the current policy of Shoprite Holdings Ltd (note 229).

[751] Principle R and provision 37 of the UK Corporate Code. These 'wider circumstances' are assumed to be the greater economic or social environment in which the company operates.

[752] Principle 8 Box 8.2 'Suggested guidelines for executive remuneration' page 31 of the Australian Corporate Code.

[753] Par 24(4) of Schedule 8 of the UK Companies Regulations. The IoDSA emphasises that the use of discretion should be limited, and the boundaries of this discretion should be clearly disclosed (IoDSA 'Linking Pay with Performance – Remuneration Committee Guidance' 2020 op cit note 130 at 15).

These measures can play an important role in protecting stakeholder interests and consideration should therefore be given to incorporating these measures specifically in the SA Companies Act. In light of the high unemployment rate in South Africa and the adverse impact this has on socioeconomic concerns of those living in our country, it is suggested that awards of variable remuneration that are based on the achievement of financial measures should be subject to 'gatekeeper' or less onerous 'modifier' provisions related to the retrenchment of employees. It seems obscene to reward executives for savings in employee costs brought about by retrenchments while the employees retrenched may be experiencing significant hardship due to the inability to find alternative employment. Similarly, these measures should be extended to all other circumstances where the achievement of financial performance measures adversely impacts the socioeconomic interests of the company's definitive stakeholders. These include health and safety incidents as well as environmental incidents.

- *Minimum vesting and post-employment shareholding provisions*

  The EC Recommendation 2009 recommends that the award of shares should require a vesting period of at least three years. Similarly, share options or any other right to acquire shares based on share price movements should not be exercisable for at least three years after their award.[754] After the shares have vested, the directors should be required to retain a fixed number of share until the end of their mandate (after allowing for the financing of costs related to the acquisition of the shares).[755]

  Bhagat and Romano propose that long-term incentive remuneration schemes should consist of restricted shares and restricted share options instead of simply shares or share options that are awarded and vest over a certain period. These shares and share options would be restricted in that the shares and the share options cannot be sold or exercised respectively for a period of at least two to four years after the executive has left the company's employment. They indicate that the advantages of restricted shares and share options would impair the ability of the executive to drive the profits through 'making public statements, managing earnings or accepting undue levels of risk for the sake of short-term price appreciation' and then leave the company before the problems

[754] Point 4.1 of EC Recommendation 2009.

[755] Point 4.3 of EC Recommendation 2009.

arise.[756] Their suggestion of a period of at least two years is generally the time it takes for the impact of these practices to unravel, while four years is considered a reasonable time for at least the intermediate term results of the new executive's plans to come to realisation.[757] As such, this arrangement has a natural clawback feature in that executives cannot benefit from the short-term generation of profits which does not drive value in the long-term. It therefore also avoids the complex procedures that are often required to recover incentive bonuses from executives that were based on these profits.[758]

Consideration should be given to amending the SA Companies Act to reflect a minimum vesting period of at least three years to provide for long-term performance. Consideration should also be given to making a substantial portion of these shares restricted in the sense that they may not be disposed of for a period of two years after the executive has left the company.

- *Minimum shareholding requirements provisions*

  Minimum shareholding requirements are not provided in any of the jurisdictions selected other the UK Corporate Code which recommends that the remuneration policy should provide for long term shareholdings which are released for sale on a phased basis and subject to total vesting and holding period of five years or more. The policy should also deal with post-employment shareholding requirements encompassing both unvested and vested shares.[759] However, no details are provided as to what should be included in the policy in this respect.

  Consideration should be given to amending the SA Companies Act to require that executives must build up a certain number of shares from vested or cash incentives, with the cost of these shares perhaps reflected as a percentage of the base salary, within a specified period of time from the executive's appointment.

iv. *Disclosure of executive remuneration policy*

King IV recommends that the policy should set out the various components of the remuneration that form part of the executive remuneration policy for the executive. Certain

[756] Ibid.

[757] Bhagat, S. and Romano, R. 'Reforming executive compensation: Focusing and committing to the long-term' (2009) 26 *Yale Journal on Regulation* 359 at 363.

[758] Ibid at 367.

[759] Provision 36 of the UK Corporate Code.

other disclosures should also be provided including the design principles relating to each component, the performance measures relating to the variable components including how they are measured, their weighting and their measurement period, how the principles 'fairness' and 'responsibility' are addressed by the policy and whether the policy includes any malus and clawback provisions. The code also recommends that the remuneration policy should illustrate the impact that the application of the policy would have on the total remuneration of the executive at the various performance levels.

However, the code does not prescribe a standard format for these disclosures such that users of the remuneration report may find the disclosures between different companies and reporting periods difficult to understand and compare.[760] The enacted amendments to the SA Companies Act also provide no indication of what disclosures should be included in the remuneration policy such that the recommendations of King IV with regard to this content are, therefore, likely to continue being applied with the same concerns associated with the lack of a standard format for these disclosures.[761]

The EC Recommendation 2009 recommend certain disclosures relating to the executive remuneration policy including an explanation as to how the performance measures chosen contribute to the long-term interests of the company, the methods to determine how targets in terms of performance measures should be met and information relating to the deferment of variable components. Further disclosures include vesting periods for share-based remuneration and the retention policy for shares after vesting.[762]

The UK Companies Regulations provide that companies are required to set out the components of the remuneration package for the directors in the form of a table with accompanying notes.[763] Companies are required to disclose how the component supports the strategic objectives of the company, the operation of the component and any deferral periods involved, the vesting periods and holding periods involved where the component consists of share-based remuneration, the maximum that may be paid out in respect of the component and certain information related to incentive-linked performance measures.[764] With respect to

[760] Chapter 2.4.2(d)(ii) above.

[761] Chapter 2.4.4(a) above.

[762] Point 5.2 of EC Recommendation 2009.

[763] Par 25(1) of Schedule 8 of the UK Companies Regulations.

[764] Par 26(a)-(e) of Schedule 8 of the UK Companies Regulations.

incentive-linked performance measures, companies are required to disclose the amount that may be paid in respect of the minimum performance level as well as further levels set out in the policy, the reasons for adopting the particular performance measures and how the performance targets relating to these measures are set.[765] In addition, where any component other than those consisting of the salary or benefits is not subject to performance measures, an explanation as to why no such measures are applicable must be provided.[766] Where there are new components in remuneration policy or any changes since the last approved policy, reasons for these new components or changes must be provided as well as how the company's policy on director remuneration differs from other employees.[767]

The UK Companies Regulations also require that the levels of executive director remuneration that could be expected from the application of the remuneration policy in its first year of application must be illustrated by means of a bar chart.[768] The bar chart must contain separate bars representing the minimum (or guaranteed) remuneration that the executive director can expect to receive, the remuneration that he or she can expect to receive if his or her performance was in line with the company's expectations (or on-target levels) and the maximum remuneration that can be expected to be received before taking into account any remuneration linked to appreciation of the company's shares. The total remuneration at the three levels represented by each bar must be indicated, while each bar of the chart must also indicate the parts of the expected remuneration that comprise of the minimum remuneration, the short-term incentives and the long-term incentives with the percentage that each part represents of the total expected remuneration.[769] The bar chart must also be accompanied by a narrative description which explains the basis of the calculation and the assumptions applied in compiling the bar chart.[770]

The German Stock Corporation Act requires that the company must disclose the contribution that the remuneration of the management board is intended to make to promoting

[765] Par 26(d) and 27(a) of Schedule 8 of the UK Companies Regulations.

[766] Par 27(b) of Schedule 8 of the UK Companies Regulations.

[767] Par 27(c)-(e) of Schedule 8 of the UK Companies Regulations.

[768] Par 33 of Schedule 8 of the UK Companies Regulations.

[769] Par 34(1)-(3) of Schedule 8 of the UK Companies Regulations. Per par 35A of Schedule 8, the policy must also indicate the maximum remuneration that the director can receive in respect of long-term incentives where the company's shares appreciate by 50% during the period as well as a description of the basis of the calculation.

[770] Par 35(1) of Schedule 8 of the UK Companies Regulations.

the company's business strategy and its long-term development. With respect to financial and non-financial performance measures, the company must provide an explanation of how these measures will contribute to promoting the company's business strategy and its long-term development, the thresholds for the awarding the variable remuneration components, and a description of the methods used to determine whether the performance measures have been met. The company must also disclose any deferral periods relating to remuneration components, any arrangements regarding malus or clawback provisions and certain discloses relating to share-based remuneration including time limits, holding conditions and how this remuneration promotes the company's business strategy and its long-term development objectives. An explanation of how the remuneration terms and employment conditions of the company's employees were taken into account in developing the policy, including which groups were involved, must also be set out.[771]

The US Federal Relations require companies to discuss the policy relating to executive remuneration in the 'Compensation discussion and analysis' section of the company's proxy form. The details to be disclosed include the objectives and purpose of the remuneration structure, and each remuneration component forming part of the structure. For each component, the company must disclose the reasons for the component forming part of the structure, how the amount payable is determined, and how each component relates to others in the structure.[772] Additional disclosures include information as to the allocation of remuneration between cash and non-cash components, the allocation of variable components between short-term and long-term, and the specific items of corporate performance that were taken into account in setting the remuneration policy.[773]

The Canadian National Instruments require listed Canadian companies to make certain disclosures with respect to their remuneration policies in the 'Compensation discussion and analysis' section of their proxy forms which are similar to the US Federal Regulations.[774] In addition to these requirements, however, companies must also describe any new developments regarding the executive remuneration policy, any benchmark companies selected for comparison, and details regarding performance measures that are based on

[771] Section 87a of the German Stock Corporation Act.

[772] Title 17 Part 229.402(b)(1) of the US Federal Regulations.

[773] Title 17 Part 229.402(b)(2) of the US Federal Regulations.

[774] Item 2.1 (1) of Form 51-102F6 Statement of Executive Compensation.

objective criteria such as earnings per share (where alternative performance measures are used, the calculation for the measure must be provided) and subjective criteria.[775] Furthermore, the company must disclose how the remuneration committee identifies and mitigates any risk that the executive will take inappropriate or excessive risks and the risks themselves that could have a material adverse effect on the company.[776]

Lastly, the Australian Corporations Act mainly deal with disclosure requirements relating to incentive-linked remuneration. With respect to variable remuneration (that is dependent on the 'satisfaction of a performance condition'), the company must disclose a detailed summary of the performance condition, an explanation as to why that performance condition was chosen, and a summary of the methods used in assessing whether the performance condition was met and the reasons as to why those methods were selected. Where the performance condition involves a comparison with factors external to the company, a summary of the factors to be used in making the comparison must be provided and if these factors relate to the performance of another company or companies, or an index in which the securities of a company or companies are included, the identity of the company, companies or index must be provided.[777]

It is suggested that the SA Companies Regulations are amended to set out the various components of the remuneration that form part of the executive remuneration policy for the executive as recommended by King IV in the form of a table accompanied by notes addressing aspects of the policy such as the level and structure of executive remuneration, as well as the performance measures relating to the variable components in line with the 'stakeholder value' approach and associated corporate governance measures.

Accordingly, the company should be required to disclose the design principles relating to each component, including whether the component is fixed or variable, any deferral periods involved, and the vesting and holding periods involved where the component consists of share-based remuneration. The company should also be required to disclose how the level of the executive's remuneration package was set with reference to market demands and in line with the principles of 'fairness' and 'responsibility' including any limits to the levels concerned, while also indicating how the structure of the package was determined with

[775] Item 2.1(2)-(4) of Form 51-102F6 Statement of Executive Compensation.

[776] Item 2.1(5) of Form 51-102F6 Statement of Executive Compensation.

[777] Section 300A(1)(bA) of the Australian Corporations Act.

reference to the different components concerned and what the structure is intended to achieve.

With regards to how the 'stakeholder' approach was applied, the company must include an explicit statement in the policy as to the company's objective in recognising the interests of its stakeholders in creating value for the company. In particular, the statement should set out the company's approach to recognising the importance of creating long-term sustainable value for its stakeholders and the value that these stakeholders in turn contribute to the company. Companies must disclose how the definitive stakeholders of the company were identified with reference to the three attributes power, legitimacy and urgency that they possess, and how they were engaged with respect to determining the aspects of financial and social value that are considered important to them. Companies must also disclose the aspects of financial and social value that have been determined through this process and how the financial and social performance measures relating to these aspects of value were determined. In particular, companies must indicate why the measures involved were selected and how each measure operates including how performance against the measure is assessed as well as the sources of data that would be used to determine whether the targets set for the performance measure were met. Lastly, companies must disclose how the weighting of each of the financial and social performance measures was arrived at, as well as the targets for each performance measure including the various thresholds involved.

All corporate governance measures pertaining to incentive-linked performance measures and other aspects of variable components should also be disclosed including malus and clawback provisions (including the circumstances in which they apply), gatekeeper and modifier provisions, the discretion of the remuneration committee to override formulaic outcomes and minimum vesting, and minimum and post-employment holding requirements relating to share-based payments.

Lastly, consideration should be given to illustrating the impact that the application of the policy would have on the levels of executive remuneration at the different performance thresholds in a standard format. In this regard, the graphic and narrative disclosures required by the UK Companies Regulations may be an option worth exploring.

c) Implementation report

King IV recommends that the implementation report section of the remuneration report should disclose the various components of remuneration that were actually paid or awarded to the

executive in the previous financial year. In addition, the code also recommends certain supporting disclosures such as how the variable components were awarded against targets set for the related performance measures. While the enacted amendments to the SA Companies Act introduce pay-ratio disclosures in line with similar disclosure in the United Kingdom and the United States, there are no references to any other prescribed disclosures and it must be assumed that the recommendations in King IV would still apply after these amendments are implemented.

i. Payments consistent with remuneration policy

King IV recommends that the implementation report provides a statement as to whether remuneration paid is consistent with the remuneration policy as well as whether there have been any deviations from the policy. However, the code does not provide the circumstances under which deviations from the policy may be allowed, the process for the approval of these deviations and the details that must be disclosed, such that the objectives of the remuneration policy may be defeated through the payment or award of executive remuneration outside of the policy.[778]

The EC Directive 2007 provides that companies may deviate from the remuneration policy in exceptional circumstances provided that these circumstances and the remuneration component that may be affected are set out in the policy. These circumstances may only involve situations where the policy may be deviated from in order to ensure the long-term sustainability of the company.[779] Where components of executive remuneration paid involve a deviation from the approved policy, the components and the exceptional circumstances involved must be disclosed.[780]

In terms of the UK Companies Act, a listed company may only make a remuneration payment to a person who is or has been a director of the company where the payment is consistent with the approved directors' remuneration policy, or consistent with an amendment to that policy that has been approved by the shareholders of the company authorising the company to make the payment concerned.[781] Similarly, a listed company may only make a payment to a person who was a director of the company for the loss of office

[778] Chapter 2.4.2 (d)(iii) above.

[779] Article 9a par 4 of EC Directive 2007.

[780] Article 9b par 1(f) of EC Directive 2007.

[781] Section 226B (1) of the UK Companies Act. A remuneration payment is defined as being any form of payment or other benefit made to a person as consideration for holding office as director of the company.

where the payment is consistent with the approved directors' remuneration policy, or consistent with an amendment to that policy that has been approved by the shareholders of the company authorising the company to make the payment concerned.[782] The UK Corporate Code also provides that these payments should not reward poor performance.[783]

The German Stock Corporation Act provides that any deviation from the remuneration policy must be disclosed including an explanation of why the deviation was necessary and the components of remuneration affected.[784]

It is suggested that the SA Companies Act be amended to adopt similar provisions to that of the EC Directive 2007, UK Companies Act and German Stock Corporation Act. As such, deviations from the policy that result in lower remuneration payments should only be permitted where the sustainability of the company is at risk. The deviation and the circumstances involved should be disclosed in the implementation report. Remuneration payments in excess of that provided in the policy, including termination payments, must be authorised in terms of an amendment to that policy as approved by the shareholders in terms of an ordinary resolution to this effect. With respect to termination payments, it is suggested that the SA Companies Act should be amended to provide that these payments must be provided for in the remuneration policy specifying the circumstances in which the payment may be made. These circumstances must at a minimum exclude terminations due to poor performance.

ii. *Remuneration table ('single, total figure table')*

King IV recommends that executive remuneration paid is set out in a table which discloses the amount of remuneration received or receivable by each member of executive management by remuneration component and as a single, total figure. These disclosures should also include that required in terms of the SA Companies Act. As the enacted amendments to the SA Companies Act merely provide that the implementation report must set out the details of the total remuneration received by each member of the executive, it is assumed that the required disclosures under the code would still apply. These disclosures and those required by the SA Companies Act are similar such that listed companies are required

[782] Section 226C (1) of the UK Companies Act.

[783] Provision 39 of the UK Corporate Code. Similarly, point 3.5 of EC Recommendation 2009 recommends that termination payments should not be made where the termination is due to poor performance.

[784] Section 162(1) 5 of the German Stock Corporation Act.

to duplicate these disclosures in the company's remuneration report and its financial statements. The code also does not prescribe a standard format for these disclosures such that companies may adopt their own formats making comparison between companies difficult to achieve for users of the implementation report.[785]

The UK Companies Regulations require the total remuneration for each statutory director to be set out in tables for both the current and preceding year and go as far as providing the template for the table concerned including separate columns for the various remuneration components, the total remuneration, the sum of fixed components for each director and the sum of variable components for each director.[786] Where benefits paid constitute a component of remuneration, a summary of the benefits paid must be indicated with the amounts involved where significant.[787] For variable remuneration consisting of short- and long-term incentives, the company must disclose the basis for the calculation of any amounts disclosed for which the performance condition or targets have not yet been fully achieved, any amounts that are subject to malus or clawback provisions and details regarding the achievement of performance measures.[788] Certain additional disclosures are required where any amounts are paid or payable to any person that has served as director of the company for the loss of office other than payments below a de minimis threshold as set by the company and stated in the report.[789]

In line with the EC Directive 2007,[790] the German Stock Corporation Act merely requires the company to disclose all fixed and variable components of remuneration paid or awarded to the executive ('management board') accompanied by an explanation as to how these components correspond with the remuneration policy, how they promote the company's long-term development and how the performance measures were applied.[791]

The US Federal Regulations require companies to disclose all components of executive remuneration actually paid or awarded in a 'summary compensation table' which, similar to

[785] Chapter 2.4.2 (d)(iii) above.

[786] Par 4-7 of Schedule 8 of the UK Companies Regulations.

[787] Par 12(1) of Schedule 8 of the UK Companies Regulations.

[788] Par 8 and 12(2)-(4) of Schedule 8 of the UK Companies Regulations. See 4.4.4 (c)(iv) below for disclosure of the details with regard to the achievement of performance measures.

[789] Par 16 of Schedule 8 of the UK Companies Regulations.

[790] Article 9b par 1(a) of EC Directive 2007.

[791] Section 162(1) 1. of the German Stock Corporation Act.

the UK Companies Regulations, depicts the actual template for the information to be disclosed. Disclosures are required for the Principal Executive Officer, the Principal Financial Officer and the three highest paid executive officers, other than the Principal Executive Officer and the Principal Financial Officer, for the last three financial years.[792] The table must be accompanied by a narrative explanation of any material factors that are necessary to assist users with understanding the information reported.[793]

The disclosure in terms of the Canadian National Instrument 51-102 Continuous Disclosure Obligations is similar to the disclosure required in terms of the US Federal Regulations in that companies are also required to disclose all components of executive remuneration actually paid or awarded in a 'summary compensation table' with a template provided for the information to be disclosed. Disclosures are required for the Chief Executive Officer, the Chief Financial Officer and the three highest paid executive officers, other than the Chief Executive Officer and Chief Financial Officer, for the last three financial years.[794] The table must be accompanied by a narrative explanation of any significant factors that are necessary to assist users with understanding the information reported.[795]

The Australian Corporations Act requires that the prescribed details of the total remuneration for each member of the executive ('key management personnel') must be disclosed.[796] These prescribed details are set out in the Australian Corporations Regulations and provide for the separate disclosure of the fixed and variable components of remuneration paid or awarded to the executive for both the current and preceding year. The regulations prescribe the minimum level in terms of which the components must be broken down into and the details for each component.[797] For variable components, the Act also requires companies to provide an explanation as to the relative proportions of the remuneration that are related to performance and those elements that are not.[798] Similarly, where a component of remuneration consists of shares in a company and is not dependent on the satisfaction of

[792] Title 17 Part 229.402(a)(3) and (c) of the US Federal Regulations.

[793] Title 17 Part 229.402(e) of the US Federal Regulations.

[794] Item 3.1 (5) of Form 51-102F6 Statement of Executive Compensation.

[795] Item 3.2 of Form 51-102F6 Statement of Executive Compensation.

[796] Section 300A (1)(c) of the Australian Corporations Act.

[797] Regulation 2M.3.03(1) of the Australian Corporations Regulations.

[798] Section 300A (1)(e)(i) of the Australian Corporations Act.

a performance condition, the reasons for the component not being dependent on a performance condition being met need to be provided.[799]

It is suggested that the SA Companies Act should be amended to require the disclosure of executive remuneration in the remuneration report for all companies that meet the threshold for an audit. This disclosure should not be duplicated in the companies' annual financial statements. The SA Companies Regulations should also be amended to prescribe the format by way of a template for the 'single, total figure' table for executive remuneration similar to the UK Companies Regulations (and that of the US and Canadian frameworks) above. These reforms would promote greater consistency in the disclosure of this information between companies and against prior years, thereby assisting users of the company's remuneration report in their analyses and strengthening this important corporate governance measure. A narrative explanation of any relevant material factors should accompany the table, as required by the US and Canadian securities' framework, while further details of the components concerned including a breakdown of the benefits provided to the executive and the basis for the calculation of the components disclosed, as provided by the UK and Australian Companies Regulations, should also be taken up in these reforms in order to promote a greater level of transparency in this regard.

iii. Share incentive scheme tables

King IV recommends that the details of awards under variable share incentive schemes for each executive member that have not vested should be set out in a separate table in the implementation report. The cash value of all awards made under the share incentive scheme that were settled during the period should also be set out in a separate table. While these disclosures are comprehensive, the code does not require disclosure as to the basis of the awards or how the value of the award was calculated such that the users of the remuneration report may not understand the reasons for the awards or how the values of the awards were calculated and, therefore, whether the awards were fair and responsible.[800]

The UK Companies Regulations require companies to provide the information recommended by King IV with respect to the share incentive schemes for interests awarded to directors during the financial year concerned while also requiring additional disclosures.[801]

[799] Section 300A (1)(d) of the Australian Corporations Act.

[800] Chapter 2.4.2 (d)(iii) above.

[801] Par 14(1) (preamble and a) of Schedule 8 of the UK Companies Regulations.

These disclosures include the description of the type of interest, the basis upon which the award was made and details as to how the value of the award was calculated.[802] With regard to the value of the award (being the 'face value') in respect of shares or share options, this value is the maximum number of shares that would vest if all performance measures and targets are met multiplied either by the share price on the date of grant or the average share price used to determine the numbers of share awarded.[803] The report must also specify whether the face value has been calculated using the share price at the date of grant or the average share price. Where the share price at the date of the grant has been used, the amount of the share price and the date of the grant must be provided. Where the average share price has been used, the average price arrived at and the period used for calculating the average price must be provided.[804]

It is suggested that the SA Companies Regulations are amended to require companies to incorporate the disclosures recommended by King IV as well as the additional disclosures required by the UK Companies Regulations with regard to the description of the interests, the basis of the awards and the calculation of the value of the awards.

iv. Details with regard to performance measures and targets achieved

King IV recommends that the company should disclose the performance measures adopted for variable remuneration, the relative weighting of each measure, the targets set for each measure and the related value of the award achievable at the various target levels, and how the company and the executive managers individually performed against the set targets. The main concern with the recommended disclosures is that the format for these disclosures is not prescribed such that companies appear to be adopting their own formats. Consequently, the assessment of the link between the individual's performance and the company's performance may be difficult to assess. There is also no required disclosure for instances where the remuneration committee has overridden a formulaic outcome in order to prevent a windfall gain that is not connected to the executive's award.[805]

The UK Companies Regulations are similar to the King IV recommendations with regard to incentive-linked performance measures, yet they also provide for disclosure as to

[802] Par 14(1)(b) of Schedule 8 of the UK Companies Regulations.

[803] Par 14(2) of Schedule 8 of the UK Companies Regulations.

[804] Par 14(3) of Schedule 8 of the UK Companies Regulations.

[805] Chapter 2.4.2 (d)(iii) above.

whether any amount of the award is due to share appreciation, how any discretion has been exercised with respect to determining the level of the award and whether this discretion was due to share price appreciation or depreciation, and whether any short-term incentives have been deferred and the percentage of the award deferred where applicable.[806] The remuneration report is also required to present a line graph that compares the total shareholder return ('TSR') on the listed equity shares of the company against a broad equity market index.[807] The name of the index selected for purposes of the graph needs to be stated as well as the reasons for selecting the index concerned.[808] The TSR graph and the index concerned must cover the last ten financial years including the financial year concerned.[809] In addition to the TSR graph, companies are also required to present the Chief Executive Officer's (CEO's) total remuneration, and the amounts of the respective short- and long-term incentives included in the total remuneration, expressed as a percentage of the maximum remuneration achievable for the last ten financials years in a table to this end.[810] The disclosure of the TSR trend provides shareholders and particularly potential shareholders with a means of comparing the company's investment returns against that of similar companies, while the disclosure related to the CEO's remuneration provides an indication of how successful the CEO has been in delivering against the targets set in the approved remuneration policy.

In line with the EC Directive 2007,[811] the German Stock Corporation Act provides that the company must present the annual change in remuneration of the members of the management and supervisory boards against the performance of the company and the average remuneration of the full-time employees of the company over the last five years. An explanation as to which employees were involved must accompany the presentation.[812]

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[806] Par 12(2)-(4) of Schedule 8 of the UK Companies Regulations.

[807] Par 18(1)(a) of Schedule 8 of the UK Companies Regulations. Per note 556 above, the TSR is calculated as the sum of the movement in the share price and dividends paid during the financial year divided by the share price at the beginning of the year.

[808] Par 18(1)(b) of Schedule 8 of the UK Companies Regulations. For top UK-listed companies, the Financial Times Stock Exchange (FTSE) 100 Total Return Index would typically be used where the company concerned is a member of this group. The FTSE 100 comprises the hundred largest companies on the main market of the London Stock Exchange by market capitalisation.

[809] Par 18(3) of Schedule 8 of the UK Companies Regulations.

[810] Par 18(2) of Schedule 8 of the UK Companies Regulations.

[811] Article 9b par 1(b) of EC Directive 2007.

[812] Section 162(1) 2 of the German Stock Corporation Act.

The US Securities Exchange Act's 'pay-versus-performance' rule requires companies to disclose how their executive remuneration (being the Principal Executive Officer and the Named Executive Officers) is paid relative to their company's performance in both a tabular and narrative format.[813] In accordance with the US Federal Regulations, the company is required to disclose the following in a table (per the template provided in the regulations): the total remuneration per the 'summary compensation table',[814] and the total remuneration actually paid separately for the Principal Executive Officer and the Named Executive Officers, the TSR of the company and the TSR of its peer group, the net income of the company (being the company's after tax profit), and a measure of financial performance selected by the company (a 'company-selected measure') for the company's last five financial years.[815] The 'company-selected-measure' may be any financial performance measure that differs from financial performance measures that are otherwise disclosed in the table (i.e. 'net income' and cumulative 'TSR') and must be selected from an unranked list of between three and seven of its most important performance measures, as disclosed in the proxy statements of the company, that link executive remuneration actually paid to the executive during the company's last financial year.[816] In addition to the above table, the company is also required to provide a clear narrative, graphical or combined narrative and graphical description of the relationships between the average remuneration of the Named Executive Officers and the TSR, net income and the 'company selected measure', as well as the relationship between the company's TSR and the TSR of its peer group.[817]

While the Canadian Securities' regulatory framework does not provide for a direct comparison of executive remuneration actually paid against the performance of the company, it does require the company to disclose a performance graph of the company's TSR against that of an appropriate index for the last five financial years and to discuss how the trend in this graph compares to the trend in the executive remuneration over the same period.[818]

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[813] Title 17 Part 229.402(v) of the US Federal Regulations.

[814] Chapter 4.4.4 (c) (ii) above.

[815] Title 17 Part 229.402(v)(1) of the US Federal Regulations. The TSR of the peer group concerned can be derived from an index such as the Standard and Poor's (S&P's) Global TSR or may be derived from the TSR's of selected companies considered by the company to be representative of the peer group that the company is part of.

[816] Title 17 Part 229.402(v)(2)(vi) of the US Federal Regulations.

[817] Title 17 Part 229.402(v)(5) of the US Federal Regulations.

[818] Item 2.2(b) of Form 51-102F6.

Similarly, the Australian Corporations Act also does not provide for a direct comparison of executive remuneration actually paid against the performance of the company, yet it does require a discussion of the link between the remuneration policy and the company's financial performance over the last five years being the company's earnings and the company's TSR.[819]

It is suggested that the SA Companies Regulations are amended to include the required disclosures as set out in King IV. These disclosures should be amplified by the requirements of the UK Companies Regulations with respect to the use of discretion by the remuneration committee which should cover all instances where the committee has used their discretion in overriding a formulaic outcome. The disclosures set out in the UK Companies Regulations with respect to the CEO's achieved remuneration against potential remuneration should also be considered as these disclosures provide useful insight into the link between the CEO's performance and that of the company. The TSR disclosure would typically be of interest to shareholders and potential shareholders only and perhaps more suited to annual reporting outside of the implementation report. Similar to the US Federal Regulations, the King IV disclosures should be set out in a standard table with the template for this tables provided in the SA Companies Regulations. In this table, the company performance measures (such as operating profit per the financial statements) upon which the incentives are linked, the targets and weightings pertaining to these performance measures, the value of the incentives at the target levels, the actual performance measures achieved and actual incentives paid or awarded should be set out in such a way that these can be linked to the remuneration policy disclosures (in particular, the illustration of the policy's operation). The portion of the incentive that is based on the individual performance of the executive should also be disclosed separately in this table. These disclosures should be accompanied by a narrative explaining how the incentive was calculated and how the incentive is linked to the performance of the company including any instances where the remuneration committee was required to use its discretion.

v. Annual percentage change in remuneration

The enacted amendments to the SA Companies Act contain disclosures regarding the 'total remuneration' relating to the employee that has the highest total remuneration and that of the employee that has the lowest total remuneration, as well as the average total remuneration

[819] Section 300A (1)(b), (1AA) and (1AB) of the Australian Corporations Act.

and the median remuneration of all its employees.[820] These disclosures only relate to the previous financial year, such that user of the remuneration report would need to wait several years and compare the remuneration reports of these years to establish whether these relative levels are increasing at similar rates as there is no requirement to provide this information for several years as a comparative.

The UK Companies Regulations provide that the implementation report must disclose the annual percentage change for the last five years of the remuneration of each director as well as the remuneration of all other employees that are employed on a full-time basis. This disclosure needs to be provided separately for the salaries (or fees), other benefits and the short-term incentives of the directors and other employees.[821] This disclosure is also consistent with the EC Directive 2007 and the German Stock Corporation Act.[822]

It is suggested that the SA Companies Regulations incorporate provisions that are similar to that of the UK Companies Regulations above for the executive management in order to provide improved transparency as to how quickly the company is addressing the pay disparities in the company concerned. Where there are large discrepancies between the increase in remuneration for the executives and that of the other employees of the company, the company must provide reasons for the discrepancies concerned.

vi. Disparity in remuneration levels

The enacted amendments to the SA Companies Act introduce the requirement for public and state-owned companies to disclose the relative remuneration levels of their employees in the implementation report of their company including the ratio of the remuneration of the highest paid employees to that of the lowest paid employees of the company. While these disclosures are intended to reduce the inequality in companies and society generally, concerns with these disclosures involve the inclusion of temporary employees and contractors in the calculation, as well as the inclusion of incentive awards in the remuneration used in these calculations. Both of these inclusions can lead to significant fluctuations in the ratio from year to year which would make the task of establishing whether the DTIC's objectives are being achieved difficult to measure. Further concerns with these disclosures involve the possible 'brain drain' that could be caused by the decrease in executive remuneration levels, the effort

[820] Chapter 2.4.4(b) above.

[821] Par 19 of Schedule 8 of the UK Companies Regulations.

[822] Chapter 4.4.4(c)(iv) above.

involved in pulling the information needed for these disclosures and whether they do in fact achieve a reduction in inequality.[823]

The United Kingdom and the United States recently introduced remuneration ratio disclosure requirements in their company and federal securities legislation respectively.

- *UK Companies Regulations*

  The UK Companies Regulations require listed companies in the UK with an average of more than 250 UK-based employees to disclose the ratios of the Chief Executive Officer ('CEO') to the total remuneration of other employees at the upper quartile, median and lower quartile respectively in a so-called 'pay ratio table' as depicted in the regulations. The total remuneration of the CEO is as disclosed in the 'single total figure' table, while the total remuneration of other employees would be calculated in the same way as for the CEO. The company is required to disclose these ratios in separate rows of the table for the current year as well as for the nine preceding years in which the company met the qualifying criteria for the number of UK-based employees.[824]

  The UK Companies Regulations provide a significant degree of flexibility to the company in its methodology to determine the total remuneration of employees at the upper, median and lower quartile in the pay ratio table. The company has the choice of three methods to choose from including the total actual remuneration paid, the total remuneration as calculated from its most recent hourly gender pay gap information collected in accordance with its disclosures in terms of the UK's Equality Act and other available data for the year, and the total remuneration calculated from this other available data to arrive at the most representative amounts for the disclosures concerned. Within each of these methods, the regulations also allow for further flexibility in the application of these methods.[825]

  Beneath the pay ratio table, the company must set out an explanation as to why it chose the method it did as the preferred option for calculating the pay ratio for the financial year concerned as well as certain aspects relating to the method it chose.[826] Where the method for the year changed from that used in the previous year, the company must also

[823] Chapter 2.3.4 (b) above.

[824] Par 19B and 19C of Schedule 8 of the UK Companies Regulations.

[825] Par 19D of Schedule 8 of the UK Companies Regulations.

[826] Par 19E(a) and 19E(c)-(h) of Schedule 8 of the UK Companies Regulations.

provide an explanation for the change.[827] The company must also set out a summary explaining why any of the pay ratios for the financial year concerned increased or decreased against the previous financial year including whether the change is due to the change in the CEO's remuneration or that of other employees, the company's employment model such as the increase in number of employees required to work in the UK, or a different method being adopted to calculate the upper quartile, the median and the lower quartile respectively. The summary should also explain any trend in the median pay ratio of financial years covered by the pay ratio table and whether the median pay ratio is consistent with the pay, reward and progression policies for all UK employees.[828]

- *US Securities Exchange Act*

  The US Securities Exchange Act's so-called 'pay-ratio' rule requires companies to disclose the ratio of the annual total remuneration of the company's Principal Executive Officer ('PEO') to that of the median of all other employees of the company.[829] The total remuneration of the PEO is as disclosed in the 'summary compensation table', while the total remuneration of other employees would be calculated in the same way as for the PEO.[830] For purposes of this disclosure, employees include all US-based and non-US-based employees, whether full-time, part-time, temporary or seasonal employees employed within the consolidated group at any date within the last three months of its completed financial year, although non-US employees may be excluded in certain circumstances.[831] The company is not required to disclose these ratios for comparative years and may only select its median employee every three years provided there has been no change in its employees or their remuneration arrangements.[832]

  The US Federal Regulations provide some flexibility in determining the method of identifying who the median employee (in terms of whose remuneration is used in the ratio) and in calculating the total remuneration concerned.[833] In identifying who the median

[827] Par 19E(b) of Schedule 8 of the UK Companies Regulations.

[828] Par 19G of Schedule 8 of the UK Companies Regulations.

[829] Title 17 Part 229.402(u)(1) of the US Federal Regulations.

[830] Title 17 Part 229.402(u)(2) of the US Federal Regulations.

[831] Title 17 Part 229.402(u)(3) and (4)(i), (ii), Instruction 1 of the US Federal Regulations.

[832] Title 17 Part 229.402(u)(4) Instruction 2 of the US Federal Regulations.

[833] Title 17 Part 229.402(u)(4) Instruction 4.1 of the US Federal Regulations.

employee is, the company may use its employee population as indicated above, statistical sampling or any other reasonable method. The company may also use a combination of statistical sampling and any other reasonable method that is appropriate for the company's facts and circumstances.[834] With respect to the determination of the total remuneration concerned, the company may use total remuneration as indicated above or any other remuneration measure that is consistently applied to all employees included in the calculation such as information derived from the company's payroll or tax records. If the latter method is used, the company must disclose this measure.[835] Companies would be permitted (although not required) to annualise the total remuneration for permanent employees that did not work for a full year.[836] The company must briefly describe the methodology used to identify the median employee or to determine the total compensation.[837] While the company may present additional information to supplement the pay ratio, the company is not required to provide a supporting discussion on the ratio and any supplementary information must not be misleading or presented with greater prominence than the pay ratio.[838]

The approaches of the United Kingdom and the United States to their pay ratio calculations provide significant flexibility with regard to the total remuneration of the employees and the employee population used in the calculation. The US Securities Commission indicates that this flexibility is intended to reduce costs and the burden of reporting for companies while preserving the perceived benefits of the intended disclosure. Yet they emphasise that this flexibility leads to pay ratio results that would only be useful to shareholders to improve their understanding of the company's remuneration practices rather than to facilitate a comparison of this information across different companies. [839]

In their response to the DTIC with respect to the Companies Amendment Bill of 2021, the IoDSA and the King Committee indicated that they supported the disclosures with regard to the relative employee remuneration including the pay ratio disclosure. They suggested,

[834] Title 17 Part 229.402(u)(4) Instruction 4.2 of the US Federal Regulations.

[835] Title 17 Part 229.402(u)(4) Instruction 4.4 of the US Federal Regulations.

[836] Title 17 Part 229.402(u)(4) Instruction 5 of the US Federal Regulations.

[837] Title 17 Part 229.402(u)(4) Instruction 5 of the US Federal Regulations.

[838] Title 17 Part 229.402(u)(4) Instruction 9 of the US Federal Regulations.

[839] Securities and Exchange Commission 'Commission Guidance on Pay Ratio Disclosure' at 2-3 last accessed at https://www.sec.gov/files/rules/interp/2017/33-10415.pdf on 7 May 2023.

however, that these amendments should have adopted two additional measures with respect to the pay ratio disclosure in order to address fluctuations in the ratio from year to year. The first measure involves using 'on target' remuneration for assessing whether progress has been made in closing the remuneration gap, as opposed to actual remuneration paid, as the latter can fluctuate significantly depending on the results achieved by the company. They did, however, concede that companies should at least be required to use the method adopted by the company in its income differential reporting in terms of the Employment Equity Act (the EEA4 form) for the purposes of consistency and simplicity. They also suggested that the annualised total remuneration of full-time permanent employees should be used in the calculation of the ratio such that amounts paid to contractors and temporary workers should be excluded.[840]

In contrast to the IoDSA and King Committee, it is suggested that the enacted amendments to the SA Companies Act with regard to the use of total remuneration as defined in the amendments should be adopted without any changes. As this definition of remuneration includes both fixed and variable remuneration actually paid (which is also the default position for the United Kingdom and United States), one would expect to see changes in the levels of remuneration paid to employees from year to year. In years with good financial results, one would expect to see higher incentives being awarded to executives than in years with poor financial results. However, if the company is fair in its remuneration practices, one would also expect employees at the bottom end of the remuneration levels in the company to share in the company's success. If the ratio is much higher in these good years, this may well be an indication that the company's remuneration practices are unfair. It is also suggested that all employees including contractors and temporary employees should be included, as contained in the enacted amendments to the SA Companies Act, in the same way that the US federal securities legislation does, as it is assumed that contractors and temporary workers are in essence filling positions at the company. Amounts paid to employees that have worked for less than a year should also not be annualised, as suggested by the IoDSA and King Committee, as they may be replacing someone who has worked for the previous part of the year. Annualising the remuneration of employees who have worked for part of the year may, therefore, result in 'double accounting'.

[840] IoDSA and King Committee 'RE: IoDSA and King Committee Comment Letter on the 2021 Companies Act Amendment Bill' op cit note 275 at S3.24.

Therefore, it is suggested that the enacted amendments to the SA Companies Act with respect to the disclosures of relative employee remuneration including the pay ratio disclosures should be adopted without changes. In particular, no flexibility should be provided either in respect to the total remuneration or the employee population used in the calculation as the disclosures are expected to be an important corporate governance mechanism relating to the levels of executive remuneration. Permitting a degree of flexibility into the calculation of the ratio would make it difficult for analysts to establish whether the company is actually decreasing its ratio over time or how the ratio of one company compares to other companies. Similar to the UK, however, the format of the disclosures should be set out in the SA Companies Regulations including the requirement to disclose the ratio for the current year and the previous nine years. The disclosure should also be accompanied by a narrative explaining why the ratio increased or decreased during the year concerned. Similar to the Employment Equity Act, the narrative should also include a statement indicating whether the company has a policy to address income differentials and if so, a brief overview of that policy.

vii. Directors' shareholding and share interests

The SA Companies Act requires that details as to the shares issued to the executive including any consideration received for those shares must be disclosed in the company's financial statements.[841] However, the Act does not provide adequate disclosure of the nature of these interests. The interests of the executive in the company, and especially where these interests have increased over the previous year, can serve to signify the executive's level of confidence in the future prospects of the company. Similarly, the converse is true where the interests have decreased over the previous year.

The UK Companies Regulations provide for further requirements with regard to the directors' ownership of shares. The remuneration report must contain, in respect of each person that has served as a director during the financial year concerned, a statement of any requirements or guidelines for the director's ownership of shares in the company and whether or not those requirements or guidelines have been met.[842] The report must set out the following details either as a table or otherwise:

- the total number of interests in shares in the company including interests of connected persons;

[841] Chapter 2.4.1(b) above.

[842] Par 17(a) of Schedule 8 of the UK Companies Regulations.

- the total number of scheme interests, including the details thereof, distinguishing between shares and share options, and between those with and without performance options;
- details of share options which are vested but unexercised, and those that are exercised in the current financial year.[843]

It is suggested that the SA Companies Regulations incorporate provisions that are similar to that of the UK Companies Regulations above for interests in the company held by the executive in order to provide full transparency in this regard.

viii. Voting results

King IV recommends that the background statement of the remuneration report sets out the most recent results of the voting on the remuneration policy and the implementation report as well as the measures taken by the company in response to these results. King IV also recommends that where the remuneration policy or the implementation report is voted against by 25 percent or more of the shareholders, the background statement should reflect who the company engaged with to ascertain the reasons for the dissenting votes and the steps taken to address all legitimate and reasonable objections and concerns.[844] The enacted amendments to the SA Companies Act, on the other hand, only require the remuneration committee to present an explanation as to how shareholder concerns with the implementation report have been taken into account at the annual general meeting following the one that at which the implementation report was not approved by the shareholders.[845] These amendments do not require the disclosure of the measures taken by the remuneration committee to address shareholder concerns where either the remuneration policy or the implementation report have been voted against by them, or the voting results concerned.

The EC Directive 2007 requires companies in member states to describe and explain all significant changes made to the company's remuneration policy, where applicable, and how the votes and views of the shareholders on the policy since the most recent vote on the remuneration policy have been take into account.[846] The voting results on the remuneration policy and the date of the vote must be published on the company's website 'without delay'

[843] Par 17(b) of Schedule 8 of the UK Companies Regulations.

[844] Chapter 2.4.2(d)(i) above.

[845] Chapter 2.4.4(c) above.

[846] Article 9a par 6 of EC Directive 2007.

after the vote.[847] The company is also required to disclose in the implementation report how the shareholder vote on the previous implementation report has been taken into account.[848]

The UK Companies Regulations require the directors' remuneration report to contain a statement setting out the voting results on resolutions relating to the remuneration policy and the remuneration (implementation) report at the last general meeting. These results must set out the percentage of votes for and against the resolution to approve the remuneration policy and the implementation report, as well as the votes withheld in respect of both the remuneration policy and the implementation report. The remuneration report must also set out the reasons for a significant percentage of votes against the policy or the report, where applicable, as well as any actions taken by the directors to address these concerns.[849]

The German Stock Corporation Act requires the company to disclose a summary of the extent of its coordination with its shareholders on the remuneration policy and implementation report, and the extent to which shareholder comments have been taken into account in its remuneration policy.[850] The Act also requires the company to disclose how the vote on the implementation report was taken into account.[851] Similarly, the Australian Corporations Act states that where at least 25 percent of the shareholders vote against the remuneration report (implementation report) at the company's most recent annual general meeting and comments were received on the remuneration report at that meeting, the company must set out the company's proposed action in response to those comments.[852]

It is suggested that the SA Companies Act (or the supporting SA Companies Regulations) incorporate similar provisions to the current recommendations of King IV and the provisions of the UK Companies Regulations. These disclosures should be set out in the background statement of the remuneration report and include the voting results on the policy and the implementation report, as well as the measures taken to address shareholder concerns, in order to achieve full transparency in this regard.

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[847] Article 9a par 7 of EC Directive 2007.

[848] Article 9b par 4 of EC Directive 2007.

[849] Par 23 of Schedule 8 of the UK Companies Regulations.

[850] Section 87a (1) 11(b) of the German Stock Corporation Act.

[851] Section 162(1) 6 of the German Stock Corporation Act.

[852] Section 300A(1)(g) of the Australian Corporations Act.

4.4.5 Shareholder vote on the remuneration policy and implementation report

King IV (as embraced by the JSE Listings Requirements) recommends that the remuneration policy and the implementation report are required to be tabled before the AGM each year for a separate non-binding or advisory vote by the shareholders of the company. Where 25 percent of the shareholders vote against either the remuneration policy or the implementation report, the board must at a minimum engage with the dissenting shareholders to ascertain the reasons for their votes and appropriately address their objections and concerns raised.[853] The enacted amendments to the SA Companies Act intend changing the shareholder vote on the remuneration policy and implementation report to that of a binding vote requiring an ordinary resolution for their separate approvals. As discussed in the previous section, these amendments do not provide for a process of engagement with dissenting shareholders on the remuneration policy. These amendments also introduce the requirement for the non-executive directors on the remuneration committee to stand for re-election where the vote on the implementation report is unsuccessful at the AGM and to be ineligible to serve on the committee for two years in the event that the report is voted against at the AGM following the second unsuccessful meeting.[854]

While the IoDSA and King Committee believe that the binding vote on the remuneration policy will improve the shareholder governance role, they are opposed to the introduction of a binding vote on the implementation report and the ineligibility of non-executive directors to serve on the remuneration committee for two years following a successive vote against the report. They indicate that the binding vote on the implementation report is retrospective and that the consequences for the company and executives of an unsuccessful vote on the report are unclear as a mandatory requirement for executives to repay amounts that were not approved may be unconstitutional and unlawful. The ineligibility of the non-executive directors to serve on the remuneration committee following a successive vote against the report may have a negative impact on the board and its continuous functioning, while the reputation of these members may also be damaged such that directors may not wish to serve on remuneration committees in the future thereby exacerbating the shortage of skills in this area.[855]

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[853] Chapter 2.4.2 (e) above.

[854] Chapter 2.4.4 (c) above.

[855] Ibid.

a) Comparable jurisdictions

The EC Directive 2007, in terms of which the legislation of the UK and Germany have largely adopted, addresses the shareholder vote on the remuneration policy and the implementation report separately in their company legislation. The US and Australia, on the other hand, adopt somewhat different approaches in their federal securities and company legislation respectively.

i. EC Directive 2007

The directive requires member states to provide for the shareholder vote on the remuneration policy at the general meeting to be either binding or non-binding (or advisory). Where the vote is binding, the director remuneration must be paid in accordance with the remuneration policy that was approved by the general meeting. Should the proposed policy not be approved, the company may continue to pay remuneration to its directors in terms of its existing practices, where no formerly approved policy exists, or in terms of the formerly approved policy where such policy exists. In either case the proposed policy must be revised and resubmitted to the following general meeting.[856] Where the vote is non-binding, the director remuneration must be paid in accordance with the remuneration policy that was submitted to the general meeting. Should the proposed policy be rejected, the policy must be revised and resubmitted to the following general meeting.[857] Member states should provide for the submission of the remuneration policy to the general meeting at least every four years and whenever there is a material change to the policy.[858]

With respect to the shareholder vote on the implementation report, member states are required to ensure companies submit the report to the AGM for an advisory vote and explain how the vote was taken into account in the following remuneration report.[859]

ii. UK Companies Act

The UK Companies Act requires the directors to submit their company's remuneration policy to the accounts meeting (defined as a general meeting at which the annual financial statements of the company are presented) for a binding vote by the shareholders of the company, in terms of an ordinary resolution to this effect, at least every three years.[860] Where

[856] Article 9a par 2 of EC Directive 2007.

[857] Article 9a par 3 of EC Directive 2007.

[858] Article 9a par 5 of EC Directive 2007.

[859] Article 9b par 4 of EC Directive 2007.

[860] Section 439A (1) of the UK Companies Act.

the remuneration policy has been revised, the revised policy must be submitted to a general meeting (other than the accounts meeting) for a binding vote by the shareholders.[861] Should the remuneration policy (or revised policy) not be approved by the shareholders at either the accounts meeting or other general meeting, as applicable, the company is required to submit the remuneration policy to the next accounts meeting or further general meeting (other than the accounts meeting), as applicable, for a binding vote.[862]

The Act also requires that the implementation report must be submitted to the accounts meeting for a non-binding or advisory vote.[863] Should the implementation report not be approved at that accounts meeting, and the remuneration policy was not put to the shareholder vote at that meeting, the remuneration policy must then be submitted to the next accounts meeting for a binding vote.[864]

The United Kingdom has, therefore, adopted the prescribed provisions of the EC Directive 2007 above and has opted to apply a binding shareholder vote in respect of the remuneration policy of the directives with the frequency of the shareholder vote on the policy of three years being shorter than the maximum of four years prescribed by the directive. While the IoDSA has previously indicated that a non-binding vote on the policy is preferable as it does not amount to a rejection of the policy and encourages engagement with dissenting shareholders,[865] it appears that the DTI (UK) had a different view. Ndzi indicates that the main purpose of introducing the binding vote on the remuneration policy in the UK Companies Act was actually to encourage improved engagement between companies and shareholders in developing the policy from an early stage of its development as opposed to only engaging after the AGM in response to a vote against the policy. The purpose of the shareholders only being required to approve the policy every three years was to avoid destabilising management teams and thereby encourage the long-term success of the company. The stability of management was also a consideration from the perspective of investors who may be concerned about losing their investments in the company. The three-year period was also a way for companies to demonstrate how director remuneration is

[861] Section 439A (1) and (7)(b)(ii) of the UK Companies Act.

[862] Section 439A (2A) of the UK Companies Act.

[863] Section 439 of the UK Companies Act. Subsection 5 of section 439 confirms that that vote of the shareholders is non-binding or advisory only.

[864] Section 439A (2) of the UK Companies Act.

[865] Chapter 2.3.4 above.

aligned with company strategy, while also avoiding the annual ratcheting up of remuneration.[866]

Unfortunately, as Ndzi indicates, studies show that the binding vote has not improved the approach of shareholders over the previous dispensation where the vote was non-binding. Shareholder engagement does not appear to have improved, and shareholders continue to abstain from voting on directors' remuneration.[867] She suggests that there are a couple of reasons for the continued apathy of shareholders towards the vote on director remuneration. First, although the binding vote was intended to encourage the shareholders participation in decision-making on directors' remuneration, their participation requires them to properly understand the remuneration policy before being able to make an informed decision on which way to vote. As directors' remuneration packages are typically complex in nature, a shareholder may have to either possess expert knowledge or consult experts to assist with the interpretation of the policy. For the average shareholders which owns an insignificant percentage of the company's shares, incurring these additional costs often leads them to abstain from the vote.[868] Secondly, globalisation and the director labour market as impacted by a lack of board independence and the remuneration disclosure requirements may also discourage the involvement of shareholders. As the director labour market is becoming more internationalised with directors becoming more mobile, local companies tend to face competition for talented directors from other countries that may have a deeper talent pool of directors and that generally pay their directors more. Increased disclosure, of course, only exacerbates the negotiating power of the directors as does a weak, compromised board that may be susceptible to the demands of influential directors. Local companies find themselves being placed under pressure to match these levels for fear of losing top directors. As a consequence, shareholders may not want to make decisions that could result in these eventualities playing out. [869]

[866] Ndzi, E.G. 'UK Shareholder Voting on Director's Remuneration: Has Binding Vote Made any Difference?' (2017) 38.5 *Company Lawyer* 139 at 143.

[867] Ndzi, E.G. op cit note 865 at 144.

[868] Ibid at 145-147

[869] Ibid at 147-149.

iii. German Stock Corporation Act

The German Stock Corporation Act requires the supervisory board to submit the remuneration policy for the management board to the AGM for a non-binding vote by the shareholders whenever there is a substantive change to the policy or and least every four years.[870] If the policy is not approved at the AGM, it must be submitted at the following AGM.[871]

The Act also provides that the implementation report of the previous year must be submitted to the general meeting for approval (or 'endorsement') being a non-binding or advisory vote.[872]

Germany has therefore also adopted the prescribed provisions of the EC Directive 2007 above and has opted to apply a non-binding shareholder vote in respect of the remuneration policy of executives. As Tröger and Walz indicate, however, the adoption of the shareholders' direct involvement in executive remuneration is in effect a 'legal transplant' that is contrary to the German tradition of providing for shareholder (and labour) representatives on the supervisory board to determine the remuneration of the management board in line with its two-tier system. They indicate that there are concerns that this arrangement may increase governance costs unnecessarily, while shifting the competence of the supervisory board to the shareholders may defeat what is already considered a sound governance system.[873]

iv. US Securities Exchange Act

The US Securities Exchange Act requires companies to conduct a separate non-binding shareholder vote on the remuneration of executives (the so-called 'say-on-pay' rule) as well as on certain termination payments (the so-called 'golden parachute' rule).[874] This rule applies to all remuneration disclosures in the proxy statement consisting of both the remuneration policy (considered to be the 'compensation discussion and analysis' section) and the implementation report (considered to be the 'summary compensation table' and other disclosures relating to remuneration actually paid or awarded as disclosed in the proxy

[870] Section 120a (1) of the German Stock Corporation Act.

[871] Section 120a (3) of the German Stock Corporation Act.

[872] Section 120a (4) of the German Stock Corporation Act.

[873] Tröger, T.H. and Walz, U. 'Does say on pay matter? Evidence from Germany' (2019) *SAFE Working Paper No. 125* at 3 available at *https://ssrn.com/abstract=2723792* last accessed on 3 January 2024.

[874] Sections 14A and 14A(c) of the US Securities Exchange Act.

statement). As such there is no separate vote on the policy, or the actual remuneration paid or awarded. In terms of the rule, a resolution for the approval of executive remuneration, as disclosed in the relevant proxy statement, is required to be submitted to the annual (or other) meeting of shareholders at least once every three years for the non-binding or advisory vote of the shareholders.[875] At least once every six years, a resolution for the approval of whether the shareholder vote on executive remuneration should be occur every one, two or three years must also be submitted.[876] The shareholder vote in this regard is also not binding on the company or the board of directors.[877] Similar rules apply in respect of remuneration to be paid or awarded under 'golden parachute' arrangements.[878]

The experience of the United States with the 'say on pay' rule appears to be mixed. Hughen, Mahfuja and Shim indicate that several studies provide support for this rule. These studies show that the rule has led to a decline in the growth of the Principal Executive Officer ('PEO') remuneration and increased pay-performance sensitivity. Boards have also reduced their PEO's remuneration in response to negative voting results in terms of the rule.[879] Allaire and Dauphin, on the other hand, indicate that studies have shown that shareholders base their vote on the performance of the company's shares rather than the company's remuneration policies and practices. Where the company's shares have outperformed that of its peers, the shareholders tend to approve any remuneration package put forward. This tendency then places pressure on management to concentrate on the short-term share performance which in turn can adversely impact the company's performance in the long-term.[880]

v. Australian Corporations Act

The Australian Corporations Act provides for the so-called 'two strikes rule' relating to the shareholder vote on the remuneration report. Similar to the United States, there is no separate shareholder vote on the remuneration policy; the provisions apply to both the policy and the implementation report as presented in the remuneration report. Where 25 percent or more of

[875] Section 14A (a)(1) of the US Securities Exchange Act.

[876] Section 14A (a)(2) of the US Securities Exchange Act.

[877] Section 14A (c) of the US Securities Exchange Act.

[878] Section 14A(b)(2) of the US Securities Exchange Act.

[879] Hughen, L., Malik, M. and Shim, E.D. 'The impact of Sarbanes–Oxley and Dodd–Frank on executive compensation' (2019) 20.3 *Journal of Applied Accounting Research* 243 at 247.

[880] Allaire, Y. and Dauphin, F. 'Should Say-on-Pay Votes be binding' (September 2016) Columbia Law School Blog on Corporations and Capital Markets available at https://clsbluesky.law.columbia.edu/2016/09/13/should-say-on-pay-votes-be-binding last accessed on 2 January 2024.

the shareholders vote against the resolution to adopt the remuneration report at an AGM (the 'earlier AGM'), this event is seen as the 'first strike'. Where at the subsequent AGM (the 'later AGM'), 25 percent or more of the shareholders again vote against the resolution to adopt the remuneration report, this event is seen as the 'second strike'. This latter event triggers a further resolution (the 'spill resolution') that must be put to the vote at this later AGM.[881] This resolution requires that another meeting (the 'spill meeting') must be held within 90 days of this later AGM, that all directors (other than the managing director) who held office at the time that the resolution to adopt the directors report at the later AGM was considered must cease to hold office before the end of the spill meeting, and that resolutions to appoint persons to the positions left vacant at the end of the spill meeting must be put to the vote.[882]

Tang indicates that the rule has improved the connection between executive pay and corporate performance. It has also led to the level of executive pay decreasing significantly since the introduction of the rule. In the year after the rule's introduction, there was evidence of executives turning down bonuses and adopting pay freezes and cuts. The main reasons appear to be due to the increase in the power of the shareholders and the board's accountability with clear consequences for the board if they fail to address the issues evident in the remuneration report. Apart from the risk of losing their positions after the adoption of the spill resolution, there is also the impact that the strike can have on the company's reputation as well as that of its executives.[883] He does, however, raise concerns as to the impact that the rule has on company's performance with the additional administrative costs and time taken to sufficiently address the issues evident in the remuneration report. Directors can end up being preoccupied with addressing issues relating to remuneration instead of focussing on running the business. The threat of a spill meeting can also lead to uncertainty in companies and deter talented directors from taking up position in public companies. Some critics have also indicated that the 90-day period for the spill meeting to be held is too short and more time is needed to set up an alternative board.[884]

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[881] Section 250U of the Australian Corporations Act.

[882] Section 250V of the Australian Corporations Act.

[883] Tang, T. 'The Two Strikes Rule on Executive Pay' 2015 Volume XI *Cross-sections, The Bruce Hall Academic Journal* 125 at 127-128.

[884] Ibid at 129-130.

Luiz, indicates that there are also concerns that only a small minority of shareholders (i.e. 25 percent) can trigger the spill resolution, meaning that a small minority of shareholders can impact the outcome of the remuneration process and this may result in abuse by them. This threshold is also made easier to achieve by the exclusion of the voting of shares held by key management personnel. Another concern is that members voting against the remuneration report may be doing so to express their dissatisfaction with matters that have nothing to do with the remuneration concerned. There is also a concern as to the costs and additional administrative burden emanating from the need to ensure that all those entitled to vote do so and hold further meetings. It has also been indicated that the holding of a spill meeting is pointless as the directors that are required to step down in terms of the spill resolution may simply be re-elected. The same result could be achieved by simply voting out the directors they are unhappy with at the next general meeting.[885]

b) Comment on the SA Companies Amendment Act

The enacted amendments to the SA Companies Act with respect to the shareholder vote on executive remuneration is similar in many respects to the approach of the UK while also adopting aspects of the Australian approach. Specifically, the binding vote in terms of an ordinary resolution at least every three years and the calling of successive general meetings to secure an approved policy as proposed is in line with the UK Companies Act procedure above. These amendments, however, go further than the UK approach by also requiring a binding vote on the implementation report (by ordinary resolution at each annual general meeting). While the EC Directive 2007 permits member states to adopt either a binding or non-binding vote on the remuneration policy, the directive does not prescribe a binding vote on the implementation report. Similarly, Germany, the United States and Australia also do not require a binding vote on the implementation report. While the Companies Amendment Bill of 2021 (the original bill preceding the SA Companies Amendment Act) required non-executive directors that serve on the remuneration committee to step down from the board in the case of a second successive vote against the implementation report similar to the Australian two-strikes rule, these amendments now only require the non-executive directors on the remuneration committee to step down from the committee.

The shareholders' vote required in terms of King IV with respect to executive remuneration continues to raise a couple of issues which are not resolved by the enacted

[885] Luiz, S. 'Executive remuneration and shareholder voting' op cit note 262 at 277.

amendments. The first issue is the vote by the shareholders themselves on the remuneration policy and implementation report (as opposed to other stakeholders who are excluded from the approval process), while the second issue is whether the shareholders' vote on the remuneration policy and implementation report should be binding or non-binding.[886]

With respect to the first issue, the shareholders are an important stakeholder of the company, yet other stakeholders often have a higher vested interest in the company. Large conglomerates typically have a more dispersed share ownership such that shareholders are more akin to investors that owners. Many of these investors are representing large pension funds i.e. are institutional investors that can move their investments to other companies that may provide a better return more easily than suppliers and employees can withdraw their 'investment' in the company.[887]

The directors of the company, on the other hand, have unlimited liability for the detrimental financial consequences of poor strategic decisions. In their response to the DTIC with respect to the Companies Amendment Bill of 2021, the IoDSA and the King Committee indicated that it is assumed that board members have been properly selected and understand the purpose of the company and its values, and should therefore be trusted with decisions on executive remuneration.

They indicated that:

> '(s)hareholders have limited liability and therefore care should be exercised when giving shareholders the authority to turnaround board decisions. It should also be kept in mind that shareholders have the right to remove directors if they so wish and we believe that this is the appropriate mechanism to use. The proposed changes provide shareholders with increased powers, yet they approve the remuneration policy which the implementation should be based on, and thus questions the role/relevance of the board as well as shareholders trust in the board they have appointed.[888]

As discussed earlier, the federal securities laws of the United States do not require the company to seek the approval of the shareholders for the remuneration policy.[889]

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[886] Chapter 2.4.2 (e) and 2.4.4 (c) above.

[887] Chapter 2.4.2 (e)(i) above.

[888] IoDSA and King Committee 'RE: IoDSA and King Committee Comment Letter on the 2021 Companies Act Amendment Bill' op cit note 275 at B2.9.

[889] Chapter 4.4.5(a)(iv) above.

Alliare and Dauphin state:

> 'the setting of the remuneration policy should be reserved for the board of directors. When egregious pay packages are given to executives, a say-on-pay vote, compulsory or not, binding or not, will always be much less effective than a majority of votes against the election of members of the compensation committee.[890]

At the same time, the board (or remuneration committee) needs to understand what the concerns of stakeholders are. While the representation of these stakeholders on the board of the company concerned may assist in understanding what their views are, this option would probably not be feasible.[891] Much of corporate governance in companies depends on the independence of the board, and as such, the board should not represent any specific stakeholder's interests but should at all times carry out their fiduciary duties in the best interests of the company itself. The preferred option would involve a process of consultation or engagement with the definitive stakeholders of the company in developing the remuneration policy in line with the 'stakeholder value' approach as discussed above.[892] Ideally, the executive directors should not be part of the board in large public interest companies similar to that in German corporate law such that one has an independent non-executive board and an executive management team (or typically, an 'executive committee'). This arrangement may also prevent the adverse influence of a dominant Chief Executive Officer over executive remuneration.

With respect to the second issue, the UK experience indicates that despite the 2013 amendments implementing a binding vote on the remuneration policy shareholders continue to be apathetic to the approval process and therefore these amendments failed to achieve their original objectives.[893] As to the binding vote on the implementation report, there is no jurisdiction in the world that provides for a binding vote on the implementation report and a binding vote is also not practical as it relates to remuneration that has already been paid or awarded (in terms of the remuneration policy).[894]

It is therefore suggested that there should not be a shareholder vote on the executive remuneration policy or the implementation report. A fully-fledged stakeholder-inclusive

[890] Allaire, Y. and Dauphin, F. op cit note 879.

[891] Chapter 3.3.2 (a) above.

[892] Chapter 4.4.4. (b)(ii) above.

[893] Chapter 4.4.5. (a)(ii) above.

[894] Chapter 2.4.4. (c) above.

approach from which the stakeholder value approach is derived demands that shareholders should be seen merely as one of the definitive stakeholders of the company. An independent non-executive board should be entrusted with the remuneration decisions relating to the executive and reforms to this effect should be implemented as an amendment to the SA Companies Act. Failing this arrangement, it appears to be of little consequence as to whether the shareholder vote on the remuneration policy is binding or non-binding. Shareholders can still express their dissatisfaction with the remuneration by voting to change or remove the board or selling their shares where the vote is non-binding. These factors, together with the possible reputational damage to directors of a dissenting vote, may be instrumental in remuneration committees typically acting on these outcomes even though the vote is non-binding. The shareholder vote on the implementation report should, however, be non-binding or advisory due to the practical issues associated with shareholder dissent.

4.5 Summary

It is suggested that sweeping changes are made to both the South African corporate governance code (as represented by King IV currently) and the SA Companies Act (including the supporting SA Companies Regulations) with respect to executive remuneration.

A revised South African corporate governance code should essentially be the principles upon which executive remuneration should be based with further explanations or clarifications as to what these principles entail. These principles should consist of the current principles of 'fairness', 'responsibility' and 'transparency' as indicated in King IV, although explained more comprehensively, and complemented further by the principle of 'simplicity'. They should underpin all aspects of executive remuneration, and especially the remuneration policy and the implementation report of the remuneration report.

The SA Companies Act and the supporting SA Companies Regulations should be amended to comprehensively address the definitions of 'remuneration' and 'executive management', the structure and content of the remuneration report (including the background statement, remuneration policy and implementation report) and the approval of the remuneration report.

'Remuneration' should be specifically defined in the SA Companies Act as provided by the enacted amendments to the Act but included amongst the definitions in section 1 of the Act with the applicable paragraph of the Act (section 30(6)) removed. While the categories statutory directors and prescribed officers as provided for in the Act should be maintained, the term 'executive management' should be specifically defined in the SA Companies Act in line with King IV. The

corporate governance measures and disclosures pertaining to the remuneration policy and implementation report should then only apply to the remuneration of individuals that are members of executive management as defined. Consideration should, however, also be given to limiting disclosures to that of the statutory directors in line with the UK company regulations or the Chief Executive Officer, the Chief Financial Officer and the next three highest paid executive officers in line with the US and Canadian securities regulations.

With regard to the remuneration policy, the level of executive remuneration should not be limited or capped through legislation, and should continue to largely be determined in line with market forces yet guided by the principles of 'fairness' and 'responsibility', while consideration should be given to requiring the structure of executive remuneration to consist of both fixed and variable components with the latter being at least 50 percent of the total remuneration package based on target levels. The 'stakeholder value' approach accompanied by certain corporate governance measures should be adopted for the financial and social performance measures relating to incentive-linked remuneration. This approach accompanied by the corporate governance measures is intended to significantly improve the protection and advancement of stakeholder interests. Certain disclosures, including the prescribed format for these disclosures as evident in the regulatory frameworks of certain jurisdictions, that promote the governance of executive remuneration should also be considered. Similarly, certain disclosures in these jurisdictions and the enacted amendments to the SA Companies Act (in particular, the relative employee remuneration and pay ratio disclosures) should be considered for the implementation report.

Lastly, the shareholders should not play any role in the approval of the remuneration policy and the implementation report beyond that of other stakeholders as these other stakeholders often have higher vested interests in the sustainability of the company than the shareholders. Instead, it is suggested that the approval of the remuneration policy and implementation report should be left in the hands of an independent non-executive board of the company (or a committee comprising certain members of this board). Failing this, it does not appear to make any difference whether the shareholder vote on the remuneration policy is binding or non-binding (or advisory). The vote on the implementation report, however, should only be non-binding (or advisory).

Chapter 5

Conclusion

South Africa continues to face extreme challenges in alleviating poverty and inequality which grip much of its population. While the state has made significant strides in this regard since the advent of democracy in 1994, especially through its social spending programs in support of its obligations to provide access to adequate food, water, housing, health services, education and social security under the SA Constitution, the current level of spending is unsustainable. Further expansion of these programs is also limited as they depend on tax revenues which are being curtailed by the lack of growth in the economy. These socioeconomic concerns are, therefore, not likely to be resolved without the contribution of business. Yet businesses can never be expected to replace the state's duty in this regard. The magnitude of the socioeconomic concerns in our country and the difficulty in defining the limits to positive obligations in this regard suggest that the implementation of legislation compelling companies to implement positive measures to address these concerns directly may not be feasible. These measures would also make South Africa an unattractive destination for much needed investment. They would also be in conflict with the common law relating to the executive's fiduciary duties unless they were subject to whether the executive considers these measures to be in the best interests of the company, were pursued in good faith and were reasonably incidental to the company concerned.

Although the primary responsibility for addressing these socioeconomic concerns remains with the state under its constitutional mandate, businesses can still play a significant role in supporting the state's duty to address these concerns. These businesses include listed companies and unlisted companies including SMMEs. Specifically, businesses should be managed to drive their optimal financial performance in order to grow the economy and create high paying employment opportunities. Apart from widening the fiscal base and reducing the demands on the state to meet the social wage, the opportunity of well-paid employment would provide its recipients with dignity and be instrumental in reducing the rampant crime experienced in this country. While companies should be allowed to prosper, they also need to be attentive to their current socioeconomic environment in the interests of their long-term sustainability. In this light, consideration should be given to the nature of performance measures relating to the variable components of their executive remuneration packages. These should be designed to drive the company's optimal financial performance and, at the same time, ensure that the interests of their stakeholders, including the interests of indigent communities, are protected and especially advanced. The design of these measures includes taking into account what the company's stakeholders would consider

of value to them in their relationship with the company (or the value that the company contributes to them) in order to drive the performance of the company in return for this value contributed.

While the recently enacted amendments to the SA Companies Act do not address incentive-linked performance measures, it is argued that the remuneration disparity provisions in these amendments that address inequality in South Africa may represent a possible change to the DTIC's approach to the role of the Act in advancing the interests of the company's stakeholders. Their original approach advocated methods outside the Act; the amendments suggest a move towards addressing socioeconomic concerns in South Africa now also through the Act. As such, the opportunity may have been created for the introduction of further reforms dealing with incentive-linked performance measures and associated corporate governance measures that serve to address these concerns. Yet, the introduction of further reforms in this area needs to be based on a properly grounded approach to stakeholder interests which the triple bottom line, IR six capitals and ESG approaches do not provide. The 'stakeholder value' approach, on the other hand, represents a superior approach to recognising and measuring the financial and social value generated by the company for its stakeholders and upon which these reforms could be based. This approach, complemented by the corporate governance measures concerned, should be incorporated into the remuneration policy of the remuneration report by way of further reforms to the SA Companies Act with certain disclosures relating to the policy incorporated into the SA Companies Regulations.

The enacted amendments to the SA Companies Act also provide an opportunity to reconsider the purpose and consequently the content of King IV as certain recommendations contained in the code relating to the remuneration report and accompanying shareholder vote may become redundant on the implementation of these amendments especially if the detailed disclosures required to the remuneration report are eventually taken up in the SA Companies Regulations. As such, a revised South African corporate governance code (with respect to the section dealing with executive remuneration) should be developed consisting of the principles 'fairness', 'responsibility', 'simplicity' and 'transparency'. These principles should be supported by explanations or clarifications as to what these principles entail and should inform the corporate governance measures pertaining to executive remuneration that are taken up in the Act and its supporting regulations.

In addition to the incorporation of the 'stakeholder value' approach and associated corporate governance measures into the SA Companies Act, certain other aspects of executive remuneration should also be incorporated by way of further amendments to the Act. These include taking steps to ensure that the disclosure requirements pertaining to executive remuneration apply to all companies that have a significant socioeconomic footprint, and that the definitions of 'remuneration' in the enacted

amendments and 'executive management' in King IV are incorporated into the definitions section of the SA Companies Act. Consideration should also be given to limiting disclosures to just statutory directors per the United Kingdom approach or certain members of the executive in terms of the United States and Canadian approaches. The detailed disclosures that the implementation report should contain, as well as the format of these disclosures, should also be incorporated into the SA Companies Regulations similar to the approaches of the United Kingdom, the United States and Australia. These disclosures include the remuneration disparity disclosures in the enacted amendments to the SA Companies Act which are a commendable addition to the regulation of executive remuneration as the current levels of executive remuneration are certainly untenable and may ultimately adversely impact the long-term sustainability of these companies if left unchecked. As these levels appear to be driven largely by market forces and societal constructs, a material change to these levels in the short-term is not likely, yet these disclosures put pressure on remuneration committees to reduce the inequality between the highest and lowest paid employees of the company over time. Lastly, although the shareholder vote on the remuneration policy may be binding in line with the enacted amendments to the Act, the vote on the implementation report should only be non-binding (or advisory) as the vote relates to remuneration that has already been paid or awarded to the executives. Ideally, the approval of the remuneration policy and implementation report should be left in the care of the non-executive directors of the company's board; the shareholders should not play any role in this process beyond being consulted as they should not have any precedence over the other stakeholders of the company.

Although these reform measures may appear to be radical, the implementation of the 'stakeholder value' approach to the setting of incentive-linked performance measures complemented by the adoption of certain corporate governance measures including disclosures from selected jurisdictions will still allow for the executive management of companies to be well rewarded for their efforts. This approach is intended to contribute towards executives managing their businesses to enable optimal and sustainable financial performance for their businesses while protecting and advancing the interests of all definitive stakeholders including indigent communities. As such, these duties would now be more constructively directed towards addressing the socioeconomic concerns prevalent in South Africa.

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